THE END OF TAXATION WITHOUT END: A NEW TAX REGIME FOR U.S. EXPATRIATES

by Bernard Schneider[*]

The United States is the only major country to tax its citizens and foreigners admitted as permanent residents (lawful permanent residents (LPRs) colloquially known as "Green Card holders") on their worldwide income, regardless of residence. This article gives an overview of the history of the United States's approach. It then reviews the different types of expatriates, their connection to the United States, and their tax and reporting burdens. This article discusses the various justifications for the worldwide taxation of nonresidents and concludes that it is no longer justified. In an era of economic globalization and increased personal mobility, worldwide taxation of nonresidents is increasingly dysfunctional. It is challenging to justify on economic or moral grounds; it is difficult, if not impossible, to enforce against many expatriates; and it sends the wrong message regarding the value of citizenship. This article proposes that the United States follow the approach of several other countries and eliminate the worldwide taxation of expatriate citizens and LPRs and replace the exit tax on those renouncing U.S. citizenship or relinquishing LPR status with a departure tax regime that would apply to all U.S. citizens and LPRs who emigrate from the United States. It also proposes that the definitions of permanent resident for tax and immigration purposes be aligned. The proposed new tax regime for U.S. expatriates would be more equitable and easier to enforce. It would also be more consistent with international tax norms and the purposes of U.S. nationality and immigration law.

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I. HISTORY OF CITIZENSHIP-BASED TAXATION

The United States is the only developed nation that taxes its nonresident citizens and LPRs.[1] Nonresident citizens were first subject to taxation during the Civil War.[2] Initially, the United States only taxed the U.S. source income of nonresident citizens.[3] The tax was imposed at a higher rate and without an exemption amount; thus, the

[1] The Philippines taxed its nonresident citizens until 1997. Tax Reform Act of 1997, Rep. Act No. 8424, § 23(B), 94:22 O.G. 1, 11 (Dec. 11, 1997) (Phil.), *available at* http://www.glin.gov/download.action?fulltextId=54025&documentId=59480&glinID=59480; STAFF OF JOINT COMM. ON TAXATION, 104TH CONG., ISSUES PRESENTED BY PROPOSALS TO MODIFY THE TAX TREATMENT OF EXPATRIATION, at B-1 (Joint Comm. Print 1995) [hereinafter JCT REPORT ON ISSUES REGARDING EXPATRIATION TAX PROPOSALS]; STAFF OF THE JOINT COMM. ON TAXATION, 104TH CONG., BACKGROUND AND ISSUES RELATING TO TAXATION OF U.S. CITIZENS WHO RELINQUISH THEIR CITIZENSHIP AND LONG-TERM RESIDENT ALIENS WHO RELINQUISH THEIR U.S. RESIDENCY, at 13 (Joint Comm. Print 1995) [hereinafter JCT REPORT ON ISSUES REGARDING RELINQUISHING U.S. CITIZENSHIP OR RESIDENCY]; Richard D. Pomp, *The Experience of the Philippines in Taxing Its Nonresident Citizens*, 17 N.Y.U. J. INT'L L. & POL. 245, 247 n.10 (1984-1985). Mexico taxed nonresident citizens until 1981. JCT REPORT ON ISSUES REGARDING EXPATRIATION TAX PROPOSALS, *supra*, at B-1; Pomp, *supra*, at 247 n.10. There was an attempt by Eritrea to tax its nonresident citizens. JCT REPORT ON ISSUES REGARDING RELINQUISHING U.S. CITIZENSHIP OR RESIDENCY, *supra*, at 13; JCT REPORT ON ISSUES REGARDING EXPATRIATION TAX PROPOSALS, *supra*, at B-1. The attempt has not been successful. Mihir A. Desai, Devesh Kapur & John McHale, *Sharing the Spoils: Taxing International Human Capital Flows*, 11 INT'L TAX & PUB. FIN. 663, 678, 689 n.39 (2004).

[2] Act of August 5, 1861, ch. 45, § 49, 12 Stat. 292, 309, *repealed by* Act of July 1, 1862, ch. 119, § 89, 12 Stat. 432, 473. No tax was actually assessed under this legislation before its repeal. Michael S. Kirsch, *Taxing Citizens in a Global Economy*, 82 N.Y.U. L. REV. 443, 450 n.21 (2007). It was then replaced by Act of July 1, 1862, ch. 119, § 90, 12 Stat. 432, 473.

[3] *See* Kirsch, *supra* note 2, at 450.

limitation of the tax base to U.S. source income may have been due not to a failure to assert a right to tax on the basis of citizenship as much as a recognition that it would be impossible to tax foreign source income.[4] In 1864, the distinctions in both the tax base and tax rate were eliminated; from that point, citizenship was clearly the jurisdictional basis for imposing an income tax on the worldwide income of nonresident citizens.[5] Similar provisions were included in the tax laws until the Civil War era income taxes expired in 1872.[6] The 1894 income tax, which was ruled unconstitutional the following year, also taxed citizens regardless of residence.[7]

The Revenue Act of 1913,[8] the first income tax enacted after the passage of the Sixteenth Amendment, imposed a tax on "every citizen of the United States, whether residing at home or abroad" and on the individual's "entire net income arising or accruing from all sources."[9] Worldwide taxation has remained a feature of every subsequent income tax act.[10]

A decade later in *Cook v. Tait*,[11] a U.S. citizen who resided in Mexico challenged the right of Congress to tax his Mexican source income.[12] The Supreme Court held that the power of the United States to tax him was based "upon his relation as citizen to the United States and the relation of the latter to him as citizen."[13] In particular, the Court focused on the benefits that arose to the taxpayer due to that citizenship, stating that "the government, by its very nature, benefits the citizen and his property wherever found."[14] However, the

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[4] *See id.*, at 449–51.

[5] Act of June 30, 1864, ch. 173, § 116, 13 Stat. 223, 281; Kirsch, *supra* note 2, at 451–52.

[6] Kirsch, *supra* note 2, at 452.

[7] Act of August 27, 1894, ch. 349, § 27, 28 Stat. 509, 553, *invalidated by* Pollack v. Farmers' Loan & Trust Co., 158 U.S. 601 (1895); Kirsch, *supra* note 2, at 453.

[8] Act of Oct. 3, 1913, ch. 16, 38 Stat. 114.

[9] Act of Oct. 3, 1913, ch. 16, § II(A)(1), (G)(a), 38 Stat. 114, 166, 171.

[10] For a list of the acts, see Kirsch, *supra* note 2, at 454 n.41.

[11] Cook v. Tait, 265 U.S. 47 (1924).

[12] Cook v. Tait, 265 U.S. at 47.

[13] Cook v. Tait, 265 U.S. at 56.

[14] *Id.* The analysis of the Court in *Cook* was flawed. It stated that the plaintiff's contention was that "the person receiving the income and the property from which he receives it must both be within the territorial limits of the United States to be within the taxing power of the United States." *Id.* at 54, but the plaintiff made no such claim. In addition, the case it cited in support of its opinion, United States v. Bennett, 232 U.S. 299 (1914), in fact involved a U.S. citizen domiciled in the United States. Reuven S. Avi-Yonah, *The Case Against Taxing Citizens*, 127 TAX NOTES 680, 681 (May 10,

Court in *Cook* did not state that such benefits are required to justify taxation.

It is settled law that the United States has the power to impose an income tax on the basis of citizenship alone, regardless of residence. Whether it is justified in doing so and whether it is wise to do so are different questions.

II. TYPES OF EXPATRIATES

The extent to which nonresident citizens and LPRs should be taxed has been debated for decades. Recently, the imposition of U.S. income taxes on U.S. persons abroad has been called into question.[15]

The current debate still largely uses terms and arguments that arose in the 1920s, even though the types of U.S. expatriates and the nature of the U.S. expatriate experience have changed radically in recent decades. Furthermore, most commentators do not distinguish between the different types of U.S. persons abroad.[16] These widely

2010).

[15] *See, e.g.*, Avi-Yonah, *supra* note 14; Reuven S. Avi-Yonah, *International Tax as International Law*, 57 Tax L. Rev. 483, 486 (2004) ("It is doubtful. . .whether the United States should continue to insist on taxing its citizens living overseas."); American Citizens Abroad, *American Citizens Abroad's Recommendation for U.S. Tax Law Reform*, 66 TAX NOTES INT'L 459 (Apr. 30, 2012); STAFF OF JOINT COMM. ON TAXATION, PRESENT LAW AND ISSUES IN U.S. TAXATION OF CROSS-BORDER INCOME, at 93 (Joint Comm. Print 2011) (discussing briefly "expanding territorial taxation to individuals"); Cynthia Blum & Paula N. Singer, *A Coherent Policy Proposal for U.S. Residence-Based Taxation of Individuals*, 41 VAND. J. TRANSNAT'L L. 705, 716–18 (2008) (rejecting citizenship based taxation not on principle but on practical grounds, in particular the likelihood of compliance and the Internal Revenue Service's inability to enforce); Jeffrey M. Colón, *Changing U.S. Tax Jurisdiction: Expatriates, Immigrants, and the Need for a Coherent Tax Policy*, 34 SAN DIEGO L. REV. 1, 9 n.20 (1997) ("One can question the fairness of taxing the worldwide income of nonresident citizens."); Brainard L. Patton, Jr., *United States Individual Income Tax Policy as It Applies to Americans Resident Overseas,* 1975 DUKE L. J. 691; John H. Christie, Note, *Citizenship as a Jurisdictional Basis for Taxation: Section 911 and the Foreign Source Income Experience*, 8 BROOK. J. INT'L L. 109 (1982). The national tax base theory proposed by Prof. Palmer implicitly rejects citizenship-based taxation. *See* Robert L. Palmer, *Toward Unilateral Coherence in Determining Jurisdiction to Tax Income*, 30 HARV. INT'L L.J. 1, 57 (1989). Prof. Peroni acknowledges the basic arguments against worldwide taxation of expatriates without taking a position; Robert J. Peroni, *Back to the Future: A Path to Progressive Reform of the U.S. International Income Tax Rules*, 51 U. MIAMI L. REV. 975, 1009–10 (1997).

[16] The use in the Internal Revenue Code of 1986 (Code) of the terms "expatriation" and "expatriate" in I.R.C. §§ 877 and 877A and related references is unfortunate, as expatriation means both emigration and renunciation of citizenship.

differing groups have different degrees of connection to the United States and do not warrant the same tax treatment. Thus, it is important to reexamine the nature of the population of U.S. persons abroad. Generally speaking, they can be broken down into the following groups:

1. *Short-Term Expatriates:*

- Citizens abroad for the short-term: citizens who have left the United States for a specific purpose (education, assignment abroad) or period of time and who intend to return to the United States. Many of those who are working temporarily abroad are employed by U.S. companies.
- LPRs abroad for the short-term: LPRs who have left the United States for a specific purpose (education, assignment abroad) or period of time and who intend to return to the United States. Many of those who are working temporarily abroad are employed by U.S. companies.
- Government employees: diplomatic and other U.S. government employees, including military personnel, who are posted abroad. They generally return to the United States at the end of their postings or tours of duty.

2. *Long-Term Expatriates*:

- Long-term or permanent expatriate citizens: citizens who have settled abroad and do not expect to return to the United States in the foreseeable future or at all.
- Long-term or permanent expatriate LPRs: LPRs who have settled abroad and do not expect to return to the United States

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See Expatriate Definition, MERRIAM-WEBSTER.COM, http://www.merriam-webster.com/dictionary/expatriate (last visited Aug. 21, 2011) ("Medieval Latin *expatriatus,* past participle of *expatriare* to leave one's own country, from Latin *ex-* + *patria* native country, from feminine of *patrius* of a father, from *patr-, pater* father . . . First Known Use: 1768") ("[*T*]*ransitive verb* 1 : banish, exile 2 : to withdraw (oneself) from residence in or allegiance to one's native country *intransitive verb* : to leave one's native country to live elsewhere; *also*: to renounce allegiance to one's native country"). (To further confuse matters, colloquially the noun "expatriate" is also used to refer to expatriate employees on generous benefits packages offered as an inducement to taking a foreign assignment.) Thus, the use of the term "expatriation" in the Code suggests that everyone who has left the United States to live abroad renounces their U.S. citizenship and/or is disloyal. Unfortunately, conflating these two senses is not new in U.S. thinking. This article uses specific and neutral terms such as "moving abroad" and "emigrating" for U.S. citizens and LPRs who have moved abroad and "giving up," "renouncing," or "relinquishing" for those ceasing to be U.S. citizens or LPRs. "Expatriate" is used in the general sense of a U.S. person (citizen or LPR) residing outside the United States for whatever reason and for whatever period.

in the foreseeable future or at all.

3. *Accidental Citizens*: individuals born in the United States but whose parents left the country soon thereafter. In many cases, they are the children of foreigners who were in the United States on a short-term basis and acquired U.S. citizenship at birth under the current expansive interpretation of jus soli.[17] If their parents are not U.S. citizens, they will likely have little or no connection to the United States.[18]

4. *Citizens by Descent*: individuals born abroad to a U.S. parent or parents are in some circumstances citizens by descent;[19] however,

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[17] 8 U.S.C. § 1401(a) (2006) ("a person born in the United States, and subject to the jurisdiction thereof" is a citizen at birth) incorporates the language of the Citizenship Clause of the Fourteenth Amendment of the U.S. Constitution. This principle has been interpreted as granting citizenship automatically even to individuals whose parents were in the United States illegally when they were born and is generally understood to be a constitutional requirement. *See, e.g.*, 7 FAM § 1111(d), *Acquisition and Retention of U.S. Citizenship and Nationality: Introduction* (June 29, 2012); Christopher L. Eisgruber, *Birthright Citizenship and the Constitution*, 72 N.Y.U.L. REV. 54 (1997); Katherine Pettit, Comment, *Addressing the Call for the Elimination of Birthright Citizenship in the United States: Constitutional and Pragmatic Reasons To Keep Birthright Citizenship Intact*, 15 TUL. J. INT'L & COMP. L. 265 (2006). *But see, e.g.*, PETER H. SCHUCK & ROGERS M. SMITH, CITIZENSHIP WITHOUT CONSENT: ILLEGAL ALIENS IN THE AMERICAN POLITY (1985); Kelly Gindele, *The Birthright of Citizenship as to Children Born of Illegal Immigrants in the United States: What Did the Drafters of the Fourteenth Amendment Intend?*, 34 N. KY. L. REV. 367 (2007); Lino A. Graglia, *Birthright Citizenship for Children of Illegal Aliens: An Irrational Public Policy*, 14 TEX. REV. L. & POL. 1 (2009); Dan Stein & John Bauer, *Interpreting the 14th Amendment: Automatic Citizenship for Children of Illegal Immigrants?*, STAN. L. & POL'Y REV., Summer 1996, at 127.

[18] Accidental citizens will however generally have held U.S. passports, if only because they were required for them to leave the country. *See* 8 U.S.C. § 1185(b) (2006). The elimination of birthright citizenship, i.e. automatic citizenship for anyone born on U.S. territory even if their parents are in the country illegally, would ameliorate this problem. Leaving aside the question of whether this understanding of birthright citizenship is constitutionally mandated, one way to accomplish this would be to enact a rule like current British law on this point. For all births in the United Kingdom on or after January 1, 1982, an individual born in the United Kingdom "shall be a British citizen if at the time of his birth his father or mother is—(a) a British citizen; or (b) settled in the United Kingdom." British Nationality Act, 1981, c. 61, § 1(1). "Settled in the United Kingdom" is defined by the Act as being in the United Kingdom "without being subject under the immigration laws to any restriction on the period for which he may remain," which includes permanent residents and certain other specific categories (such as refugees and asylees). *Id.*, § 50(2).

[19] Provided the requirements of 8 U.S.C. § 1401(c) or (g) have been satisfied. 8 U.S.C. § 1401 (2006). Section 1401(c) provides that a foreign born child of two U.S. citizen parents is a U.S. citizen at birth if at least one parent resided in the United

many such individuals are nominal citizens in the sense that, although their birth was registered with U.S. consular officials, subsequently and particularly as adults, they have little or no connection to the United States. They may not have lived in the United States, held a U.S. passport, or otherwise derived any benefit from their status as a U.S. citizen.

5. *Unaware Citizens by Descent*: individuals who under U.S. nationality law are U.S. citizens by descent from a U.S. citizen parent or parents but who are not aware of their status as U.S. citizens.[20] Typically entitled to the nationality of the land of their birth or of a non-U.S. citizen parent, they may not have been registered as U.S. citizens by their parents; the United States may therefore be as unaware of their existence as they are of their status as U.S. citizens.

III. NUMBER OF NONRESIDENT CITIZENS AND LPRS AND TAX INVOLVED

How many U.S. citizens and LPRs live abroad? The simple answer is that no one knows because there has never been a complete, systematic count.[21] Various estimates range from three to seven million. Counting is not aided by the fact that, as suggested above, the population of U.S. citizens abroad is very complex. It includes assignees temporarily working abroad for U.S. companies; government employees; military personnel; spouses of foreign nationals; naturalized citizens who have returned to their country of origin; accidental citizens who returned as children to their parent's country; citizens by descent who have never lived in the United States;

States or its outlying possessions prior to the child's birth. Section 1401(g) provides that a foreign born child of one U.S. citizen and one non-citizen parent is a U.S. citizen at birth if the U.S. citizen parent was physically present in the United States or its outlying possessions for at least five years, at least two of which were after the parent was fourteen years of age, prior to the child's birth.

[20] They may be children of U.S. citizen parents who believe that they lost U.S. citizenship under prior law, for example, upon naturalization abroad, *see* 8 U.S.C. § 1481 (1982), and are not aware that they are now considered U.S. citizens under U.S. case law. *See* Afroyim v. Rusk, 387 U.S. 253 (1967); Vance v. Terrazas, 444 U.S. 252 (1980). The parents whose citizenship has been "restored" are of course also subject to all the obligations of U.S. citizenship, including U.S. taxation.

[21] *See, e.g.*, *U.S. Citizens Overseas: Hearing Before the Subcomm. on Int'l Operations of the H. Comm. on Foreign Affairs,* 102d Cong. 24 (1991) [hereinafter *Hearing on U.S. Citizens Overseas*] (testimony of Henry Valentino, Dir., Fed. Voting Assistance Program, Dep't of Def.) (noting that there was no comprehensive list of U.S. citizens overseas of which he was aware).

students; and retirees. Many of these citizens have little or no regular contact with the U.S. government such that there is no easy way to calculate their numbers. This is particularly the case for U.S. citizens who live in stable democracies or in the country of their other nationality because they may have little need to contact the U.S. government.[22] In addition, some U.S. citizens may keep a low profile and restrict their contact with the United States precisely because they do not wish to pay taxes to the United States.

The ideal basis for determining the number of U.S. taxpayers abroad would be a full census of U.S. persons who live overseas. Unfortunately, the Census Bureau and the Government Accountability Office (GAO) have indicated that it is difficult to obtain reliable data on overseas citizens given the inherently voluntary nature of participation, the lack of complete address data necessary to determine rates of participation and to follow up with non-respondents, and a lack of resources to deal with these and other issues.[23] In 2004, the GAO stated that "counting all American citizens overseas as part of the census would require enormous resources but still not yield data at the level of quality needed for purposes of congressional apportionment."[24] Given that the Census Bureau's mission derives from the Constitution's requirement for a census in order to determine Congressional apportionment,[25] which does not cover U.S. persons overseas, the Census Bureau's reluctance to count U.S. citizens abroad is unsurprising.

The Census Bureau has noted that it could theoretically use various administrative records to estimate the size of the overseas U.S. citizen population.[26] These estimates would provide a "rough

[22] For example, until the implementation of the Western Hemisphere Travel Initiative in 2007 and 2009 for air and land travel, respectively, U.S. citizens living in Canada, Mexico, and the Caribbean did not need a U.S. passport to enter the United States. *See Western Hemisphere Travel Initiative*, U.S. DEP'T OF HOMELAND SECURITY, http://www.dhs.gov/files/programs/gc_1200693579776.shtm (last visited Aug. 11, 2012).

[23] U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-04-898, COUNTING AMERICANS OVERSEAS AS PART OF THE DECENNIAL CENSUS WOULD NOT BE COST-EFFECTIVE 16-20 (2004); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-04-1077T, COUNTING AMERICANS OVERSEAS AS PART OF THE CENSUS WOULD NOT BE FEASIBLE 10-12 (2004) [hereinafter GAO REPORT OVERSEAS CENSUS WOULD NOT BE FEASIBLE].

[24] GAO REPORT OVERSEAS CENSUS WOULD NOT BE FEASIBLE, *supra* note 23, at i.

[25] U.S. CONST. art. I, § 2, cl. 3.

[26] U.S. CENSUS BUREAU, ISSUES OF COUNTING AMERICANS OVERSEAS IN FUTURE CENSUSES 7 (2001), http://www.census.gov/population/www/socdemo/

order of magnitude" of the population; however, each set has coverage, accuracy, and access issues.[27] None on its own would give a complete, reliable estimate of the size of the population, and there is the likelihood of a high degree of duplication between the sources.[28] Even if the Census Bureau could merge, match, and eliminate duplication in the various files, the data would not cover any individuals who are not reflected in any administrative records,[29] and it would not cover most LPRs The counting of LPRs is complicated by the fact that LPRs typically do not notify the U.S. government of their presence overseas because residence abroad might contribute to a finding of abandonment of U.S. residence.[30] Potential sources of information include the following:

- Federal government records on employees and their dependents;
- Tax return information;
- Department of State Bureau of Consular Affairs registrations and passport applications;
- State records of voter registration and absentee ballots; and
- Records of recipients of Social Security benefits.[31]

The various administrative records that cover overseas citizens were developed for different purposes. Most include individuals, such as minors, who are unlikely to be taxpayers. Most importantly, none of the lists is comprehensive. Most of the sources do not include accidental, nominal and unaware citizens, nor do they include LPRs. Thus, they both under- and over-count the number of overseas taxpayers.

For workload and crisis planning purposes, the Bureau of Consular Affairs (BCA) of the Department of State has compiled internal estimates of the number of U.S. citizens in various countries. The Department of State estimated that 1.8 million civilian

overseas/overseas-congress-report.pdf.

[27] *Id.*

[28] *Id.*

[29] *Id.*

[30] U.S. TREASURY DEP'T OFFICE OF TAX POLICY, INCOME TAX COMPLIANCE BY U.S. CITIZENS AND U.S. LAWFUL PERMANENT RESIDENTS RESIDING OUTSIDE THE UNITED STATES AND RELATED ISSUES 25 (1998) [hereinafter TREASURY PAPER ON INCOME TAX COMPLIANCE]. Although a database of LPRs is maintained by U.S. Citizenship and Immigration Services, it does not indicate whether the LPR is outside the United States. *Id.*

[31] U.S. CENSUS BUREAU, *supra* note 26, at 8–9.

(nonmilitary, nongovernment) U.S. citizens lived abroad in 1983,[32] and it estimated that 2.2 million civilian citizens lived abroad in 1988.[33] In July 1999, the Bureau of Consular Affairs estimated that there were 3,784,693 private (i.e. non-military, non-government) U.S. citizens living outside the country.[34] These were only estimates; the Department of State and the BCA do not have comprehensive information on the number of U.S. citizens living overseas at any given time.[35] Furthermore, the BCA has neither the expertise nor the resources to conduct an accurate count of U.S. citizens in any given country.[36] Embassies prepare the estimates using embassy registrations, information from local immigration authorities, and informal surveys of employers and institutions such as the local American Chamber of Commerce.[37] Consular registration is purely voluntary, and many do not register, particularly in stable Western countries. U.S. citizens who do register generally live in countries suffering from unrest.[38] Even for those who do register, the information generally does not remain valid for long because many expatriates are highly mobile.[39] The Department of State has conceded that the reliability of its estimates depends on the information available to it for different locations.[40] Even where

[32] *United States Citizens Living in Foreign Countries and Not Filing Federal Income Tax Returns: Hearing Before the Subcomm. on Commerce, Consumer, and Monetary Affairs of the H. Comm. on Gov't Operations*, 99th Cong. 4 (1985) [hereinafter *US Citizens Not Filing Federal Income Tax Returns*] (statement of Johnny C. Finch, Senior Associate Director, General Government Division, GAO).

[33] GEN. ACCOUNTING OFFICE, GAO/GGD-93-93, TAX ADMINISTRATION: IRS ACTIVITIES TO INCREASE COMPLIANCE OF OVERSEAS TAXPAYERS 7 (1993) [hereinafter GAO REPORT ON IRS ACTIVITIES TO INCREASE COMPLIANCE OF OVERSEAS TAXPAYERS].

[34] U.S. Dep't of State, Bureau of Consular Affairs, *Private American Citizens Residing Abroad*, OVERSEAS DIGEST (July 1999), http://www.overseasdigest.com/amcit_nu2.htm.

[35] *Americans Abroad, How Can We Count Them?: Hearing Before the Subcomm. on the Census of the H. Comm. on Gov't Reform,* 107th Cong. 13–14 (2001) [hereinafter *Hearing on Counting Americans Abroad*] (statement of Edward A. Betancourt, Dir., Office of Pol'y Rev. & Inter-Agency Liaison, Overseas Citizens Services, Bureau of Consular Affairs, Dep't of State).

[36] *Id.* at 13.

[37] *Id.*

[38] *Id.* at 41.

[39] *Id.* at 14.

[40] GEN. ACCOUNTING OFFICE, GAO/GGD-98-106, TAX ADMINISTRATION: NONFILING AMONG U.S. CITIZENS ABROAD 7 (1998) [hereinafter GAO REPORT ON NONFILING AMONG U.S. CITIZENS ABROAD].

information is provided by the foreign authorities, not all U.S. citizens may be listed, and the U.S. embassy in the location may not be aware of all U.S. citizens there.[41]

Similarly, passports for adults are valid for ten-year periods; thus, the address on many passport applications also quickly becomes out of date.[42] In some cases, the address listed on the application is not a good indicator of where the applicant lives, as some tourists apply overseas and some expatriates apply before moving overseas.[43] Although the passport application form requests the applicant's Social Security number, pursuant to section 6039E, the Department of State is not required to verify the number,[44] and it is unclear whether it could deny a passport application for failure to provide a Social Security number.[45] A review of 304,000 passport applications made in 1995 and 1996 found that about 133,000 or 44 percent did not include Social Security numbers and could not be readily matched to a Social Security number.[46] In 1993, the Internal Revenue Service (Service) dropped the penalty program associated with passport applications because of the difficulty in determining the Social Security number of applicants who did not include one in the application.[47]

There is also the question of verification of citizenship. An unknown number of persons who are U.S. citizens under U.S. law have never attempted to establish their status as such. To determine such an individual's citizenship status, it could be necessary to determine the citizenship status of the individual's parents or grandparents, including whether the individual or the individual's parent or grandparent fulfilled the residency requirements under prior law. To be certain of continued status as a U.S. citizen, it could also be necessary to ascertain whether the individual or a parent or grandparent engaged in any behavior that would have caused him or her to lose U.S. citizenship.[48]

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[41] *Id.*

[42] *Hearing on Counting Americans Abroad, supra* note 35, at 14.

[43] GAO REPORT ON IRS ACTIVITIES TO INCREASE COMPLIANCE OF OVERSEAS TAXPAYERS, *supra* note 33, at 9.

[44] *Id.*

[45] GAO REPORT ON NONFILING AMONG U.S. CITIZENS ABROAD, *supra* note 40, at 16.

[46] *Id.* at 11.

[47] *Id.* at 15.

[48] *Hearing on Counting Americans Abroad, supra* note 35, at 15. For example, under prior law 8 U.S.C. § 1484, naturalized citizens lost their U.S. citizenship by continuous residence for three years in a country of which the individuals were former

Under the Uniformed and Overseas Citizens Absentee Voting Act of 1986 (UOCAVA),[49] all U.S. citizens abroad are eligible to vote in federal elections.[50] Overseas voting has been used as a proxy for the number of nonresident citizens because it covers, in principle, all adult overseas U.S. citizens; minors not entitled to vote will in most cases not have sufficient income to be required to file tax returns. In addition, although voting is an essentially voluntary activity, and many overseas U.S. citizens do not vote in the United States, there probably is a high correlation between those who remain connected enough to the United States to vote and those who file U.S. tax returns.

The GAO has generated several UOCAVA estimates. One report estimated that UOCAVA covers more than 6.5 million people, including 1.4 million in military service, 1.3 million military dependents of voting age, and approximately 3.7 million overseas citizens unaffiliated with the government, about 2 million of whom are of voting age.[51] In another report, the GAO estimated that UOCAVA covers "about 6.1 million citizens, including 2.7 million military members and their dependents at home and abroad and roughly 3.4 million citizens who reside overseas."[52] In another report it estimated that 2.7 million military service members and their dependents and 3.9 million citizens live overseas.[53] In yet another report it estimated the

nationals or in which their place of birth was situated or by continuous residence for five years in any other foreign state or states. This rule was declared unconstitutional in Schneider v. Rusk, 377 U.S. 163 (1964), and subsequently repealed by Act of Oct. 10, 1978, Pub. L. No. 95-432, § 2, 92 Stat. 1046. Naturalized citizens who left the United States within one year of naturalization to reside permanently abroad were subject to revocation of naturalization under former 8 U.S.C. § 1451(d); this was repealed by the Immigration and Nationality Technical Corrections Act of 1994, Pub. L. No. 103-416, § 104, 108 Stat. 4305. (There is currently no requirement for most applicants for naturalization to intend to reside permanently in the United States, 8 U.S.C. § 1427, and no requirement to remain in the United States.) Many other examples could be cited of determinations that would have to be made under prior law.

49 Uniformed and Overseas Citizens Absentee Voting Act of 1986, Pub. L. 99-410, 100 Stat. 924.

50 UOCAVA requires states to allow U.S. citizens otherwise allowed to vote in federal elections the right to vote while overseas. 42 U.S.C. § 1973FF-1(a) (2011).

51 U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-06-521, ELECTIONS: ABSENTEE VOTING ASSISTANCE TO MILITARY AND OVERSEAS CITIZENS INCREASED FOR THE 2004 GENERAL ELECTION, BUT CHALLENGES REMAIN 1 (2006) [hereinafter GAO REPORT ON ABSENTEE VOTING ASSISTANCE FOR 2004 ELECTION].

52 GEN. ACCOUNTING OFFICE, GAO-01-704T, ISSUES AFFECTING MILITARY AND OVERSEAS ABSENTEE VOTERS 1 (2001).

53 GEN. ACCOUNTING OFFICE, GAO-01-1026, VOTING ASSISTANCE TO MILITARY

number of overseas citizens not affiliated with the U.S. government at 3.7 million, in addition to 1.4 million military service members and 1.3 million military dependents of voting age.[54]

Foreign census information is insufficient for the purpose of determining the number of U.S. citizens abroad, let alone U.S. taxpayers. Many countries collect data on the nationality of their residents; however, the usefulness of this data is limited because of how U.S. citizens are defined.[55] Dual nationals who are citizens of their country of residence as well as of the United States are not typically recorded as U.S. citizens.[56] Foreign countries may also not categorize an individual as a U.S. citizen when the individual has more than one non-local citizenship. Furthermore, some countries categorize foreigners by country of birth and not citizenship.[57] In addition, foreign censuses may include only permanent residents or individuals intending to reside in the country for a certain period of time.[58] For example, in 2006 the Canadian census recorded 250,535 self-reported immigrants of U.S. origin.[59] Among other things, this number does not include Canadians with LPR status who have returned to Canada because, under Canadian law in general and for census purposes in particular, their U.S. immigration status is irrelevant. In general, foreign counts of U.S. persons are unlikely to consider U.S. immigration status.

Ironically, the Service does not accurately count the number of tax returns filed by nonresident citizen and LPR taxpayers that it does receive. The Service does not generally distinguish between citizens and LPRs because they file the same return (Form 1040).[60] Although

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AND OVERSEAS CITIZENS SHOULD BE IMPROVED 3 (2001).

[54] U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-06-1134T, DOD EXPANDS VOTING ASSISTANCE TO MILITARY ABSENTEE VOTERS, BUT CHALLENGES REMAIN 1 (2006).

[55] GAO REPORT ON NONFILING AMONG U.S. CITIZENS ABROAD, *supra* note 40, at 7.

[56] *See id.*

[57] *Id.*

[58] *Id.*

[59] *See 2006 Census: Place of Birth for the Immigrant Population*, STATISTICS CANADA, http://www12.statcan.ca/census-recensement/2006/dp-pd/hlt/index-eng.cfm (follow "Immigration and Citizenship" hyperlink; then follow "Canada, Provinces and Territories" hyperlink under "Birthplace" heading) (last visited Aug. 11, 2012).

[60] GEN. ACCOUNTING OFFICE, GAO/GGD-88-54, TAX ADMINISTRATION: OPPORTUNITIES EXIST FOR IMPROVING IRS' ADMINISTRATION OF ALIEN TAXPAYER PROGRAMS 9 (1988); GAO REPORT ON NONFILING AMONG U.S. CITIZENS ABROAD, *supra* note 40, at 8.

certain forms (such as Form 2555) ask about citizenship, this information apparently is not tracked. In addition, the Service does not necessarily keep track of the filer's country of residence.[61]

The Service classifies individual tax returns as "international" if the return gives a foreign mailing address; includes a Form 2555 claiming the foreign earned income exclusion or deduction (FEIE) or the foreign housing exclusion or deduction (FHE); or reports amounts in foreign currencies.[62] If none of these are the case, the return is not classified as international.[63] Form 2555 does not capture all foreign taxpayers because not all overseas taxpayers utilize the FEIE or FHE, as discussed below. As the foreign tax credit (FTC) regime is not limited to nonresidents, it would be difficult if not impossible to determine nonresident filers from such information, which the Service does not in any case report. Finally, individual taxpayers are required to report their items of income and loss in U.S. dollars.[64] The Service reported information, therefore, cannot readily be used to determine the number of individuals filing from outside the United States.

The Service also collects the Report of Foreign Bank and Financial Accounts (FBAR Form) regarding certain foreign assets.[65] Unfortunately, its utility in determining the number of U.S. persons abroad is limited. First, the requirement to file a FBAR Form is not limited to nonresidents. Second, a taxpayer may not be required to file a FBAR Form even if there is foreign income to report.[66] Finally, taxpayers are unlikely to file a FBAR Form if they did not file a tax return; thus, it is of little additional value in terms of finding taxpayers abroad.

Several other government entities have estimated the number of individual tax returns that are filed from outside the United States. For example, according to a Congressional report, in 1976 there were 164,000 individual tax returns filed from outside the United States

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[61] GAO REPORT ON NONFILING AMONG U.S. CITIZENS ABROAD, *supra* note 40, at 8.

[62] *Id.*

[63] *Id.*

[64] I.R.C. § 985(b)(1); Treas. Reg. § 1.985-1(b)(1)(i) (as amended in 2001).

[65] U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-478T, TAX COMPLIANCE: OFFSHORE FINANCIAL ACTIVITY CREATES ENFORCEMENT ISSUES FOR IRS 5 (2009).

[66] *Id.* at 5; U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-04-972T, DATA SHARING AND ANALYSIS MAY ENHANCE TAX COMPLIANCE AND IMPROVE IMMIGRATION ELIGIBILITY DECISIONS 3 (2004) [hereinafter GAO REPORT DATA SHARING AND ANALYSIS MAY ENHANCE TAX COMPLIANCE] (statement of Michael Brostek, Dir., Strategic Issues).

other than from military post offices.[67] In 1983, about 700,000 individual tax returns were filed by U.S. taxpayers living abroad.[68] Of those returns, about 250,000 used regular foreign mailing addresses, and about 450,000 used the APO/FPO (Army Post Office and Fleet Post Office) mail system, which is used by military personnel, federal government personnel and some government contractors.[69] In 1995, about 935,000 individual returns were classified as being from abroad.[70] Given the estimated number of U.S. taxpayers abroad, these figures suggest that only a fraction of nonmilitary, nongovernment returns were filed, and that many, perhaps most, individuals not affiliated with the government did not file.

The problems that plague a census of U.S. citizens abroad are precisely the issues that arise in the tax context. Namely, both are impossible to administer consistently and are effectively voluntary, at least for those with little connection to the United States.

Based on the above estimates, there are likely at least six million U.S. citizens living abroad, not including nominal, accidental and unaware citizens, and an unknown number of LPRs. Given the number of foreign returns, it is clear that a large number, perhaps a majority, of nongovernment overseas U.S. taxpayers do not file. Economic and demographic changes mean that the number of nonfilers is likely to increase, despite recent attempts at enforcement. Economic and professional opportunities outside the United States are becoming increasingly attractive, especially as the world's economic center of gravity moves to Asia. In addition, unlike in the past, immigrants to the United States now sometimes return to their countries of origin. These phenomena will lead to increasing numbers of U.S. persons abroad, including citizens by descent that have little or no active connection to the United States. The number of nonfilers can thus also be expected to rise.

Given the problems with calculating the number of U.S. persons abroad, it is difficult even to estimate the percentage or number of nonfilers. Because of this difficulty and the lack of knowledge about

[67] PRESIDENTIAL REPORT TO THE S. COMM. ON FOREIGN RELATIONS, 96TH CONG., REP. ON U.S. LAW AFFECTING AMERICANS LIVING AND WORKING ABROAD 19 (Comm. Print 1980).

[68] GEN. ACCOUNTING OFFICE, GAO/GGD-87-14, TAX ADMINISTRATION: IRS CAN IMPROVE ITS COLLECTION PROCEDURES FOR TAXPAYERS LIVING OVERSEAS 1 (1986).

[69] *Id.*

[70] GAO REPORT ON NONFILING AMONG U.S. CITIZENS ABROAD, *supra* note 40, at 10.

the locations and average incomes per country of U.S. citizens abroad, it is impossible to estimate the international individual income tax gap with any degree of reliability.[71] However, given the operation of the FTC and FEIE, many if not most U.S. expatriates likely have no U.S. tax liability. It seems doubtful that the revenue to be gained from the worldwide taxation of U.S. expatriates exceeds the likely cost of increased enforcement.

IV. CURRENT TAX AND TAX-RELATED TREATMENT OF NONRESIDENT CITIZENS AND LPRS

A. *Income Taxation of Nonresident Citizens and LPRs*

U.S. citizens, LPRs,[72] and those treated as residents for U.S. tax purposes (collectively, "U.S. tax residents")[73] are subject to income

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[71] *Id.* at 6.

[72] The Code provides that LPRs are considered resident in the United States for tax purposes, i.e. regardless of whether they otherwise satisfy the test for tax residence; I.R.C. § 7701(b)(1)(A)(i). This remains the case as long as LPR status is not revoked or administratively or judicially determined to have been abandoned, even if the individual no longer lives in the United States; I.R.C. § 7701(b)(6)(B). *See also* Treas. Reg. § 301.7701(b)-1 (as amended in 2008).

[73] Non-LPR non-citizens are treated as residents for tax purposes only if they are physically present in the United States for at least 31 days during the current calendar year and at least 183 days during a 3 year period that includes the year in question. Each day in the tested year is treated as a full day, each day in the immediately preceding year is treated as a third of a day and each day in the second preceding year is treated as a sixth of a day. I.R.C. § 7701(b)(3)(A). Generally speaking, individuals are considered to be present in the United States on any day for which they are in the United States for any part of the day. I.R.C. § 7701(b)(7)(A). Individuals who satisfy the requirements of the substantial presence test above may still be able to avoid U.S. tax resident status if they were in the United States for less than 183 days in the current year and have a tax home, as defined in Treas. Reg. § 1.911-2(b) (as amended in 1985), in a country to which they have a closer connection than to the United States. I.R.C. § 7701(b)(3)(B); Treas. Reg. § 301.7701(b)-2(c), -2(d) (as amended in 1993). This "closer connection" is established by demonstrating that the individual has maintained more significant contacts with the foreign country, including the location of family and a permanent home, personal belongings and personal bank accounts. Treas. Reg. § 301.7701(b)-2(d) (as amended in 1993). Alternatively, the individual may be able to be treated as a nonresident under the terms of an applicable tax treaty. Where the individual is a resident of both countries under a tax treaty, the order of priority in determining residence typically is permanent home; "center of vital interests," which is similar to the "closer connection" test; habitual abode; and citizenship, in that order. *See, e.g.*, U.S. Model Income Tax Convention, art. 4, para. 4, Nov. 15, 2006; Convention Between the United States of America and Canada with Respect to Taxes on Income and Capital,

tax on their worldwide income, regardless of the taxpayer's residence or the source of the income.[74] Gross income includes housing and other employment benefits paid by an employer.[75] Moving expenses reimbursed by the employer are also included in gross income.[76]

By contrast, individuals who are considered nonresidents for tax purposes ("U.S. tax nonresidents") are generally subject to U.S. income tax at a flat rate of thirty percent on U.S. source income that is not effectively connected with a U.S. trade or business,[77] and at the regular graduated rates on income that is effectively connected with a U.S. trade or business.[78] For this purpose, gain from the sale of U.S. real property interests is treated as effectively connected with a U.S. trade or business and taxed at the regular graduated rates on income.[79] Net capital gains are not taxable unless they are fixed or determinable annual periodic income (FDAP income)[80] or are effectively connected with a U.S. trade or business.[81] Foreign source income and capital gains are not subject to U.S. tax if earned by U.S. tax nonresidents.

The above suggests that U.S. citizens and LPRs abroad are treated the same as U.S. citizens and LPRs resident in the United States. Their tax affairs, however, are considerably more complicated than those of otherwise similarly situated domestic taxpayers due to the greater likelihood of the foreign tax provisions' applying to them, as will be discussed below.

Two regimes are designed to ameliorate the double taxation of expatriates. The first is the FTC regime that applies to all U.S. taxpayers.[82] The FTC mechanism provides a nonrefundable credit for

U.S.-Can., art. IV, para. 2, Sept. 26, 1980, T.I.A.S. No. 11,087 [hereinafter US-Canada Tax Treaty]; Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains, U.S.-U.K., art. 4, para. 4, July 24, 2001, T.I.A.S. No. 13,161 [hereinafter US-UK Tax Treaty].

[74] I.R.C. § 61(a) ("gross income means all income from whatever source derived").

[75] Treas. Reg. § 1.61-21 (as amended in 2012).

[76] I.R.C. § 82.

[77] I.R.C. § 871(a)(1). Under certain circumstances, a nonresident may elect to be treated as tax resident. *See* I.R.C. § 7701(b)(4).

[78] I.R.C. § 871(b).

[79] I.R.C. § 897(a)(1)(A).

[80] I.R.C. § 871(a)(1)(A).

[81] I.R.C. § 871(b).

[82] I.R.C. § 901. Prof. Gann has pointed out that there are now also independent, treaty-specific foreign tax credits. *See* Pamela B. Gann, *The Concept of an*

foreign income taxes paid on foreign source income to the extent of the U.S. income tax that would be due on that income.[83] Complicated sourcing, timing, and limitation rules apply in calculating the credit available.[84] Excess credits, that is credits that cannot be utilized in the year in which they are generated, can be carried back one year and then carried forward for ten years, after which time they expire.[85]

From the point of view of the taxpayer, the FTC has two major limitations. First, the FTC is limited to foreign income taxes.[86] Thus, the FTC excludes wealth taxes and consumption taxes such as the value added tax that constitute a major portion of some expatriates' tax burdens.[87] Second, the U.S. Treasury, understandably unwilling to subsidize foreign tax revenues, only provides a nonrefundable credit for foreign taxes.[88] That is, the FTC provides no credit for foreign taxes that exceed the U.S. level of taxation on that income.

The second regime that is designed to ameliorate double taxation is the joint operation of the FEIE and FHE rules.[89] Congress first enacted the foreign earned income provisions in 1926.[90] The FEIE and FHE rules allow taxpayers to exclude, or in some cases deduct, a certain amount of foreign earned income and foreign housing expenses.

In order to qualify, the taxpayer must have his or her tax home in a foreign country and meet either the bona fide residence or the physical presence test.[91] An individual's tax home is his or her "regular or principal . . . place of business."[92] In the absence of a regular or principal place of business, the tax home is the individual's "regular

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Independent Treaty Foreign Tax Credit, 38 TAX L. REV. 1, 2 (1982).

[83] I.R.C. §§ 901(b), 904(a).

[84] *See* I.R.C. §§ 901-908.

[85] I.R.C. § 904(c).

[86] I.R.C. § 901(b).

[87] This point is made by, among others, Prof. Patton. Patton, *supra* note 15, at 722–24. Wealth or net asset taxes can be deducted in some cases; *see* Rev. Rul. 70-464, 1970-2 C.B. 152 (the personal fortune tax levied on a U.S. citizen residing in Zurich, Switzerland is not allowable as a foreign tax credit; however, the portion allocable to securities held for the production of income is deductible under section 164). State and local sales taxes are deductible, *see* I.R.C. § 164(b)(5), but value added taxes are not, even though most developed countries other than the United States impose value added taxes, not sales taxes.

[88] I.R.C. § 904(a).

[89] I.R.C. § 911.

[90] Revenue Act of 1926, § 213(b)(14), 44 Stat. 9 (1926).

[91] I.R.C. § 911(d)(1).

[92] Treas. Reg. § 1.911-2(b) (as amended in 1985).

place of abode in a real and substantial sense."[93] To satisfy the bona fide residence test, the taxpayer must be a U.S. citizen and establish that he or she "has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year."[94] The primary consideration for bona fide residence is the location of the individual's residence and family.[95] As can be seen, there are two major limitations to this exclusion: namely that it is not available to LPRs and that the test is not satisfied if one's tax home is in the United States for even one day during the tax year. Once the test is satisfied, the taxpayer may use it even for incomplete years.[96]

The physical presence test, by contrast, is available to both citizens and LPRs.[97] Under the physical presence test, the taxpayer must be present in a foreign country for at least 330 days during any consecutive twelve-month period.[98] Only full days spent abroad count as days in a foreign country.[99] The term foreign country means a territory under the sovereign control of a government other than the United States.[100] The place of receipt is immaterial.[101] Physical presence is a more objective test than bona fide residence.[102] In addition, the physical presence test is more flexible insofar as it does not require a tax home in a foreign jurisdiction for an entire calendar year, only 330 days of presence. On the other hand, it is possible to have one's bona fide residence abroad for an entire year without meeting the requirements of the physical presence test.

If the expatriate meets one of these tests, he or she can exclude certain amounts of foreign earned income and housing costs. For the

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93 *Id.*

94 I.R.C. § 911(d)(1)(A). Normally this would be the calendar year, unless the taxpayer had died abroad and a return was filed for a short tax year under I.R.C. § 443(a)(2); *see* Estate of Roodner v. Commissioner, 64 T.C. 680 (1975).

95 Treas. Reg. § 1.911-2 (as amended in 1985).

96 Treas. Reg. § 1.911-3(d)(3) (as amended in 1985).

97 I.R.C. § 911(d)(1)(B).

98 *Id.*

99 I.R.C. § 911(d)(1)(B); Treas. Reg. § 1.911-2(d)(2) (as amended in 1985).

100 Treas. Reg. § 1.911-2(h) (as amended in 1985). Thus, Antarctica and the North Sea are not considered foreign countries; Martin v. Commissioner, 50 T.C. 59, 62 (1968) (Antarctica); Plaisance v. United States, 433 F. Supp. 936, 939 (E.D. La. 1977) (North Sea).

101 Treas. Reg. § 1.911-3(a) (as amended in 1985).

102 Lance B. Gordon & E. Daniel Leightman, *Tax Planning for United States Citizens and Resident Aliens Working Abroad*, 15 SW. U. L. REV. 1, 11 (1984); William Newton, *Foreign Gross Income Exclusion: Section 911*, 16 U. MIAMI INTER-AM. L. REV. 373, 380 (1984-1985).

2012 tax year, this amount is $95,100.[103] If the taxpayer does not satisfy the bona fide residence or physical presence test for the entire tax year, the amount is prorated.[104] Foreign earned income is defined as foreign source funds attributable to services performed by the individual while a bona fide resident or physically present abroad,[105] including the fair market value of any remuneration not paid in cash.[106] Foreign earned income is considered earned in the year during which the services that gave rise to the income were performed, not the year of receipt.[107] Several items are specifically excluded from the definition of earned income, including amounts received as a pension or annuity;[108] amounts paid by the United States or a U.S. agency to its employees;[109] and any compensation received after the end of the tax year following the tax year in which the services to which the amounts are attributable were performed.[110]

Housing expenses are "reasonable expenses paid or incurred during the taxable year. . .for housing for the individual."[111] Deductible housing expenses include rent, utilities, insurance, and residential parking.[112] Extravagant housing expenses are not considered reasonable and therefore not excludable.[113] The amounts excluded under the FEIE and FHE cannot exceed the FEIE amount for that year.[114] Housing expenses in excess of sixteen percent of the FEIE limit for the year can be excluded, up to a maximum of thirty percent of that limit.[115] This upper limit has been increased for certain locations by the Service.[116] The amounts appear arbitrary, and many locations and countries are excluded.[117] Also, they only cover areas

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[103] Rev. Proc. 2011-52, § 3.28, 2011-45 I.R.B. 701.

[104] Treas. Reg. § 1.911-3(d)(2)(i), -3(d)(3) (as amended in 1985).

[105] I.R.C. § 911(b)(1)(A).

[106] Treas. Reg. § 1.911-3(b)(1) (as amended in 1985).

[107] I.R.C. § 911(b)(2)(B); Treas. Reg. § 1.911-3(d)(1) (as amended in 1985).

[108] I.R.C. § 911(b)(1)(B)(i); Treas. Reg. § 1.911-3(c)(2) (1985).

[109] I.R.C. § 911(b)(1)(B)(ii).

[110] I.R.C. § 911(b)(1)(B)(iv); Treas. Reg. § 1.911-3(e)(2) (1985).

[111] Treas. Reg. § 1.911-4(a) (as amended in 1985).

[112] Treas. Reg. § 1.911-4(b)(1), -4(b)(2) (as amended in 1985).

[113] I.R.C. § 911(c)(3)(A).

[114] I.R.C. § 911(d)(7).

[115] I.R.C. § 911(c)(1).

[116] These adjustments are authorized by I.R.C. § 911(c)(2)(B). For 2011, the amounts are given in I.R.S. Notice 2011-8, 2011-1 C.B. 503.

[117] For example, for 2012 adjusted limitations for China are only given for Beijing, Shanghai, and Hong Kong, and the amounts for Beijing and Shanghai are $71,200 and $57,001, respectively. I.R.S. Notice 2012-19, 2012-10 I.R.B. 440, § 3.

within the city limits of the cities included even though someone commuting from the suburbs may have equally high housing costs.[118] If the taxpayer does not satisfy the bona fide residence or physical presence test for the entire tax year, the amount is prorated.[119]

In order to prevent "double dipping," no FTC is allowed for foreign taxes paid on income excluded under the FEIE and FHE regimes.[120] Since the passage of the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA),[121] the FEIE and FHE have operated as exemptions with progression; that is, any income excluded under the FEIE or the FHE is included for the purposes of determining the marginal tax rate applicable to any income that is not excluded.[122] The elections for the FEIE and the FHE are made separately and must be made on a return or amended return timely filed.[123] Once made, the election continues unless revoked.[124] An election can be revoked in any subsequent year.[125] If revoked, for example by claiming the FTC on an amount that would be excludible, the election cannot be re-elected for five years without the permission of the Service.[126] It is therefore particularly important to consider any plans to move between high and low tax jurisdictions.

Since in many cases both the FTC and the FEIE and FHE are available, the two need to be considered together.

[118] Martin A. Goldberg, Cynthia Kruth & Mary J. Miller, *Management Repercussions of the Increased Tax on Americans Working Overseas*, INT'L BUS. & ECON. RESEARCH J., Nov. 2007, at 31, 34–35.

[119] Treas. Reg. § 1.911-3(d)(2)(i), -3(d)(3) (as amended in 1985).

[120] I.R.C. § 911(d)(6). For a detailed history of section 911, *see* Christie, *supra* note 15; Jeffrey Evans, *911: The Foreign Earned Income Exclusion—Policy and Enforcement*, 37 VA. J. INT'L L. 891 (1997); Kirsch, *supra* note 2, at 457-63; Philip F. Postlewaite and Gregory E. Stern, *Innocents Abroad? The 1978 Foreign Earned Income Act and the Case for Its Repeal*, 65 VA. L. REV. 1093, 1095-1108 (1979). For a summary, see Gann, *supra* note 82, at 59-60 n.176.

[121] Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. 109-222, 120 Stat. 345 (2006).

[122] I.R.C. § 911(f), as added by TIPRA § 515(c).

[123] I.R.C. § 911(a); Treas. Reg. § 1.911-7(a) (as amended in 2008).

[124] I.R.C. § 911(e)(1); Treas. Reg. § 1.911-7(a) (as amended in 2008).

[125] I.R.C. § 911(e)(2); Treas. Reg. § 1.911-7(b)(1) (as amended in 2008).

[126] I.R.C. § 911(e)(2); Treas. Reg. § 1.911-7(b)(1) (as amended in 2008).

	LOW TAX JURISDICTION	HIGH TAX JURISDICTION
INCOME BELOW FEIE LIMIT	1. FEIE/FHE	2. FTC or FEIE/FHE
INCOME ABOVE FEIE LIMIT	3. FEIE/FHE and FTC on excess	4. FTC, or FEIE/FHE and FTC on excess

As the above table indicates, there are four possible combinations:[127] (1) a taxpayer in a low tax jurisdiction (i.e., with an effective tax rate lower than that of the United States) with foreign income lower than the FEIE/FHE limit; (2) a taxpayer in a high tax jurisdiction (i.e., with an effective tax rate higher than that of the United States) with foreign income lower than the FEIE/FHE limit; (3) a taxpayer in a low tax jurisdiction with foreign income higher than the FEIE/FHE limit; and (4) a taxpayer in a high tax jurisdiction with foreign income higher than the FEIE/FHE limit. In the first scenario, the FEIE will shield all foreign earned income from U.S. tax liability, with the result that the taxpayer will only pay the foreign tax liability. In the second, either the taxpayer will use the FTC to eliminate the U.S. tax liability or the FEIE to exclude the income completely. In the fourth, the taxpayer will use the FTC to eliminate the U.S. tax liability or the FEIE to exclude income up to the limit and the FTC for the remaining tax liability. The choice in the second and fourth scenarios will depend on the exact configuration of earned income versus taxable housing benefits and the effects of the differences in adjusted gross income on other sections of the return.[128] The net effect in all of these scenarios is the effective total exemption of foreign earned income. Only in the third scenario is a taxpayer likely to incur a U.S. tax liability because the FEIE and FHE will not cover the total income and the FTC is not sufficient to eliminate the U.S. tax liability (unless there is a carryover).[129]

The above analysis does not apply to foreign investment income

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[127] In fact, this is a simplification of real life, in that this analysis does not take into account the effects of the change in adjusted gross income due to the operation of the FEIE and FHE and that it assumes that all foreign income is taxed by both the United States and the foreign jurisdiction.

[128] In a high tax jurisdiction, it may be better to use the FTC regime even if one can exclude income, for example if one has little or no housing expenses and wants to generate excess FTC for carry back to a previous year or possible carry forward to a future tax year. *See* I.R.C. § 904.

[129] For a different analysis of the interactions between the FTC and the FEIE and FHE, *see* James G. S. Yang & Agatha E. Jeffers, *Optimal Decision Between Foreign Tax Credit and Foreign Earned Income Exclusion*, 7 INT'L J. BUS. RESEARCH 111 (2007); Evans, *supra* note 120, at 909–10.

because the FEIE only applies to earned income, i.e. wages.[130] The tax liability on investment income can only be offset by the FTC. Therefore, the United States will impose a tax on the difference between the foreign tax paid and the U.S. tax liability on any foreign investment income.

Although the above suggests that U.S. persons abroad are generally not much worse off than U.S. persons in the United States, the more salient comparison is to nonresident aliens. But for their citizenship or immigration status, U.S. taxpayers abroad would be treated like nonresident aliens, i.e. generally taxed at a flat rate of thirty percent on U.S. source income that is not effectively connected with a U.S. trade or business[131] and at the regular graduated rates on income that is effectively connected with a U.S. trade or business,[132] including on gain from the sale of real property interests in the United States.[133] Net capital gains are not taxable unless they are FDAP income.[134] Needless to say, foreign source income of nonresident aliens is not taxed by the United States.

It can therefore be said that the primary income tax cost of citizenship for nonresidents, part of what could be called the citizenship penalty, is limited with respect to U.S. source income to the difference between the liability of a nonresident alien and their actual liability. For example, if dividends would have been withheld on at fifteen percent pursuant to the provisions of a tax treaty, then the citizenship penalty is the excess of the effective rate on the income over that percentage. For foreign source income, the penalty is the tax liability that remains after the utilization of the FTC, FEIE, and FHE. That is, there is a net U.S. tax liability primarily in low tax jurisdictions on investment income and to the extent that earned income exceeds the FEIE maximum.[135] An additional penalty also exists in the form of intrusive and complicated reporting requirements.

The argument has been made that various provisions of the Code compensate for the fact that nonresidents are taxed on their worldwide income. In particular, commentators have argued that the

[130] I.R.C. § 911(d)(2)(A).

[131] I.R.C. § 871(a)(1).

[132] I.R.C. § 871(b).

[133] I.R.C. § 897(a)(1)(A).

[134] I.R.C. § 871(a)(1)(A). These tax benefits make the United States arguably the world's biggest tax haven for non-U.S. resident non-U.S. citizens.

[135] This point, although not the term "citizenship penalty," is to be found in Gann, *supra* note 82, at 63.

FTC weakens the argument against worldwide taxation because it lowers, and sometimes eliminates, the actual tax liability and is an implicit recognition that foreign taxes are being paid.[136] This argument, however, is faulty on several grounds. First, the FTC only covers income taxes paid to another country and therefore does not account for the full tax burden of U.S. individuals abroad. Second, it is of most benefit to expatriates who live in high income tax jurisdictions and have high income levels. It is considerably less beneficial to expatriates in low tax jurisdictions who receive no more benefits from the United States for the U.S. taxes they pay because they do not benefit from a FTC offset. Third, the operation of the FTC, FEIE, and FHE are complicated, and they affect other items of tax.[137] Most importantly, however, the argument is backwards. It is the imposition of worldwide taxation on expatriates that requires the FTC regime, at least with respect to expatriates;[138] the FTC cannot and does not justify worldwide taxation. Conversely, the FTC would not be required for expatriates and the FEIE and FHE could be completely eliminated if worldwide taxation was not imposed on U.S. expatriates.

B. Phantom Gains From Foreign Exchange Rate Variations

Generally speaking, individual U.S. taxpayers are considered to have the U.S. dollar as their "functional currency" and are required to compute and pay their taxes in U.S. dollars with the currency value determined as on the date of each transaction.[139] Calculating taxes in U.S. dollars can cause difficulties for taxpayers who do not operate in a U.S. dollar-denominated world. If the U.S. dollar falls with respect to the taxpayer's actual functional currency, this will translate for U.S. tax purposes into an increase in income or gain and therefore U.S. tax liability, even though there has been no increase in income or gain in real terms. In other words, U.S. taxpayers are exposed to foreign exchange rate risk on their tax returns. Put another way, the United States taxes the depreciation of its own currency. In addition, gains due to foreign exchange are treated as ordinary income, even if the

[136] Kirsch, *supra* note 2, at 478–79.

[137] For example, the use of the FTC could reduce or eliminate a credit such as the Earned Income Tax Credit or, in 2009 and 2010, the Making Work Pay Tax Credit, where the exclusion of income would not.

[138] The FTC was added to mitigate the double taxation inherent in worldwide taxation. *See* Michael J. Graetz & Michael M. O'Hear, *The "Original Intent" of U.S. International Taxation*, 46 DUKE L.J. 1021, 1044-45 (1996-1997).

[139] I.R.C. § 985(b)(1); Treas. Reg. 1.985-1(b)(1)(i) (as amended in 2001).

underlying transaction generates capital gain or loss.[140]

For example, a taxpayer values an asset and determines its basis in U.S. dollar terms on the date of the asset's acquisition. Expenses that are added to basis are converted into U.S. dollars at the exchange rate on the date paid. When the asset is sold, the gain is calculated on the date of disposition. By this mechanism, it is possible to have a real loss in the foreign currency that appears as a (phantom) gain in U.S. dollar terms and is taxed accordingly in the United States. The absurdity of this situation is compounded to the extent there is a loan in a foreign currency that has appreciated over the course of the term of the loan. The loss in U.S. dollar terms on the loan cannot be offset against a gain, if any, on the sale of the underlying asset.[141]

To the extent taxpayers utilize the FTC or FEIE/FHE, a similar potential for devaluation of the credit or exclusion exists. If the U.S. dollar declines relative to a taxpayer's actual functional currency, the U.S. dollar value of the taxpayer's FTC decreases even though there is no reduction in the taxpayer's foreign tax burden in real terms. Similarly, the value of the FEIE and FHE also decreases because the exclusions are not adjusted for currency fluctuations.

U.S. taxpayers who have to settle a tax bill in U.S. dollars that they may not have are also exposed to foreign exchange rate changes when acquiring U.S. dollars to pay their taxes. Furthermore, U.S. taxpayers in jurisdictions where the currency is not legally convertible into dollars or where the conversion is restricted may still be required to pay in U.S. dollars.[142] The taxpayer may be placed in a position in which the only way to satisfy his or her U.S. tax obligation is to violate local currency regulations.

C. Retirement Accounts and Pension Plans

When overseas taxpayers make contributions to foreign retirement accounts and pension plans, they are typically subject to U.S. taxation even though the country of residence may exempt the contribution from taxation. This problem is only overcome if the contribution is covered by a specific provision for pension

[140] I.R.C. § 988.

[141] Quijano v. United States, 93 F.3d 26 (1st Cir. 1996); Rev. Rul. 90-79, 1990-2 C.B. 187.

[142] For the procedure that must be followed for such "blocked income" to be deferrable, *see* Rev. Rul. 74-351, 1974-2 C.B. 144, *modified by* Rev. Rul. 81-290, 1981-2 C.B. 108. Any such income ceases to be deferrable if it is used for nondeductible personal expenses. *Id.*, at Question 3.

contributions in an income tax treaty between that country and the United States.[143]

D. Passive Foreign Investment Companies

Investment and saving decisions present various planning issues for expatriates. One of the most relevant and frustrating problems relates to foreign mutual funds. They are problematic for U.S. expatriates because they involve the expatriate in the passive foreign investment company (PFIC) rules.

A PFIC is a foreign corporation that satisfies either a statutory income test or an asset test.[144] A foreign corporation is classified as a PFIC if either (1) seventy-five percent or more of its gross income for the tax year is passive income (the "income test");[145] or (2) fifty percent or more of the assets held by the corporation during the tax year produce passive income or are held for the production of passive income (the "asset test").[146]

U.S. shareholders of a PFIC are subject to tax and interest charges on either the disposition of appreciated PFIC stock or on the receipt of an "excess distribution" regarding the PFIC stock.[147] The gain on the disposition or the excess distribution is considered earned ratably over the shareholder's holding period. The amount of the gain or excess distribution that is allocated to a particular year is taxed at the highest ordinary income rate in effect for that year.[148] In addition, an interest charge is imposed on the benefit of the deferral.[149]

Alternatively, the shareholder may elect to treat the PFIC as a qualified electing fund (QEF).[150] If the election is made, the shareholder must include his or her pro-rata share of the PFIC's ordinary income and net capital gain in his or her taxable income for the year.[151] The shareholder includes in gross income the deemed distributions for the shares owned.[152] To avoid double taxation, the

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[143] *See, e.g.,* US-Canada Tax Treaty, *supra* note 73, art. XVIII; US-UK Tax Treaty, *supra* note 73, art. 18.

[144] I.R.C. § 1297(a).

[145] I.R.C. § 1297(a)(1).

[146] I.R.C. § 1297(a)(2).

[147] *See* I.R.C. § 1291; Treas. Reg. § 1.1291-1 (as amended in 2004).

[148] I.R.C. § 1293(a)(1)(A).

[149] I.R.C. § 1291(c)(3).

[150] *See* I.R.C. § 1295; Treas. Reg. § 1.1295-1 (as amended in 2004).

[151] I.R.C. § 1293(a).

[152] I.R.C. § 1293(a).

shareholder's basis in the QEF stock is increased by QEF income already included in taxable income and decreased by any distributions that were previously taxed under the QEF rules.[153]

Finally, a U.S. shareholder in PFICs with "marketable stock" may elect to have mark-to-market treatment apply to his or her PFIC stock and thereby include the built-in gain or loss on the PFIC stock in the current tax year.[154] Marketable stock is stock that is regularly traded on a qualified exchange or other market.[155] If a taxpayer elects to apply the mark-to-market regime, he or she must report as gross income the excess of the stock's fair market value over the stock's basis.[156] To the extent that the stock's basis exceeds the fair market value at the end of the tax year, the taxpayer may take a deduction.[157] As with the gain or loss from a sale or exchange of PFIC stock, the gross income inclusions or deductions are treated as ordinary income or loss.[158] The basis of the stock subject to a mark-to-market election is increased by any amount that was included in gross income and reduced by any amount taken as a deduction.[159] An election under the mark-to-market regime is effective indefinitely from the tax year of the election, unless the Service consents to a revocation of the election or the stock ceases to be marketable stock.[160]

While the PFIC rules apply to all U.S. taxpayers, they fall particularly heavily on nonresident taxpayers. Most foreign mutual funds and other investment vehicles are PFICs but do not provide the accounting information necessary to make the mark-to-market election, thus leaving U.S. shareholders with the negative tax consequences of either the default tax treatment or the QEF election. Although the PFIC rules are primarily designed to prevent deferral, they make it difficult for U.S. persons abroad to invest where they live.

E. Estate and Gift Taxation of Nonresident Citizens and LPRs

Another aspect of the citizenship penalty is in the application of

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[153] I.R.C. § 1291(d)(1), (2).

[154] I.R.C. § 1296(a).

[155] I.R.C. § 1296(e); Treas. Reg. § 1.1296-2(a) (as amended in 2004); Treas. Reg. § 1.1296-1 (as amended in 2004) (examples of "marketable" stocks).

[156] I.R.C. § 1296(a)(1).

[157] I.R.C. § 1296(a)(2).

[158] I.R.C. § 1296(c)(1).

[159] I.R.C. § 1296(b)(1).

[160] I.R.C. § 1296(k).

the estate and gift tax regime. Indeed, some commentators have argued that the primary reason some wealthy persons renounce U.S. citizenship is to avoid U.S. wealth transfer taxes rather than U.S. income taxes.[161]

The U.S. estate and gift tax system distinguishes between U.S. citizens and noncitizens. U.S. citizens are subject to the estate tax on the value of their taxable estate at the time of their death, regardless of where the property is located.[162] Gifts are subject to gift tax regardless of where the property is located.[163] A credit is allowed against the U.S. estate tax for foreign estate or inheritance taxes paid with respect to property located in a foreign country that is included in the U.S. gross estate.[164] There is no foreign tax credit in the gift tax regime.

Noncitizens, including LPRs, are considered residents for estate and gift tax purposes if they are domiciled in the United States at the time of their death or of the gift.[165] Nonresidents are subject to the estate tax only on property considered located within the United States.[166] Among other things, shares in U.S. corporations are considered U.S. property for purposes of the estate tax, but shares in foreign corporations are not.[167] It is therefore possible for a nonresident alien to avoid the estate tax completely by holding his or her U.S. assets through a foreign corporation.[168] In addition, in the

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[161] *See, e.g.*, Gene Steuerle, *Alternatives to the Expatriate Tax*, 67 TAX NOTES 567 (Apr. 24, 1995); JCT REPORT ON ISSUES REGARDING EXPATRIATION TAX PROPOSALS, *supra* note 1, at 4.

[162] I.R.C. § 2001(a); I.R.C. § 2031.

[163] I.R.C. §§ 2501(a), 2503(a).

[164] I.R.C. § 2014.

[165] I.R.C. §§ 2101(a), 2103 and Treas. Reg. § 20.0-1(b)(1) (as amended in 1994) (estate tax); I.R.C. § 2511(a) and Treas. Reg. § 25.2501-1(b) (as amended in 1983) (gift tax). Thus, it is possible for LPRs, particularly those who are outside the United States, to be considered a non-resident for estate tax purposes while being a resident for income tax purposes by virtue of their LPR status. The same could be true for non-citizens who are residents for income tax purposes because they satisfy the substantial presence test but are considered not domiciled in the United States.

[166] I.R.C. § 2103. For nonexclusive lists of property that are and are not considered located in the United States, *see* I.R.C. § 2104 and I.R.C. § 2105, respectively.

[167] I.R.C. § 2104(a); Treas. Reg. § 20.2104-1(a)(5) (as amended in 1974); *see* Treas. Reg. § 20.2105-1(f) (as amended in 1974).

[168] For a further discussion of ways to avoid the estate tax, *see, e.g.*, Robert L. Williams, Richard P. Layman & Dawn Nicholson, *Nondomiciliary Planning to Remove Assets from U.S. Estate Tax*, 105 TAX NOTES 843 (Nov. 8, 2004) (emphasizing the interplay with the UK inheritance tax).

case of nonresidents, the gift tax only applies to transfers of tangible personal or real property in the United States.[169] Thus, for some types of U.S. property both the estate and gift tax regimes can be avoided by transferring the property inter vivos instead of by a will.

F. Social Security and Medicare Taxes

Another aspect of the citizenship penalty is the potential to pay employment taxes twice. Generally speaking, both U.S. citizen and LPR employees of a U.S. employer who perform services outside the United States are subject to employment (Social Security and Medicare) taxes.[170] No U.S. employment taxes are due if the individual is covered by a social security agreement between the United States and the country of employment under which employment taxes are due only to the foreign country.[171] Thus, overseas U.S. employees of U.S. employers may be subject to social security taxes in the United States as well as their country of employment unless there is a social security agreement in place.

Similarly, in lieu of the employment taxes levied on employer and employee, the self-employed pay a self-employment tax.[172] Unless a social security agreement between the United States and the expatriate's country of residence provides otherwise,[173] self-employed expatriates are required to make payments to the U.S. social security system in addition to any contributions required by their country of residence. Furthermore, self-employment tax is due on any amounts excluded from income under the FEIE and FHE rules.[174]

These requirements are in place even though the Windfall Elimination Provisions (WEP) may apply.[175] The regular Social

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[169] I.R.C. § 2501(a)(2).

[170] I.R.C. § 3121(b).

[171] I.R.C. § 3101(c) (employee portion) and I.R.C. § 3111(c) (employer portion). There are currently social security agreements, sometimes known as totalization agreements, in force with the following countries: Australia, Austria, Belgium, Canada, Chile, the Czech Republic, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, Norway, Poland, Portugal, South Korea, Spain, Sweden, Switzerland and the United Kingdom; *U.S. International Social Security Agreements*, SOCIAL SECURITY ADMINISTRATION, www.socialsecurity.gov/international/agreements_overview.html (last modified July 20, 2012).

[172] I.R.C. § 1401.

[173] I.R.C. § 1401(c).

[174] I.R.C. § 1402(a)(11).

[175] Social Security Amendments of 1983, Pub L. 98-21, §111, 97 Stat. 65 (codified as amended at 42 U.S.C. § 415(a)(7)).

Security benefit formula is weighted to provide workers with low average lifetime earnings a larger proportion of their earnings than workers with high average lifetime earnings.[176] Certain federal and state employees have pensions from employment not covered by Social Security.[177] WEP was designed to eliminate the "windfall" to those government employees who receive government pensions and a higher Social Security payment due to the weighted benefit formula.[178] The effect on expatriates who are entitled to a foreign pension and are not covered by a totalization agreement is to reduce their Social Security pension by as much as half,[179] even though their foreign state pension is based on contributions made to that system.

G. Foreign Insurance Excise Tax

Code section 4371 imposes a federal excise tax on certain premiums paid to a foreign insurer not engaged in a U.S. trade or business (the foreign insurance excise tax (FIET)).[180] The FIET is imposed on the gross amount of the premium.[181] The liability is four percent for casualty risks wholly or partly within the United States, one percent for a life, sickness, or accident insurance policy, or an annuity contract on the life of, or hazards to, a U.S. citizen or resident, and one percent on a reinsurance policy covering either of the above risks.[182] A premium payment includes any consideration paid for assuming and carrying the risk or obligation, as well as any additional assessment or charge paid under the insurance contract.[183]

The person who pays the premium to the foreign insurer is responsible for paying the FIET.[184] If the tax is not paid by the person paying the premium to the foreign insurer or reinsurer, it must be paid by any person who makes, signs, issues or sells any of the documents or instruments subject to the excise tax, or for whose use or benefit

[176] ALISON M. SHELTON, CONG. RESEARCH SERV., Rep. No. 98-35, SOCIAL SECURITY: THE WINDFALL ELIMINATION PROVISION (WEP) 1 (2010).

[177] *Id.*

[178] *Id.* at 3.

[179] *Id.* at 2, 3.

[180] The author would like to thank Virginia La Torre Jeker for pointing out this provision.

[181] Treas. Reg. § 46.4371–3(b) (1960).

[182] I.R.C. § 4371.

[183] Treas. Reg. § 46.4371–3(b) (1960).

[184] Treas. Reg. § 46.4374–1(c) (as amended in 2002).

such document or instrument is made, signed, issued, or sold.[185] Thus, the U.S. person for whose benefit the policy is issued may be liable even if he or she does not directly pay the premium to the foreign insurer. The beneficiary must therefore ensure that the tax is being paid. Again, this operates to discourage the use of local financial services.

V. REGULATORY HEADACHES: THE INCREASING COMPLIANCE COST OF BEING A U.S. TAXPAYER ABROAD

Overseas U.S. taxpayers are also subject to a variety of administrative and compliance requirements.

A. FBAR

One filing requirement that has gained notoriety in recent years is the requirement to report foreign bank and financial accounts.[186] The foreign bank account reporting regime (FBAR) is a good example of a requirement that may be reasonable in regards to domestic U.S. taxpayers but that falls disproportionately on and unfairly burdens U.S. persons abroad.

The FBAR was created pursuant to the Bank Secrecy Act of 1970 (BSA).[187] Congress was concerned that U.S. taxpayers were using foreign banks and other financial institutions in so-called secrecy jurisdictions to evade U.S. financial and tax rules.[188] According to the language of the statute, Congress intended to require reporting without "burdening unreasonably persons who legitimately engage in international financial transactions."[189] In 1992, the Service became responsible for investigating potential violations of the law,[190] and

[185] I.R.C. § 4374.

[186] The report is made on Treasury Form TD F 90-22.1, commonly referred to as the Foreign Bank Account Report (FBAR Form). DEP'T OF THE TREASURY, TDF 90-22.1, REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS (2012), www.irs.gov/pub/irs-pdf/f90221.pdf.

[187] Bank Secrecy Act of 1970, Pub. L. No. 91-508, 84 Stat. 1114.

[188] *See* United States v. Clines, 958 F.2d 578 (4th Cir. 1992); 31 U.S.C. § 5311 (2011).

[189] Bank Secrecy Act of 1970 § 241(a). Virtually identical language appears in the current statute; s*ee* 31 U.S.C. § 5314(a) (2011).

[190] I.R.S. Treas. Dir. 15-41, IRM Exhibit 4.26.1-2 (December 1, 1992); Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, and Why It Matters*, 7 HOUS. BUS & TAX L.J. 1, 15 (2006).

enforcement authority was delegated to the Service in 2003.[191] The delegation took place because of the Service's greater resources to pursue violations.[192] More importantly, it was part of a move to make the form a tool in international tax enforcement by the IRS.[193]

Under BSA section 5314,

> the Secretary of the Treasury shall require a resident or citizen of the United States or a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or maintains a relation for any person with a foreign financial agency.[194]

Pursuant to this section, the Treasury promulgated regulations that provide that:

> [e]ach United States person having a financial interest in, or signature or other authority over, a bank, securities, or other financial account in a foreign country shall report such relationship to the Commissioner of Internal Revenue for each year in which such relationship exists and shall provide such information as shall be specified in a reporting form prescribed under 31 U.S.C. 5314 to be filed by such persons.[195]

This requirement is implemented in the FBAR Form, which includes instructions that make up a large part of the available guidance. The FBAR Form is an annual report filed by U.S. taxpayers with a financial interest in or signatory authority over financial accounts in a foreign country for any year in which the aggregate value of the account or accounts exceeds $10,000.[196] The deadline for

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[191] Financial Crimes Enforcement Network, Delegation of Enforcement Authority Regarding the Foreign Bank Account Report Requirements, 68 Fed. Reg. 26,489 (May 16, 2003) (codified at 31 C.F.R. § 1010.810(g)); I.R.S. News Release IR-2003-48 (April 10, 2003); 31 C.F.R. § 1010.810(c)(2) (2010).

[192] Financial Crimes Enforcement Network, Delegation of Enforcement Authority Regarding the Foreign Bank Account Report Requirements, 68 Fed. Reg. 26,489; *see also* Sheppard, *supra* note 191, at 16.

[193] Eschrat Rahimi-Laridjani, *FBAR—Where We Are and How We Got There*, 9 J. TAX'N FIN. PROD., no. 3, 2009 at 29, 29.

[194] 31 U.S.C. § 5314(a) (1982).

[195] 31 C.F.R. § 1010.350 (2011).

[196] DEP'T OF THE TREASURY, TDF 90-22.1, REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS (2012), www.irs.gov/pub/irs-pdf/f90221.pdf.

filing the form is June 30 of the year following the calendar year covered by the form.[197]

Because FBAR is authorized by the BSA and not the Code, the FBAR Form is not a tax return and is not strictly speaking a Service form. Among other things, this means that the filing deadline is a receipt, not a postmark, deadline.[198] In addition, FBAR is not covered by the protections of the Code. For example, a civil penalty imposed for FBAR violations is not a tax penalty and is therefore not subject to the notice of deficiency procedures;[199] thus, the Tax Court has no jurisdiction over the assessment.[200] The FBAR Form is also not covered by the confidentiality rules of section 6103.

In 2004, the penalties for individuals who fail to comply with the FBAR reporting requirements were dramatically increased.[201] In the case of nonwillful violations, the Service may impose a maximum penalty of $10,000 per violation.[202] No penalty can be imposed if (i) the violation was due to "reasonable cause" and (ii) the amount in the transaction or the balance in the account at the time of the transaction was properly reported.[203] In addition to the substantial increase in penalty amounts from the prior law, introduction of a reasonable cause standard effectively shifted the burden of proof from the Service, which had to establish that a violation was willful, to the taxpayer, who must meet the reasonable cause exception. In the case of willful violations, the Service may impose a per violation penalty of $100,000 or fifty percent of the balance in the account at the time of the violation, whichever is greater.[204] Criminal penalties can range up to $250,000 or five years in prison.[205] The Service has six years in which to assess a civil penalty in connection with FBAR Forms. It is unclear, however, whether the statute of limitations is tolled if an FBAR Form is not filed.[206] Criminal and civil penalties can be imposed for the same violation.[207]

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[197] *Id.*

[198] *See id.* at 7.

[199] 31 U.S.C. § 5321(a)(5)(A) (2011).

[200] *Id.* § 5321(b)(1); 31 C.F.R. §1010.810(g) (2011).

[201] American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 821, 118 Stat. 1418, 1421.

[202] 31 U.S.C. § 5321(a)(3) (2011).

[203] *Id.* § 5321(a)(5)(B)(ii).

[204] *Id.* § 5321(a)(5)(C)(i), (D)(i).

[205] *Id.* § 5322(b).

[206] *Id.* § 5321(b)(1).

[207] 31 U.S.C. § 5321(d) (2011).

Historically, enforcement of the requirements was quite weak.[208] In particular, criminal prosecutions for FBAR violations have been rare—although enforcement has increased in recent years.[209] For example, on June 17, 2008, the Service issued a press release titled "IRS Reminds Taxpayers to Report Certain Foreign Bank and Financial Accounts by June 30."[210] In mid-2008, the Internal Revenue Manual was updated to include guidance regarding compliance examinations for FBAR.[211] Since then, there has been a stream of pronouncements from the Service.[212]

The Treasury reported that 204,689 FBAR forms were filed in 1999[213] and estimated that one million U.S. taxpayers had foreign accounts.[214] In 2005, 281,762 FBAR forms were filed.[215] The figure of one million U.S. taxpayers with foreign accounts clearly does not take into account the millions of taxpayers living abroad, most of whom presumably have bank accounts, although not necessarily a FBAR filing obligation.

B. FATCA

If the FBAR reporting requirement was not complicated, intrusive, and onerous enough, the Hiring Incentives to Restore Employment Act of 2010[216] (HIRE Act) imposed additional compliance requirements on U.S. taxpayers abroad.[217] New section

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[208] DEP'T OF THE TREASURY, REPORT ON THE U.S.A. PATRIOT ACT 8 (2002), http://www.treasury.gov/press-center/press-releases/Documents/356report.pdf.

[209] *Id.*

[210] I.R.S. News Release IR-2008-79 (June 17, 2008).

[211] *See* IRM 4.26.17, *Report of Foreign Bank and Financial Accounts (FBAR) Procedures* (May 5, 2008).

[212] *See, e.g.*, I.R.S. Notice 2009-62, 2009-35 I.R.B. 260; I.R.S. Notice 2010-23, 2010-11 I.R.B. 441; I.R.S. Notice 2011-31, 2011-17 I.R.B. 724; I.R.S. Notice 2011-54, 2011-29 I.R.B. 53.

[213] DEP'T OF THE TREASURY, *supra* note 208, at 7.

[214] DEP'T OF THE TREASURY, *supra* note 208, at 6.

[215] U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-07-212, BANK SECRECY ACT: FINCEN AND IRS NEED TO IMPROVE AND BETTER COORDINATE COMPLIANCE AND DATA MANAGEMENT EFFORTS 42 (2006).

[216] Hiring Incentives to Restore Employment Act (HIRE Act) of 2010, Pub. L. 111-147, 124 Stat. 71.

[217] The provisions were first put forward as part of the Stop Tax Haven Abuse Act, S. 681, 110th Cong. (2007), H.R. 2136, 110th Cong. (2007). After being advanced in several other bills, one titled the Foreign Account Tax Compliance Act (FATCA), they were finally enacted as part of the revenue offset provisions of the HIRE Act. They are commonly referred to as the FATCA provisions.

6038D requires any individual who, during any taxable year, holds an interest in a "specified foreign financial asset" to attach to his or her tax return certain information with respect to the asset, if the aggregate value of all such assets exceeds $50,000 or a higher amount as prescribed by the Treasury regulations.[218] This amount has been increased to $200,000, or $400,000 for married taxpayers filing jointly, on the last day of the tax year, or $300,000 or 600,000, respectively, at any time during the tax year, for those abroad who satisfy the bona fide residence or physical presence tests of section 911(d)(1).[219] The specified foreign financial assets are reported on Form 8938.[220] The definition of such assets is even broader than the definition of "foreign bank and financial account" under the FBAR rules and covers: 1) any financial account maintained by a foreign financial institution; 2) any stock or security issued by a non-U.S. person; 3) any financial instrument or contact held for investment that has an issuer or counterparty that is a not a U.S. person; and 4) any interest in a foreign entity.[221] For each of these assets, the individual must disclose detailed information identifying the account and the financial institution in which it is held, and the name and address of the issuer of the stock or security, instrument, contract or interest.[222]

The new section imposes an initial penalty of $10,000 for failure to disclose the information, with the possibility of additional $10,000 penalties for every thirty-day period, or fraction thereof, if the taxpayer has not provided the information within ninety days of the Service's mailing a notice of failure to notify to the individual.[223]

Section 6662 was amended to add new subsection (j), which provides that the penalty on the portion of any understatement that is attributable to any transaction involving an undisclosed foreign financial asset is increased to forty percent.[224] The statute of limitations was extended to six years in the case of taxpayers who omit from gross income an amount based on one or more foreign assets in excess of $5,000 about which information is required to be reported

[218] I.R.C. § 6038D(a), *added by* HIRE Act § 511.

[219] Temp. Treas. Reg. § 1.6038D-2T(a)(3), (4) (2012).

[220] INTERNAL REVENUE SERV., FORM 8938, STATEMENT OF SPECIFIED FOREIGN FINANCIAL ASSETS (2011). Filing was suspended until the final form was issued. I.R.S. Notice 2011-55, 2011-29 I.R.B. 53.

[221] I.R.C. § 6038D(b).

[222] I.R.C. § 6038D(c).

[223] I.R.C. § 6038D(d).

[224] Hiring Incentives to Restore Employment Act (HIRE Act) of 2010, Pub. L. 111-147, § 512, 124 Stat. 71.

under section 6038D.[225]

For individuals, the above provisions became effective starting in 2011.[226] The statute of limitations provision is effective for income tax returns filed after March 18, 2010 and for returns filed on or before that date if the statute of limitations with respect to that return has not expired as of the date of enactment.[227]

Despite these extensive new foreign reporting requirements, the FBAR requirements continue to apply, so that taxpayers abroad will be subject to two overlapping sets of rules.

The HIRE Act also introduced a complex and intrusive reporting regime for Foreign Financial Institutions (FFIs).[228] A FFI is broadly defined as any foreign entity that accepts banking deposits, holds financial assets for others as a substantial portion of its business, or is engaged in investment.[229] A thirty percent withholding tax is imposed on all U.S. source transfers to a FFI,[230] unless it enters into an agreement with the Service to provide annual reports to the Service regarding accounts owned by U.S. persons.[231] The rules were to take effect on January 1, 2013,[232] but in recognition of the difficulties imposed by the FFI provisions, the Service has announced that the provisions will be phased in between June 30, 2013 and January 1, 2015.[233]

The FFI provisions have been widely criticized for their complexity, disproportionate cost, heavy-handedness, extra-territoriality, and unprecedented use of withholding to force disclosure of information. Domestic and foreign commentators have noted their overreach, complexity, and technical problems.[234] Foreign

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[225] I.R.C. § 6501(e), *amended by* HIRE Act § 513.

[226] HIRE Act §§ 511(c), 512(b).

[227] *Id*. § 513(d).

[228] I.R.C. §§ 1471-1474, *added by* HIRE Act § 501.

[229] I.R.C. § 1471(d)(4), (5).

[230] I.R.C. § 1471(a)(1).

[231] I.R.C. § 1471(b), (c).

[232] HIRE Act § 501(d).

[233] I.R.S. Notice 2011-53, 2011-32 I.R.B. 124.

[234] *See, e.g.*, Scott D. Michel & H. David Rosenbloom, *FATCA and Foreign Bank Accounts: Has the U.S. Overreached?*, 62 TAX NOTES INT'L 709, 711 (May 30, 2011) (noting their cost, complexity and overreach as well as the fact that the failure to include U.S. institutions in the passthrough provisions constitutes a major potential loophole); Melissa A. Dizdarevic, *The FATCA Provisions of the Hire Act: Boldly Going Where No Withholding Has Gone Before*, 79 FORDHAM L. REV. 2967 (2011) (arguing that "without further guidance or revisions. . .withholding [as] a punitive measure. . .is both undesirable and unacceptable"); American Citizens Abroad, *Expat*

governments have objected to their extraterritorial reach,[235] and foreign institutions are resisting acting as agents for the Service and bearing the cost of U.S. tax enforcement.[236] Some non-U.S. financial institutions have decided not to deal with U.S. citizens, and if the FFI provisions are implemented as passed, more FFIs can be expected to cease providing banking services to U.S. taxpayers, including U.S. taxpayers abroad.[237] U.S. LPRs and dual citizens not born in the

Group Calls for FATCA Repeal, 63 TAX NOTES INT'L 797 (Sept. 12, 2011); Editorial, *Tax-Haven Wars: Congress Is Scheming to Export IRS Meddling Overseas*, WASH. TIMES, Jan. 4, 2012, http://www.washingtontimes.com/news/2012/jan/4/tax-haven-wars/; Gary Clyde Hufbauer, *The Foreign Account Tax Compliance Act: Imperial Overreach*, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS (July 22, 2011, 9:09 AM), http://www.piie.com/blogs/realtime/?p=2276.

[235] *See, e.g.*, Michel & Rosenbloom, *supra* note 234, at 711; *Read Jim Flaherty's Letter on Americans in Canada*, FINANCIAL POST, Sept. 16, 2011, http://business.financialpost.com/2011/09/16/read-jim-flahertys-letter-on-americans-in-canada/.

[236] *See, e.g.*, Letter from Japanese Bankers Association to Stephen E. Shay, Manal Corwin, Michael Danilack, Steven A. Musher & John Sweeney, Internal Revenue Serv. (Oct. 28, 2011), http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_JBA_102811_122011.pdf; Letter from European Banking Federation & Institute of International Bankers to Manal Corwin, Michael Danilack & Steven A. Musher, Internal Revenue Serv. (April 30, 2012), http://www.iib.org/associations/6316/files/04302012IIB-EBFSubmission_FATCA.pdf; David Jolly & Brian Knowlton, *Law to Find Tax Evaders Denounced*, N.Y. TIMES, Dec. 26, 2011, http://www.nytimes.com/2011/12/27/business/law-to-find-tax-evaders-denounced.html?_r=1. Costs have been estimated to run at least as high as several billion U.S. dollars, borne by the financial industry. *See* Letter of European Banking Federation and Institute of International Bankers, *supra*. The Joint Committee on Taxation has estimated the gross increase in revenue to the U.S. Treasury for the period 2010-2020 to be $8.174 billion. STAFF OF JOINT COMM. ON TAXATION, JCX-6-10, ESTIMATED REVENUE EFFECTS OF THE REVENUE PROVISIONS CONTAINED IN AN AMENDMENT TO THE SENATE AMENDMENT TO THE HOUSE AMENDMENT TO THE SENATE AMENDMENT TO H.R. 2847, THE "HIRING INCENTIVES TO RESTORE EMPLOYMENT ACT" SCHEDULED FOR CONSIDERATION BY THE HOUSE OF REPRESENTATIVES ON MARCH 4, 2010 (2010).

[237] *See* Louis Armitstead, *Lloyds Bank Hit by Obama Tax Purge: Banking Group Drops American Customers in UK Ahead of Costly Proposals to Stamp Out Tax Evasion*, TELEGRAPH, June 13, 2009, http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/5526129/Lloyds-Bank-hit-by-Obama-tax-purge.html; Julia Werdigier, *ABN to Close U.S. Citizens' Investment Portfolios*, N.Y. TIMES, Feb. 26, 2008, http://www.nytimes.com/2008/02/26/business/worldbusiness/26iht-abn.4.10436956.html; Ben Wright, *Toxic Citizens? Banks Are Cutting American Expatriates Adrift*, WALL STREET J., June 13, 2010, http://online.wsj.com/article/SB10001424052748704002104575290451594973266.html; *European Banks Stop Serving American Customers*, SPIEGEL ONLINE, Dec. 14, 2011, http://www.spiegel.de/international/business/reaction-to-us-tax-law-european-banks-stop-serving-american-customers-a-803742.html; Sanat Vallikappen, *U.S. Millionaires Told Go Away As Tax*

United States can be expected to take the obvious countermeasure of not disclosing that they are U.S. persons. Thus, in addition to causing additional hardship for U.S. persons abroad, the new rules will likely make U.S. persons more reticent about their U.S. connection, instead of open about it.

C. Additional Reporting Requirements

Taxpayers who own interests in foreign entities are subject to additional requirements: Form 5471, Information Return of US Persons with Respect to Certain Foreign Corporations; Form 8865, Information Return with Respect to Certain Foreign Partnership; and Form 8858, Information Return with Respect to Certain Disregarded Entities. These forms are designed to cover all U.S. taxpayers but affect especially those located overseas.

VI. ARGUMENTS FOR AND AGAINST THE WORLDWIDE TAXATION OF EXPATRIATES

A. Competitiveness and Export Promotion Arguments

The taxation of U.S. persons abroad and the exceptions to the current tax regime have been analyzed and debated on various grounds. Since the 1920s, the arguments surrounding the taxation of U.S. persons abroad have largely assumed that the worldwide taxation of expatriates is justified. The focus of attention has been on the FEIE and FHE.[238] The discussions have largely proceeded on the assumption that the relevant scenario is U.S. companies employing U.S. citizens abroad to sell U.S. manufactured goods, and now also services, abroad.[239]

The competitiveness or export promotion argument in favor of the FEIE and FHE is that U.S. taxpayers abroad should not be taxed on their earned income on the grounds that they increase the competitiveness of U.S. businesses by increasing U.S. exports and expertise; subjecting U.S. taxpayers abroad to U.S. as well as local taxation would discourage them from working abroad and would

Evasion Rule Looms, May 8, 2012, http://www.bloomberg.com/news/2012-05-08/u-s-millionaires-told-go-away-as-tax-evasion-rule-looms.html.

[238] *See, e.g.,* Postlewaite & Stern, *supra* note 120, at 1093 (referring to the FEIE as “special treatment” and “preferential tax treatment”).

[239] *See* Kirsch, *supra* note 2, at 464.

therefore be anti-competitive.[240] Thus, the FEIE and FHE benefit expatriates who are working in the national commercial interest, or their employers, if their U.S. tax liability is covered by their employers through tax equalization or otherwise. But is this correct, and even if it is, does it justify a tax concession?

Proponents of the FEIE and FHE also argue that U.S. persons working abroad benefit the U.S. economy because they are more likely to purchase U.S. products and to promote the United States in immaterial ways. An expatriate testified before Congress that "we are on the front lines of American business competitiveness. . . . We are your front line civilian troops. . . . We are the ones representing American businesses."[241] Similarly,

> [w]e constitute an educated group, one that speaks foreign languages, one that is interested in foreign cultures. Since we take our culture to the places we visit and live in, we broaden the influence of the United States and its values of democracy and free enterprise. Through our work overseas, in industry, commerce, and the professions, we advance the economic goals of the United States by contributing to a stronger America, through increasing our trade overseas and thus also increasing employment in the United States.[242]

Expatriates also learn skills that are then available on their return to the United States. But these arguments, perhaps once valid, are increasingly difficult to sustain. Whereas once many people's only contact with the United States was through U.S. citizens living abroad, today, with tourism, the internet, and U.S. material and cultural exports, foreigners have many ways to access U.S. culture.[243] Similarly, the United States is not dependent on returning citizens for foreign

[240] *See, e.g.*, Kirsch, *supra* note 2, at 511–21 (discussing and rejecting this line of reasoning). There have been attempts to quantify the effects of the FEIE and FHE. *See* JOHN MUTTI, U.S. TREASURY DEP'T OFFICE OF TAX ANALYSTS, THE AMERICAN PRESENCE ABROAD AND U.S. EXPORTS 33 (1978); GEN. ACCOUNTING OFFICE, ID-81-29, AMERICAN EMPLOYMENT ABROAD DISCOURAGED BY U.S. INCOME TAX LAWS (1981). *See also* JANE G. GRAVELLE & DONALD W. KIEFER, CONG. RESEARCH SERV., Rep. No. 78-91 E, U.S. TAXATION OF CITIZENS WORKING IN OTHER COUNTRIES: AN ECONOMIC ANALYSIS 56-57 (1978).

[241] *Hearing on U.S. Citizens Overseas*, *supra* note 21, at 31-32 (statement of Stephanie Simonard, Chair, World Federation of Americans Abroad).

[242] *Id.* at 38. These types of argument are made frequently; *see, eg.*, *Hearing on Counting Americans Abroad*, *supra* note 35, at 55-56 (statement of L. Leigh Gribble).

[243] Kirsch, *supra* note 2, at 466–67.

language and culture skills.

The tax arguments are also problematic. First, a U.S. company's decision to hire a U.S. or foreign citizen is not necessarily driven by tax factors. It is influenced by issues such as skill levels and familiarity with the local market.

Second, part of the argument is the claim that foreign operations of, and the use of U.S. employees abroad by, U.S. multinationals expand U.S. exports. Whether this effect outweighs the substitution effect of foreign production substituting for U.S. produced exports is unknown. Similarly, the connection between the employment of U.S. citizens abroad and net increase in exports is undetermined.[244]

Third, the various primary and secondary impacts on taxpayers, employers, and the economy due to changes in the taxation of expatriates are difficult to separate or quantify. If taxes are raised on U.S. persons abroad, the initial, primary effect is an increased tax burden on and revenues from those individuals. If some respond by leaving those jobs and returning to the United States, tax revenues may either increase further or decrease. Revenues may increase if the returning taxpayers take or create well-paying positions without displacing others and pay more in taxes than they would have abroad. Conversely, revenues may decrease if the new positions are not well-paying or if the returnees cause others to become or remain unemployed.[245] If the individuals remain overseas, the revenue may exceed or fall short of estimates, depending on who bears the tax increase. If the U.S. employee bears it as a reduction in wages, this should not decrease the estimate. If the employer bears the increase as a reduction in profits, revenues may decrease if there is a decrease in corporate income tax collections, and this may exceed the increase in individual income tax that may be paid. On the other hand, revenues may not be affected if the employer is able to pass the additional expense onto its customers. Over the longer term, this may lead to a decrease in the number of U.S. persons employed abroad, with the possible increase or decrease referred to above. Finally, if export sales are lost because non-U.S. persons favor their home countries' suppliers, this could lead to further decreases in profits and tax revenues.[246] Thus, it is impossible to determine whether tax

[244] GRAVELLE & KIEFER, *supra* note 240, at 56–58.

[245] GEN. ACCOUNTING OFFICE, ID-78-13, IMPACT ON TRADE OF CHANGES IN TAXATION OF U.S. CITIZENS EMPLOYED OVERSEAS 61 (1978) [hereinafter IMPACT OF CHANGES IN TAXATION OF U.S. CITIZENS OVERSEAS].

[246] *Id.* at 64.

collections will increase or decrease.[247]

Fourth, part of the justification for a tax concession is that U.S. taxpayers abroad are subject to a greater and, by implication, an unfair tax burden.[248] Similarly, it has been argued that increased foreign expenses that are compensated by employers (tax equalization, education in the local American school, trips back to the United States, etc.) are not real increases in standard of living and therefore should not be taxed.[249] Overseas expatriates, however, are not necessarily subject to an increased tax burden or general cost of living, and these may not be stable over time.

Thus, it is difficult to argue that living overseas justifies special tax treatment for expatriates. Most of the alleged benefits of expatriates to the United States and the U.S. economy are general, if not illusory. As the Congressional Research Service has noted, "it must be observed that the relationship between U.S. tax treatment of citizens working in other countries and the quantity of U.S. exports is indirect and uncertain."[250] Furthermore, "there is no clear evidence that artificially encouraging Americans to work abroad through the tax code serves any identifiable national purpose. Therefore, the resulting increased 'competitiveness' of American firms and citizens in foreign locations appears to be at the expense of other Americans."[251] Somewhat less negatively, the GAO noted that "[w]e have not attempted to judge the merits of this position [that U.S. citizens favor U.S. suppliers in procurement] or to appraise its quantitative importance, not because the position seems implausible to us but because we know of no way to evaluate it objectively."[252]

> [T]he contribution of U.S. citizens residing in foreign countries to the American balance of payments is not unambiguously positive and may, on balance, be negative. Moreover, capturing all of these effects in a single number is by no means easy, for many assumptions must be made whose realism will undoubtedly affect the confidence with which the

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[247] *Id.*

[248] *See, e.g.*, Patton, *supra* note 15, at 697–98, 726–27, apps. 1 & 2 (pages unnumbered between 736 & 737) (discussed as part of his argument against the taxation of expatriates).

[249] *See, e.g.*, Christie, *supra* note 15, at 137–38.

[250] GRAVELLE & KIEFER, *supra* note 240, at iv.

[251] *Id.* at v, 57.

[252] IMPACT OF CHANGES IN TAXATION OF U.S. CITIZENS OVERSEAS, *supra* note 245, at 13.

conclusions are received.[253]

More generally, broad generalizations regarding the expenses and tax status of expatriates are, like many of the arguments in favor of the FEIE and FHE, increasingly out of date. Many expatriates are not sent by U.S. companies on assignment but go abroad of their own volition for education, professional advancement, or personal reasons. Many U.S. persons working abroad are hired locally and are paid local wages and not given the more generous expatriate salary packages. In addition, tax equalization by employers appears to be less common than it was in the past.

Thus, the arguments in favor of special tax treatment for U.S. taxpayers overseas are based on several tenuous propositions. First is the assumption that all or at least most U.S. expatriates promote U.S. interests because they work for U.S. businesses;[254] are more likely to purchase or procure U.S. products; acquire expertise that enriches the sum total of U.S. knowledge; or somehow by their mere presence abroad and their shining example improve the image of the United States. Second is the assumption that any benefit to U.S. businesses is a benefit to the United States. There may have been some correlation between what is good for business and good for the United States when U.S. corporations manufactured and were headquartered in the United States and were largely owned by U.S. persons; however, in an era of widely-owned multinationals and global supply chains, it is difficult to assume that "U.S. production" is necessarily made in the United States or that the profits of U.S. businesses inure to U.S. persons and are taxable by the United States.[255] To treat the interests of U.S. companies and the U.S. economy as interchangeable or even closely linked is therefore highly problematic.[256] Finally, even if it were possible to quantify the benefits to the U.S. economy and treasury from the activities of expatriates, the FEIE and FHE regimes are not the most targeted and efficient way of encouraging expatriates and increasing the desired effects of expatriates.[257]

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[253] *Id.* at 12.

[254] For example, IMPACT OF CHANGES IN TAXATION OF U.S. CITIZENS OVERSEAS, *supra* note 245; GRAVELLE & KIEFER, *supra* note 240. Studies do not consider or consider only in passing the increasingly common scenario of U.S. citizens not working for U.S. employers; *see, e.g.*, *id.*

[255] IMPACT OF CHANGES IN TAXATION OF U.S. CITIZENS OVERSEAS, *supra* note 245, at 11.

[256] *See* Kirsch, *supra* note 2, at 465–66.

[257] IMPACT OF CHANGES IN TAXATION OF U.S. CITIZENS OVERSEAS, *supra* note

B. Horizontal and Vertical Equity and the Ability to Pay

Ultimately, the taxation of U.S. expatriates should be based on equity and fairness, not competitiveness or export promotion. If the worldwide taxation of nonresidents is justified, it is hard to justify section 911.[258] Conversely, if worldwide taxation does not stand up to scrutiny, then it should be eliminated, not ameliorated by the FEIE and FHE.

Several arguments have been advanced to justify the taxation of the worldwide income of U.S. expatriates. Both horizontal and vertical equity have been invoked. Horizontal equity requires that persons who are similarly situated (i.e., have the same economic income) should pay the same amount of taxes.[259] Vertical equity requires that persons with greater incomes should pay more taxes than persons with lesser incomes.[260] Like the ability to pay argument, the horizontal and vertical equity arguments do not address which taxpayers should be within the pool of persons that are being compared.[261] Implicit in the arguments for and against section 911 is the understanding that U.S. expatriates can legitimately be compared

245, at 27.

[258] *See, e.g.*, Postlewaite & Stern, *supra* note 120 (arguing for repeal of the FEIE on grounds that it violates tax equity without a countervailing economic purpose); John A. Papahronis, *Taxation of Americans Abroad Under the ERTA: An Unnecessary Windfall*, 4 NW. J. INT'L L. & BUS. 586 (1982) (arguing that the liberalized FEIE enacted in 1981 violated the principle of tax equity and would not be effective in achieving the purported goal of export promotion, and discussing alternatives to the FEIE).

[259] Colón, *supra* note 15, at 30; Hale E. Sheppard, *Perpetuation of the Foreign Earned Income Exclusion: U.S. International Tax Policy, Political Reality, and the Necessity of Understanding How the Two Intertwine*, 37 VAND. J. TRANSNAT'L L. 727, 734 (2004).

[260] Colón, *supra* note 15, at 30; Sheppard, *supra* note 259, at 734.

[261] Among those who assume that that is the correct comparison are Marcia Field & Brian Gregg, *U.S. Taxation of Foreign Earned Income of Private Employees*, *in* U.S. DEP'T OF THE TREASURY, ESSAYS IN INTERNATIONAL TAXATION 99, 114 (1976); Postlewaite & Stern, *supra* note 120, at 1121–22, 1125–26; GRAVELLE & KIEFER, *supra* note 240, at 35–46. The equity argument is discussed in detail in Kirsch, *supra* note 2 and Renée Judith Sobel, *United States Taxation of Its Citizens Abroad: Incentive or Equity*, 38 VAND. L. REV. 101 (1985). Christie, *supra* note 15, at 133, accepts the proposition that overseas citizens should be compared to all U.S. citizens in principle, but proceeds to reject citizenship-based taxation primarily on the grounds that overseas citizens are subject to higher costs and do not enjoy the full benefits of citizenship; the weakness of this approach is that the former is not necessarily true. He also argues, more persuasively, that they simply do not have the minimum economic contacts with the United States to justify taxation.

to domestic taxpayers.[262] Yet most commentators simply assume that the jurisdictional nexus has been satisfied and the inclusion justified.[263] While short-term expatriates clearly should be considered members of U.S. society for purposes of this analysis, the argument will generally be much weaker with reference to long-term expatriates, depending on their ties to the United States. The argument for comparison falls apart completely in connection with accidental, nominal, and unaware citizens, whose connection to the United States is typically minimal to nonexistent.

C. Political Allegiance

If political allegiance is a justification for taxation, then citizenship is the correct criterion, but this rationale for the taxation of nonresidents is not usually stated explicitly. As a study commissioned by the League of Nations in 1923 noted,

> [a] citizen of a country living abroad is frequently held responsible to his own country, though he may have no other ties than that of citizenship there. His is a political fealty which may involve political duties and may also confer political rights. It may well be that the political rights are such as to imply a political obligation or duty to pay taxes.
>
> In modern times, however, the force of political allegiance has been considerably weakened. The political ties of a non-resident to the mother-country may often be merely nominal. His life may be spent abroad, and his real interests may be indissolubly bound up with his new home, while his loyalty to the old country may have almost completely

[262] Kirsch, *supra* note 2, at 479.

[263] *See, e.g.*, Papahronis, *supra* note 260, at 599 (arguing that the substitution of citizenship based taxation with what he refers to as "severance taxation" is not justified on export promotion grounds because "a departure from citizenship taxation [would be] just another way of discriminating among taxpayers without any discernible furtherance of Congressional policy."). One exception is Prof. Kirsch, who considers this issue explicitly and concludes that they should be considered members of U.S. society. Kirsch, *supra* note 2, at 479–84. By contrast, Prof. Gann argues they should not be considered in the same pool. *See* Gann, *supra* note 82, at 64–65. Profs. Fleming, Peroni, and Shay state that "there is less clarity [regarding the applicability of the equity argument] when the connection with the United States is less extensive [than that of permanent residence]," but they conclude that the issue is outside the scope of the article. J. Clifton Fleming, Jr., Richard J. Peroni & Stephen E. Shay, *Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income*, 5 FLA. TAX REV. 299, 309–10, 309 n.18 (2001).

> disappeared. In many cases, indeed, the new home will also become the place of a new political allegiance . . . In the modern age of the international migration of persons as well as of capital, political allegiance no longer forms an adequate test of individual fiscal obligation. It is fast breaking down in practice, and it is clearly insufficient in theory.[264]

What was already questionable in 1923 seems clearly to not be the case almost a century later. Furthermore, what is the justification for U.S. exceptionalism on this point? Why should political allegiance to the United States be any more demanding and costly than to any other country?

D. Benefits of Citizenship

The benefits of citizenship that allegedly accrue to U.S. citizens abroad have been used to justify the worldwide taxation of nonresidents;[265] they are also implicit in discussions of horizontal or vertical equity.[266] But are these arguments persuasive? If the benefits

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[264] *Report on Double Taxation Presented by Profs. Bruins, Einaudi, Seligman & Sir Josiah Stamp to the Financial Comm.*, League of Nations Doc. E.F.S.73.F.19 (1923). The study argued that the better grounds for the taxation of individuals are domicile or permanent residency and economic allegiance, whose elements are (1) the acquisition or origin of wealth, (2) the location of wealth, (3) the enforceability of the rights to wealth, and (4) the consumption or other disposition of wealth. *Id.* at 19–20.

[265] *See, e.g.*, Postlewaite & Stern, *supra* note 120, at 1121, 1125–26 (claiming that general expenditures "benefit the American abroad as much as they benefit any domestic taxpayer"); Sheppard, *supra* note 259, at 747-48 (making the point in the context of the debate over the justification for the FEIE and FHE); *see also* David R. Tillinghast, *A Matter of Definition: 'Foreign' and 'Domestic' Taxpayers*, 2 INT'L TAX & BUS. LAW. 239, 242–44 (1984) (claiming that nonresident citizens enjoy "substantial legal and practical protections" by reason of their U.S. citizenship but citing only the right to reenter the United States). Prof. Colón, who argues for a mark-to-market system on relinquishing U.S. citizenship, says only that "[o]ne can question the fairness of taxing the worldwide income of nonresident citizens," but he proceeds to accept the status quo. Colón, *supra* note 15, at 9 n.20. The absence of benefit is used as partial evidence of the non-justification of taxation; *see, e.g.*, Patton, *supra* note 15, at 699–700.

[266] *See, e.g.*, Postlewaite & Stern, *supra* note 120, at 1121 ("Tax equity dictates that taxpayers — foreign and domestic — be treated consistently."). Similarly, by arguing in favor of "tax incentives" in order to increase exports, government studies such as GRAVELLE & KIEFER, *supra* note 240, implicitly accept the position that U.S. taxpayers residing abroad should be included in the pool of people subject to taxation. (The report proceeds to discuss equity arguments for tax relief on the grounds that costs of living are higher, and therefore real incomes lower, in many

received are minimal, taxation on that basis is unjustified. Let us consider the alleged benefits in turn.

Most U.S. government expenditures fall into three broad categories. First are general domestic expenditures, such as for infrastructure, policing or education; these expenditures benefit all U.S. residents and do not benefit U.S. expatriates except to the extent that they later move to the United States.[267] Second are specific benefits for which there is a fee or for which the individual has already paid, such as the issuance of a U.S. passport or Social Security payments. Finally, there are general expenditures such as international policing that arguably benefit U.S. persons abroad, but not as distinct from all persons outside the United States.[268] None of these justify taxation of nonresident U.S. citizens or LPRs.

What of specific benefits cited as justifying the worldwide taxation of nonresidents? Historically, one of the most commonly cited benefits of citizenship was the protection of U.S. individuals abroad, and this is often cited as a justification for the taxation of expatriates (although it does not justify taxation of LPRs, who do not generally benefit from such protection).[269] While protection may have once been an important benefit in the days of gunboat diplomacy, it cannot reasonably be said to be the case today. Although there have been

locations abroad.) Of course, some point out the weakness of this assumption. *See, e.g.*, Gann, *supra* note 82, at 64 (pointing out that the initial question is not whether or not section 911 should be retained, but whether the proper equity comparison is between U.S. citizens living abroad and those living in the United States). Another author who makes the contrary point explicitly is Andrew Walker, *The Tax Regime for Individual Expatriates: Whom to Impress?*, 58 TAX LAW. 555, 585–86 (2005) (noting that taxation based only on nationality does not satisfy horizontal equity, as resident and nonresident taxpayers are not similarly situated and that the benefits that accrue to the latter are minimal). *Contra* Blum & Singer, who state that "[i]n theory, citizenship-based taxation may have merit: it is arguable that U.S. citizens living abroad generally do receive significant benefits from their status as citizens, and fairness suggests that they should be taxed differently from a nonresident alien;" Blum & Singer, *supra* note 15, at 716. They go on to reject citizenship-based taxation only on the grounds of practicality, in particular the likelihood of compliance and the Service's ability to enforce; *id.* at 717–18.

[267] Patton, *supra* note 15, at 699.

[268] Even Prof. Kirsch, who argues in favor of worldwide taxation of nonresidents, appears to concede that these benefits, not being limited to U.S. citizens, are not sufficient to justify taxation. Kirsch, *supra* note 2, at 471–72 ("However, commentators have observed that it is difficult to defend citizenship-based taxation based solely on collective benefits because these collective benefits are not limited to U.S. citizens, but also accrue to residents and nationals of other countries.").

[269] *See, e.g.*, Sheppard, *supra* note 260, at 747; Kirsch, *supra* note 2, at 472–73.

some notable and dramatic evacuation cases in recent memory, they affected only a small number of expatriates.[270] Considering the large number of expatriates and the fact that most live in stable states, these cases are not relevant for most expatriates. On the contrary, it can be argued that it was their citizenship that endangered the U.S. citizens in those countries.[271] In fact, given the unpopularity of the United States in many parts of the world, and the threat of terrorism directed at U.S. citizens, many U.S. citizens choose to keep a low profile abroad. Anecdotal evidence suggests that many U.S. dual nationals choose to travel on their other passport and not advertise their U.S. connection.[272] It is thus doubtful whether U.S. protection can be considered a benefit for most overseas U.S. citizens.

Another argument is that the consular services offered to U.S. citizens abroad help to justify worldwide taxation;[273] however, it is hard to measure the extent to which U.S. citizens abroad actually avail themselves of these services and how useful they are. It is likely that they are of little practical use to long-term expatriates and those living

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[270] *See* Norman Kempster, *U.S. Steps Up Evacuation of Foreigners from Liberia*, L.A. TIMES, April 12, 1996, at A13, for a discussion of the 1996 evacuation from Liberia. *See* Josh White, *U.S. Prepares Huge Lebanon Evacuation*, WASH. POST, July 18, 2006, http://www.washingtonpost.com/wp-dyn/content/article/2006/07/17/AR2006071701421.html, for a discussion of the 2006 evacuation from Lebanon. *See also U.S. Citizens Remain in Dark About Evacuation*, MSNBC (July 17, 2006), http://www.msnbc.msn.com/id/13902115/ns/world_news-mideast_n_africa/t/uscitizens-remain-dark-about-evacuation. More recently, there have been evacuations from Japan after the radioactive leak at the Fukushima Nuclear Power Plant. *See, e.g.*, Michele Travierso, *U.S. Begins 'Voluntary Evacuations' of American Citizens from Japan*, TIME, Mar. 17, 2011, http://newsfeed.time.com/2011/03/17/u-s-begins-voluntary-evacuations-from-japan; *Japan Quake: U.S. Evacuation Plane Leaves with 100*, BBC NEWS, Mar. 17, 2011, http://www.bbc.co.uk/news/world-us-canada-12777022. There have also been discussions of the evacuations from Egypt and Libya. *See, e.g.*, Liam Stack & J. David Goodman, *U.S. Begins Evacuation Flights from Chaotic Cairo Airport*, N.Y. TIMES, Jan. 31, 2011, http://www.nytimes.com/2011/02/01/world/middleeast/01exodus.html; *Egypt Protests: Canada and US Evacuate Citizens*, BBC NEWS, Jan. 31, 2011, http://www.bbc.co.uk/news/world-us-canada-12327616; William Branigin, Mary Beth Sheridan & Colum Lynch, *Obama Condemns Violence in Libya, Asks for 'Full Range of Options'*, WASH. POST, Feb. 23, 2011, http://www.washingtonpost.com/wp-dyn/content/article/2011/02/22/AR2011022206935.html.

[271] *See* Kirsch, *supra* note 2, at 472–73.

[272] This despite the fact that the U.S. Department of State believes that the U.S. passport is "the most valuable document in the world"; 7 FAM § 1311(g), *Passport Services: Summary* (July 9, 2008).

[273] *See, e.g.*, Sheppard, *supra* note 260, at 747.

in stable democracies.[274] Furthermore, in most situations when help would be useful, for example in the case of complications with local authorities, the U.S. government's ability to act is clearly circumscribed by its lack of jurisdiction. In particular, if a U.S. dual national is in the country of his or her other nationality, the United States is normally prohibited by international law from becoming involved on the individual's behalf.[275]

The right to vote is another frequently cited justification for taxation of expatriate citizens.[276] The fundamental problem with this argument is that it puts the cart before the horse — it is taxation that requires representation, not representation that justifies taxation.[277] In fact, worldwide taxation preceded universal overseas voting rights.[278] Furthermore, this argument does not address the taxation of LPRs, who of course do not have the right to vote.

The argument based on the benefits from being raised or trained in the United States is highly problematic.[279] First, the price for those benefits, in the form of taxes or other costs, may have already been paid for during the period of residency. Second, it does not justify the taxation of accidental citizens and citizens by descent who have never lived in the United States.[280] Finally, any such benefits would be very unevenly distributed and impossible to quantify.

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[274] *See* Patton, *supra* note 15, at 699 n.28.

[275] Convention on Certain Questions Relating to the Conflict of Nationality Law, art. 4, Apr. 13, 1930, 179 L.N.T.S. 89 (stating that "[a] State may not afford diplomatic protection to one of its nationals against a State whose nationality such person also possesses") (Hague Convention). Although only a handful of countries have ratified the Hague Convention, the article arguably reflects customary international law.

[276] *See, e.g.*, Kirsch, *supra* note 2, at 474–76.

[277] *See* Avi-Yonah, *supra* note 14, at 682–84.

[278] *See* 42 U.S.C. §§ 1971–1973 (2011). Even independent of the question of the taxation of expatriates, it would not be unreasonable for U.S. citizens abroad to have no voting rights, or for those rights to be limited to an initial period abroad, on the grounds that they do not have the same stake in the electoral process. For example, except for Canadian government employees, Canadian expatriates can only vote in federal elections for five years after they move abroad. Canada Elections Act, S.C. 2000, c. 9, § 11(d). This limitation is currently being challenged in court. Gillian Frank and Jamie Duong v. Canada (AG), No. CV-12-45397t (Can. Ont. Sup. Ct. J. filed May 18, 2012); *Expat Voters Launch Legal Challenge of '5-Year Rule'*, CBC NEWS, May 23, 2012, http://www.cbc.ca/news/canada/story/2012/05/23/pol-cp-ex-pat-voter-rights-five-year-rule-lawsuit.html.

[279] Even Prof. Kirsch, who argues in favor of worldwide taxation of nonresidents, admits that "relying on past benefits as a justification for citizenship-based taxation is dubious." Kirsch, *supra* note 2, at 477.

[280] Avi-Yonah, *supra* note 14, at 683.

Some supporters of the taxation of nonresident citizens who concede that there is no direct correlation between the income tax and any benefits of citizenship nonetheless argue that there is a general benefit to citizenship.[281] This is simply an argument from desperation and can be easily dismissed. One cannot justify the imposition of extensive tax and reporting burdens on the basis of some inchoate "general benefit."

The right to move to or visit the United States without restriction is probably the only substantial benefit to long-term citizen expatriates and is the only one that is relevant to most accidental, nominal, and unaware citizens.[282] The value of this right will depend on the individual's connections to his or her country of residence, the political and economic situation in that country, and the additional citizenship the individual holds. Some long-term expatriates, accidental citizens, and citizens by descent will value it little. Although it is fair to say that U.S. citizenship is likely to have some value for most U.S. expatriates, this value is impossible to quantify. An unquantifiable, even inchoate right is a very weak peg on which to hang the heavy hat of worldwide taxation and financial regulation. Furthermore, the right to return is no greater than the parallel right held by expatriates of other countries, who are not subject to worldwide taxation by their county of citizenship while nonresident.

Finally, taxation can be justified if it is based on sufficient economic contacts with the taxing jurisdiction. But in the case of long-term expatriates and accidental, nominal, and unaware citizens, there is insufficient contact to justify worldwide taxation. Most if not all of the economic activity of such individuals takes place outside the United States. To the extent there is economic contact with the United States, except in limited cases such as investment restricted to citizens, it could have been conducted as an alien, and often on better economic terms (e.g., investment income not connected with a U.S. trade or business earned by a foreign person would not be taxed). Thus, casual or limited economic activity cannot be used to justify worldwide taxation.

The above discussion should make it clear that most nonresident LPRs enjoy few of the benefits allegedly held by nonresident citizens. They cannot vote. They do not enjoy the protection of the United States abroad, to the extent that this is even a benefit.[283] Finally, and

[281] *See, e.g.*, Kirsch, *supra* note 2, at 470–71.

[282] Kirsch, *supra* note 2, at 476; *see also* Gann, *supra* note 82, at 65–66.

[283] Walker, *supra* note 266, at 586.

perhaps most fundamentally, their LPR status is revocable upon a finding that they have abandoned their U.S. residence.[284] Generally speaking, aliens are subject to inspection by immigration officers upon arrival in the United States.[285] This includes LPRs returning to the United States from a trip abroad, if the absence was for a period of 181 or more days.[286] If the return is after a "temporary trip" abroad,[287] the LPR is a "special immigrant"[288] entitled to reentry. Otherwise, the LPR can be denied reentry to the United States on the grounds that he or she has abandoned U.S. residence. An LPR intending to leave the United States temporarily can apply for a reentry permit.[289] An application demonstrates an intent to maintain U.S. residence. The permit is generally valid only for two years and is not renewable.[290] After that point, the LPR should apply at the local diplomatic post for a determination that he or she is a returning resident.[291] Neither the reentry permit, nor the reentry visa, nor the Green Card itself guarantees reentry into the United States;[292] a colorable claim to U.S. residence merely shifts the burden of proof to the U.S. Citizenship

[284] Contrast this to the position of U.S. citizens, whose status is much more secure. If LPRs naturalize in the United States, their U.S. citizenship is almost irrevocable, barring fraud in acquisition. *See* 8 U.S.C. § 1451 (2012). For both native and naturalized U.S. citizens, loss of U.S. citizenship now requires intent to renounce. *See* 8 U.S.C. § 1481(a) (2012); Afroyim v. Rusk, 387 U.S. 253 (1967); Vance v. Terrazas, 444 U.S. 252 (1980).

[285] 8 U.S.C. § 1101(a)(3) (2012) (defining the term "alien" to include anyone who is not a citizen or national of the United States, including LPRs). 8 U.S.C. § 1101(a)(15) (2012) includes LPRs in the definition of immigrants (because they do not fall into one of the subsequent categories of non-immigrants). Their arrival at a U.S. point of entry for admission into the United States may therefore be an "application for admission" within the meaning of 8 U.S.C. § 1101(a)(4) (2012), subjecting them to inspection under 8 U.S.C. § 1225 (2011).

[286] 8 U.S.C. § 1101(a)(13)(C)(ii) (2011) (stating that an LPR entering the United States after an absence of 180 days or less shall not be considered to be applying for admission to the United States).

[287] A "temporary trip" has been defined as a trip for a relatively short, fixed period of time; a trip that will terminate upon the occurrence of an event having a reasonable possibility of occurring within a relatively short period of time; or a trip where the LPR maintains a continuous, uninterrupted intention to return to the United States, as demonstrated by objective factors (family ties, purpose of departure, property, bank accounts, business affiliations, payment of taxes, etc.). Chavez-Ramirez v. I.N.S., 792 F.2d 932, 937 (9th Cir. 1986).

[288] 8 U.S.C. § 1101(a)(27)(A) (2011).

[289] 8 U.S.C. § 1203(a) (2011).

[290] 8 U.S.C. § 1203(b) (2011).

[291] *See* 8 U.S.C. § 1204 (2011).

[292] 8 U.S.C. § 1201(h) (2011).

and Immigration Services. Thus, once having left the United States, most nonresident LPRs are at risk of losing their LPR status. As a practical matter, continued payment of taxes seems to be the most important factor in finding the continued intent to maintain U.S. residence, but it neither guarantees such a finding from the immigration authorities nor is it compatible with the principles of the immigration laws.[293]

Thus, only short-term expatriates and U.S. government employees and military personnel can be said to have, as a group, the nexus to the United States that justifies including them in the U.S. tax net.

E. Neutrality

Typically, neutrality in the tax context has been discussed in terms of capital export and capital import neutrality. Capital export neutrality examines whether, from the point of view of the country of the investor, a person pays the same tax on his or her investment income regardless of where the income is earned.[294] If foreign source income is taxed at a lower rate than U.S. source income, U.S. taxpayers have an incentive to shift capital abroad, thereby distorting capital allocation. Capital export neutrality is economically efficient because it makes the allocation of capital tax neutral.[295] This position generally supports worldwide taxation because tax considerations do not affect investment decisions.[296] Capital export neutrality presupposes that the exporting country should tax its individuals; it does not address the jurisdictional question of whether taxation on that basis should apply to nonresidents.[297] By contrast, capital import neutrality attempts to achieve neutrality from the point of view of the country where the investments are made. This supports a territorial

[293] Fundamentally, this contradiction derives from the discrepancy between the definition of LPR for purposes of the immigrations laws and that of a U.S. tax resident under the tax laws. In particular, Code section 7701(b)(6)(B) provides that an individual is a LPR unless that status has been revoked or administratively or judicially determined to have been abandoned. Thus, individuals who effectively abandon U.S. residence without formally relinquishing their LPR status and surrendering their Green Card remain U.S. tax residents and are subject to worldwide taxation.

[294] Kirsch, *supra* note 2, at 488 n.196.

[295] *See* Kirsch, *supra* note 2, at 488 n.196; Peroni, *supra* note 15, at 977.

[296] Kirsch, *supra* note 2, at 488 n.196; Peroni, *supra* note 15, at 977.

[297] Kirsch, *supra* note 2, at 489 n.197.

system of taxation.[298]

Fundamentally, neither version of capital neutrality is the correct model for analyzing the effects of taxation on individual behavior. In most cases, and unlike some corporations, individuals choose their residence on the basis of more than just taxation, and that residence is not generally subject to easy manipulation under a reasonably constructed residence test. The non-tax nature of that decision should be respected. The United States should not assume that a move abroad is motivated by a desire to decrease U.S. tax liability and therefore should be ignored for tax purposes.[299] Furthermore, most individuals' income is primarily derived from personal services and labor. The relevant framework is therefore labor neutrality, not capital neutrality. Worldwide taxation of expatriates violates labor export neutrality.[300] Individuals should be free to decide where they provide their services and have their decision respected by the tax system.[301]

F. Tax Imperialism

The worldwide taxation of nonresidents can also be seen as a form of tax imperialism – the United States is overriding the incentives that foreign countries have put in place to attract U.S. taxpayers and investment. A foreign country's decision to impose a lower tax rate than the United States reflects its judgment on how to tax and may even be specifically designed to attract foreign labor or capital. To the extent that the United States arrogates to itself the right to tax the difference between the foreign country's effective tax rate and its own, even when its citizens reside in that foreign country, the United States is breaching inter-nation equity. It is also against the principle that the country of residence has a stronger claim to tax income sourced in that country than the country of citizenship.[302]

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[298] *Id.* at 488 n.196.

[299] *See* Alice G. Abreu, *The Difference Between Expatriates and Mrs. Gregory: Citizenship Can Matter*, 67 TAX NOTES 692 (May 1, 1995); Alice G. Abreu, *Taxing Exits*, 29 U.C. DAVIS L. REV. 1087, 1158 (1996).

[300] Christie, *supra* note 15, at 139.

[301] *See* Patton, *supra* note 15, at 714. The focus on residence or domicile prevents the manipulation of tax liability by use of telecommuting.

[302] *See* Walker, *supra* note 266, at 587–88; *see also* Patton, *supra* note 15, at 729.

VII. COMPLIANCE AND ENFORCEMENT

The issues of compliance and enforcement loom large in any discussion of the taxation of nonresidents. Generally speaking, taxpayers who live abroad can be divided into two categories. The first category consists of civilian expatriates, government employees, and military personnel who expect to return to the United States in the short term and are more likely to comply with U.S. tax rules. It also includes the employees of U.S. employers, who are more likely to comply with U.S. tax rules because they are tax equalized, although this appears to be increasingly less common; because the employer provides for U.S. tax services; or because their employer is reporting their tax information to the Service. Some taxpayers who have no U.S. tax liability after the operation of the FTC may be more inclined to file on the basis that there is only a reporting requirement, while others may be less inclined on the grounds that they have no U.S. tax liability.

The second category consists of all others taxpayers. Many long-term expatriates and accidental and nominal citizens feel that double filing requirements and the potential for double taxation are inherently unfair. Furthermore, if they do not have earned income that is reported to the United States and have little U.S. source income, or little economic connection to the United States, they may feel that there is little risk in noncompliance. The greater the feeling of grievance regarding double taxation, and the greater the likely cost, either in terms of actual U.S. liability or onerous reporting requirements, the more likely they are not to comply.

The extent of noncompliance is difficult to determine in part because the number of U.S. citizens and LPRs abroad is unknown. In 1985, the GAO ran a sample of U.S. taxpayers abroad and estimated that 60.9% of those individuals did not file.[303] Because of the sensitivity of the information, the GAO did not disclose the source of the information on the taxpayers.[304]

The Department of State estimated that 1.8 million civilian (nonmilitary, nongovernment) U.S. citizens lived abroad in 1983.[305] Only about 246,000 individual income tax returns were filed in that year.[306] Some of the 1.8 million may not have had a filing requirement

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[303] *US Citizens Not Filing Federal Income Tax Returns*, *supra* note 32, at 2.
[304] *Id.*
[305] *Id.* at 4.
[306] *Id.*

or may have been included in a joint return, but these statistics suggest a high degree of noncompliance. For 2006, 334,851 taxpayers filed Form 2555.[307] Although Form 2555 is not filed by all overseas taxpayers, this statistic also suggests a high degree of nonfiling.

Detecting overseas income is very difficult for the Service. Typically, the Service compares taxpayers' income tax returns to information returns such as forms W-2 or 1099 in order to identify unreported or underreported income or nonfilers.[308] Not surprisingly, there is much higher compliance when such information is reported.[309] For offshore entities and employers, which are generally not subject to U.S. information reporting requirements, this kind of information is not available, and the Service has acknowledged that this makes it difficult to determine the relevant tax liability of even domestic taxpayers.[310] The Service generally receives few if any such reports on persons living overseas.[311]

Although the Service receives information records from some of its treaty partners through exchange of information programs, much of the data is unusable because of different tax years or the absence of U.S. taxpayer identification numbers.[312] Few foreign information returns received from tax treaty partners include wage information.[313] Foreign tax information also generally does not contain information

[307] Scott Hollenbeck & Maureen Keenan Kahr, *Individual Foreign-Earned Income and Foreign Tax Credit*, STATISTICS OF INCOME SPRING BULLETIN I.R.S. PUB. 1136, Spring 2009, at 54, 57 fig. A.

[308] GAO REPORT DATA SHARING AND ANALYSIS MAY ENHANCE TAX COMPLIANCE, *supra* note 66, at 48.

[309] GAO REPORT ON NONFILING AMONG U.S. CITIZENS ABROAD, *supra* note 40, at 3; GAO REPORT ON IRS ACTIVITIES TO INCREASE COMPLIANCE OF OVERSEAS TAXPAYERS, *supra* note 33, at 8 (stating that independent contractors, employees of foreign corporations, and retired persons are believed to be the most noncompliant). The study could identify only 380,577 returns as being probably filed by expatriates, out of an estimated 3.1 million U.S. citizens (not LPRs) abroad, itself probably an underestimate. GAO REPORT ON NONFILING AMONG U.S. CITIZENS ABROAD, *supra* note 40, at 9 tbl.1.

[310] GAO REPORT DATA SHARING AND ANALYSIS MAY ENHANCE TAX COMPLIANCE, *supra* note 66, at 48.

[311] GAO REPORT ON IRS ACTIVITIES TO INCREASE COMPLIANCE OF OVERSEAS TAXPAYERS, *supra* note 33, at 8; GAO REPORT ON NONFILING AMONG U.S. CITIZENS ABROAD, *supra* note 40, at 13.

[312] GAO REPORT ON IRS ACTIVITIES TO INCREASE COMPLIANCE OF OVERSEAS TAXPAYERS, *supra* note 33, at 8.

[313] *US Citizens Not Filing Federal Income Tax Returns*, *supra* note 32, at 14; GAO REPORT ON NONFILING AMONG U.S. CITIZENS ABROAD, *supra* note 40, at 13.

on citizenship.[314] This is unsurprising; most countries tax domestically on the basis of residence, and therefore citizenship is irrelevant. Similarly, they have no reason to associate domestic returns filed by U.S. citizens (who may also be their own nationals) with those individuals' U.S. tax identification numbers. More broadly, foreign jurisdictions have no reason or incentive to track U.S. citizens specifically. The information is irrelevant to their tax collection efforts and as they do not tax on the basis of citizenship, they have no interest in tracking and providing such information on U.S. nationals in their country in exchange for equivalent information on their own nationals in the United States.[315]

Investigating the returns of overseas taxpayers therefore involves investigating any known employers and relevant financial entities as well as trying to find anything not reported. Put another way, the Service must investigate a range of unknowns. Unless there is specific information, such investigations are very labor intensive at best. The investigation of nonfilers would be even more difficult, and most nonfilers are probably not even known to the Service. The Service has conceded that it does not know the extent of nonfiling by taxpayers overseas.[316]

Serious questions also exist as to the size of the tax gap. A series of studies by the IRS have indicated that of apparent nonfilers, some had no obligation to file because they did not have the required minimum income, while others had a filing obligation but no actual tax liability because of the operation of the FTC, FEIE, and FHE regimes.[317] Taking into account enforcement costs, the abolition of worldwide taxation of nonresidents is therefore likely to be revenue neutral.

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[314] *US Citizens Not Filing Federal Income Tax Returns*, *supra* note 32, at 6.

[315] By contrast, foreign countries may have an interest in cooperating with the United States in specific areas such as the reporting of income from foreign bank accounts. *See* U.S. TREASURY DEP'T, JOINT STATEMENT FROM THE U.S., FR., GER., IT., SPAIN AND THE U.K. REGARDING AN INTERGOVERNMENTAL APPROACH TO IMPROVING INT'L TAX COMPLIANCE AND IMPLEMENTING FATCA (2012), http://www.treasury.gov/press-center/press-releases/Documents/020712%20Treasury%20IRS%20FATCA%20Joint%20Statement.pdf.

[316] GAO REPORT ON IRS ACTIVITIES TO INCREASE COMPLIANCE OF OVERSEAS TAXPAYERS, *supra* note 33, at 7.

[317] *Id.* at 9–10. There was a plan to analyze the income tax revenue generated solely by taxation on the basis of U.S. citizenship, i.e. the income tax component of the citizenship penalty, which study was expected to demonstrate that citizenship jurisdiction is not significant for revenue purposes, *see* Gann, *supra* note 82, at 63-64, nn.182-85, but no such study appears to have been released.

Enforcement is also an issue. The Service generally cannot collect unpaid taxes from assets located in a foreign country.[318] Traditionally, under the Revenue Rule the courts of one sovereign do not enforce the tax judgments of the other. Although this rule has been narrowly interpreted in the United States, it is widely accepted worldwide.[319] Only five U.S. tax treaties address the provision of general assistance in collecting tax judgments, and only the one with Canada provides for "substantial assistance."[320] Generally, however, foreign countries have no incentive to cooperate with the United States in its attempt to enforce worldwide taxation of nonresidents, which is seen as an example of U.S. tax exceptionalism and a problem for the United States to sort out. In the absence of U.S. assets, any tax liability may therefore be uncollectible.

Both the compliance and enforcement problems associated with expatriate taxation can be expected to increase. With the rise of Asia and the general increase in global mobility, the number of long-term expatriates, dual nationals, accidental citizens, and citizens by descent is likely to grow. Most of these people will not be employed by U.S. employers, and many will have little connection to the United States. Their incentive to comply with U.S. tax law will be minimal, assuming they are even aware of the rules.

The effect of these difficulties in enforcing the taxation of nonresident taxpayers on domestic compliance is unclear, as is the effect of exemption of expatriates from U.S. taxation. If expatriates are perceived by domestic taxpayers as being part of the U.S. tax community, the widespread noncompliance by expatriates may undermine confidence in U.S. tax enforcement and weaken domestic compliance. On the other hand, if the taxation of expatriates is eliminated, domestic taxpayers might consider its elimination unjust and become less compliant. Both noncompliance and nontaxation may lead to support for restrictions on, for example, the voting rights of expatriates.

The effects on expatriates are clearer. The increasingly harsh enforcement of tax and reporting compliance against expatriates has

[318] GAO REPORT ON NONFILING AMONG U.S. CITIZENS ABROAD, *supra* note 40, at 3, 14. The exceptions are collections under the mutual collection assistance agreements with Canada, Denmark, France, the Netherlands, and Sweden. *Id.* at 3 n. 5, 14.

[319] Regarding the Revenue Rule, *see*, *e.g.*, William J. Kovatch, Jr., *Recognizing Foreign Tax Judgments: An Argument for the Revocation of the Revenue Rule*, 22 HOUS. J. INT'L L. 265 (2000).

[320] Walker, *supra* note 266, at 590, nn.111–12.

led to great distress, anger and alienation among expatriates.[321] U.S. worldwide taxation and the increasingly onerous reporting requirements have led some expatriates to decide that U.S. citizenship has become too burdensome.[322]

Given the high degree of expatriate noncompliance, the effects on expatriates, the anger generated toward the United States, and the likelihood that tax revenues will not increase substantially even with greatly increased enforcement, the United States should stop trying, and failing, to tax expatriates.

VIII. CURRENT EXIT TAX REGIME

A. Current Law

The logical consequence of citizenship-based taxation is the fact that there is no legal way to escape the burdens of U.S. taxation without renouncing one's U.S. citizenship or relinquishing one's LPR status. At the same time, there has long been a perception that anyone giving up citizenship must be doing so for nefarious purposes and should not be allowed to "get away with anything." This perception has led to a series of provisions imposing a tax cost to relinquishing citizenship and, more recently, LPR status.

A regime for the taxation of former citizens has been in place since the Foreign Investors Tax Act of 1966.[323] Under the version of section 877 currently in force,[324] certain U.S. citizens who renounced their citizenship and "long-term permanent residents" who abandoned or lost their LPR status before June 17, 2008, have a

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[321] *See, e.g.*, Amy Feldman, *Taxpayers with Overseas Accounts Seethe at Penalties*, REUTERS, Dec. 8, 2011, http://www.reuters.com/article/2011/12/08/us-usa-taxes-foreign-idUSTRE7B723920111208; Brian Knowlton, *Many Americans Abroad Surprised by Tax Code's Nasty Bite*, N.Y. TIMES, May 10, 2012, http://www.nytimes.com/2012/05/11/us/11iht-expats11.html?_r=2&pagewanted=1&ref=global (focusing on individuals who were not aware they are considered U.S. citizens by the United States).

[322] *See, e.g.*, Atossa Araxia Abrahamian, *Special Report: Tax Time Pushes Some Americans to Take a Hike*, REUTERS, Apr. 16, 2012, http://www.reuters.com/article/2012/04/16/us-usa-citizen-renounce-idUSBRE83F0UF20120416.

[323] Foreign Investors Tax Act of 1966, Pub. L. No. 89-809, 80 Stat. 1539. Enactment of section 877 was driven by concern that the more favorable treatment of nonresidents would encourage some U.S. citizens to relinquish their U.S. citizenship and move abroad. S. REP. NO. 89-1707 (1966), *reprinted in* 1966-2 C.B. 1059, 1078.

[324] Although section 877A has superseded section 877, the latter is still applicable to "expatriations" that occurred before June 17, 2008. For a history of the 1990s changes to section 877, *see* Abreu, *Taxing Exits*, *supra* note 299, at 1087 n.3.

continuing obligation to file and pay taxes for a period of ten years after the renunciation or abandonment.[325] Long-term permanent residents are aliens who were LPRs for eight of the fifteen years prior to their abandonment of LPR status.[326] Loss of LPR status for purposes of this regime included claiming benefits as a foreign resident under a tax treaty.[327] The regime applied to any expatriate who (1) had an average annual net income tax liability of more than $139,000 (for expatriations during 2008) in the five years ending before the date of expatriation (the "net tax test")[328]; (2) had a net worth of $2 million or more (including worldwide assets) on the date of expatriation (the "net worth test");[329] or (3) failed to certify on Form 8854 that he or she had complied with all U.S. federal tax obligations for the five years preceding the date of expatriation.[330]

If the Code section 877 regime applies, for each year of the ten year period following expatriation the expatriate is generally subject to tax on the higher of (1) the tax on U.S. source income and gains on a net basis at the graduated rates applicable to individuals or (2) the thirty percent withholding tax on a gross basis on income not connected with a U.S. trade or business.[331] For purposes of the calculation, U.S. source income includes income that is not normally taxed in the hands of nonresident aliens.[332] For any year in which the expatriate is physically present in the United States for more than thirty days, he or she is taxed as a U.S. citizen or resident on worldwide income.[333]

Individuals subject to the regime must file Form 1040NR for each year of the ten year period following renunciation or abandonment and attach a statement to the return listing all items of U.S. and foreign source income, whether or not taxable in the United States. They must also file Form 8854 each year during the ten-year period.[334] Failure to file Form 8854 or incorrect filing of the form may subject

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[325] I.R.C. § 877(a)(1).

[326] I.R.C. § 877(e)(1), (2).

[327] I.R.C. § 877(e)(2).

[328] I.R.C. § 877(a)(2)(A), (C); Rev. Proc. 2007-66, § 3.29, 2007-45 I.R.B. 970.

[329] I.R.C. § 877(a)(2)(B).

[330] I.R.C. § 877(a)(2)(C).

[331] I.R.C. § 877(b).

[332] I.R.C. § 877(d).

[333] I.R.C. § 877(g).

[334] I.R.C. §§ 877(a)(1), 6039G(b); INTERNAL REVENUE SERV., FORM 8854, INITIAL AND ANNUAL EXPATRIATION STATEMENT (2011).

the individual to a $10,000 penalty.[335]

Two highly restrictive exceptions were created for certain dual citizens and minors, who needed only to certify that they complied with their U.S. tax obligations for the five years preceding their expatriation, even if they satisfied the net tax or net worth test.[336] An individual satisfied the exception for dual citizens if he or she (i) became a dual citizen at birth and continued to be a citizen of the other country; (ii) was never a U.S. resident; (iii) never held a U.S. passport; and (iv) was not present in the United States for more than 30 days during any of the ten calendar years preceding the renunciation of citizenship.[337] The exception was thus largely limited to citizens by descent who never lived in the United States. Because U.S. citizens are required to enter and leave the United States on a U.S. passport,[338] the third requirement could be read to require that they had never even visited the United States.

An individual satisfied the exception for minors if (i) he or she became a U.S. citizen at birth; (ii) neither parent was a U.S. citizen at the time of birth; (iii) he or she renounced U.S. citizenship before the age of 18½; and (iv) he or she was present in the United States for no more than thirty days during any of the ten calendar years preceding the renunciation of citizenship.[339] The exception was therefore largely limited to accidental citizens who did not live in the United States after the age of eight. As minors are not generally allowed to renounce U.S. citizenship, on the grounds that they do not have an understanding of the nature and consequences of the oath of renunciation,[340] it effectively allowed only a six-month window for such individuals to avoid the imposition of section 877.

In addition to the penalties of section 877, the Immigration and Nationality Act[341] was amended to deny those covered by section 877 re-entry into the United States if the U.S. Attorney General

[335] I.R.C. § 6039G(c).

[336] I.R.C. § 877(c)(1).

[337] I.R.C. § 877(c)(2).

[338] 8 U.S.C. § 1185(b) (2011) ("Except as otherwise provided by the President and subject to such limitations and exceptions as the President may authorize and prescribe, it shall be unlawful for any citizen of the United States to depart from or enter, or attempt to depart from or enter, the United States unless he bears a valid United States passport.").

[339] I.R.C. § 877(c)(3).

[340] *See, e.g.*, *Renunciation of U.S. Citizenship*, U.S. DEP'T OF STATE (Feb. 1, 2008), http://travel.state.gov/law/ citizenship/citizenship_776.html.

[341] 8 U.S.C. § 1182 (2011).

determines that the former citizen renounced his or her citizenship for the purpose of avoiding U.S. taxes.[342] Under this provision, known as the Reed Amendment,[343] such an individual is "inadmissible," like terrorists, Nazis, and international child abductors, among others.[344]

Under section 877A, as enacted by the Heroes Earnings Assistance and Relief Tax Act of 2008,[345] a new expatriate exit tax was put in place. The exit tax regime operates by taxing expatriates on a deemed disposition of their worldwide assets at fair market value on the day before the expatriation.[346] The tax applies to unrealized net gains in excess of $651,000 in 2012 and is adjusted annually.[347] The mark-to-market rules do not apply to certain deferred compensation items and tax deferred accounts and to interests in non-grantor trusts.[348] The exit tax regime covers the same categories of expatriates

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[342] 8 U.S.C. § 1182(a)(10)(E) (2011) ("Any alien who is a former citizen of the United States who officially renounces United States citizenship and who is determined by the Attorney General to have renounced United States citizenship for the purpose of avoiding taxation by the United States is inadmissible.").

[343] *See* Michael S. Kirsch, *Alternative Sanctions and the Federal Tax Law: Symbols, Shaming, and Social Norm Management as a Substitute for Effective Tax Policy*, 89 IOWA L. REV. 863, 896 (2004). The Reed Amendment is intended to prevent a tax-motivated expatriate from returning to the United States. *Id.* Representative Reed, in proposing the amendment, stated, "in an instrumental way, I would hope in the future if those very slick and smart tax lawyers advising their clients about how to avoid their taxes suggest expatriation they should also indicate very clearly that the consequences are you cannot return at will to the United States." *Id.* (citing *Mark-Up of Immigration Legislation: Hearing Before the H. Comm. on the Judiciary*, 104th Cong. (1995) *in* Fed. News Service, Nov. 15, 1995, at 50). According to Prof. Kirsch, Representative Reed introduced this amendment in response to the actions of Kenneth Dart. Mr. Dart surrendered his citizenship to avoid U.S. taxes and became a citizen of Belize. He reportedly convinced the Belize government to appoint him as a consular official to the United States. Mr. Dart planned to open a consular office in Sarasota, Florida, his former hometown and the city where his family still lived. *Id.* at 892 n.133. If Mr. Dart had been allowed to enter the United States as a diplomatic representative of Belize, he could have resided there for the entire year without becoming a resident alien for U.S. income tax purposes. *Id.* (citing I.R.C. § 7701(b)(5)(A)(i), (5)(B), which exempts foreign diplomats and consular officials from the substantial presence test for income tax residence). After the introduction of the Reed Amendment, but before it was enacted, Belize withdrew its request to appoint Mr. Dart as a consular official. *Id.*

[344] *See* 8 U.S.C. § 1182(a) (2011).

[345] Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110-245, 122 Stat. 1624.

[346] I.R.C. § 877A(a)(1).

[347] I.R.C. § 877A(a)(3); Rev. Proc. 2011-52, § 3.27, 2011-45 I.R.B. 701.

[348] I.R.C. § 877A(c).

as the prior regime.[349] The average annual net income tax amount was $151,000 for 2012 and is adjusted annually.[350]

Two exceptions can apply to expatriates that are slightly broader than the exceptions contained in section 877. First, an individual is exempt from the exit tax regime if he or she (i) files Form 8854; (ii) became a dual citizen at birth and continued to be a citizen and tax resident of the other country at the time of renunciation of citizenship; and (iii) was a resident of the United States for no more than ten of the fifteen tax years ending with the tax year during which the renunciation of citizenship occurs.[351] This exception is largely limited to dual citizens who live in the country of their other nationality. The second exemption applies if the individual (i) files a Form 8854; (ii) renounces his or her U.S. citizenship before the age of 18½; and (iii) was a resident of the United States for no more than ten years before the date of renunciation.[352] This exception is limited to citizens who did not live in the United States for more than ten years before the age of eighteen and a half. As minors are not generally allowed to renounce U.S. citizenship, it effectively allows only a six-month window for such individuals to avoid the imposition of section 877A.

B. Number of Individuals Reported Under Code Sections 877 and 877A

From the rhetoric about individuals renouncing their U.S. citizenship, one could be forgiven for assuming that the number of pernicious tax-motivated renunciations and relinquishments is large and rising steadily. Contrary to this perception, the number of renunciations and relinquishments is small, and there is no reason to assume that most are tax-motivated or have a significant impact on U.S. tax revenues.

Section 6039G(d) requires the Secretary of the Treasury to publish the names of individuals who have been determined to have renounced U.S. citizenship or abandoned LPR status to avoid taxes under section 877 or 877A. For the period from 1996, when names first began to be published,[353] through the end of 2011, only 11,184

[349] I.R.C. § 877A(g).

[350] Rev. Proc. 2011-52, § 3.26, 2011-45 I.R.B. 701.

[351] I.R.C. § 877A(g)(1)(B)(i).

[352] I.R.C. § 877A(g)(1)(B)(ii).

[353] This requirement was added to the Code in the Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-91, 110 Stat. 1936.

names were published in the Federal Register.[354] Several points about these lists need to be kept in mind. First, the lists do not distinguish between U.S. citizens renouncing their citizenship and LPRs relinquishing LPR status. Second, the lists include only those covered by section 877 or 877A.[355] Thus, U.S. citizens who renounce their citizenship and long-term LPRs who relinquish their LPR status who do not satisfy the net tax and net worth tests and who certify on Form 8854 that they have complied with their U.S. federal tax obligations

[354] For 1996, 90 names were published; 62 Fed. Reg. 4570 (Jan. 30, 1997). For 1997, 1812 names were published; 62 Fed. Reg. 23,532-23,533 (April 30, 1997); 62 Fed. Reg. 39,305-39,311 (July 22, 1997); 62 Fed. Reg. 59,758-59,762 (Nov. 4, 1997); 63 Fed. Reg. 6609-6611 (Feb. 9, 1998). For 1998, 398 names were published; 64 Fed. Reg. 48,894-48,896 (Sept. 8, 1999); 65 Fed Reg. 15,041-15,042 (March 20, 2000); 63 Fed. Reg. 56,696-56,698 (Oct. 22, 1998); 64 Fed. Reg. 3339 (Jan. 21, 1999). For 1999, 433 names were published; 64 Fed. Reg. 19,858-19,860 (April 22, 1999); 64 Fed. Reg. 38,944-38,946 (July 20, 1999); 64 Fed. Reg. 56,837-56,839 (Oct 21, 1999); 65 Fed. Reg. 5020-5021 (Feb. 2, 2000). For 2000, 455 names were published; 65 Fed. Reg. 35,423-35,426 (June 2, 2000); 65 Fed. Reg. 50,050-50,051 (Aug. 16, 2000); 65 Fed. Reg. 80,494-80,495 (Dec. 21, 2000); 66 Fed. Reg. 48,913-48,915 (Sept. 24, 2001). For 2001, 491 names were published; 66 Fed. Reg. 48,915-48,918 (Sept. 24, 2001); 66 Fed. Reg. 48,912-48,913 (Sept. 24, 2001); 67 Fed. Reg. 11,375-11,377 (Mar. 13, 2002); 67 Fed. Reg. 11,374-11,375 (Mar. 13, 2002). For 2002, 503 names were published; 67 Fed. Reg. 19,621-19,622 (Apr. 22, 2002); 67 Fed. Reg. 47,889-47,890 (July 22, 2002); 67 Fed. Reg. 66,456-66,457 (Oct. 31, 2002); 68 Fed. Reg. 4549-4551 (Jan. 29, 2003). For 2003, 571 names were published; 68 Fed. Reg. 23,180-23,181 (Apr. 30, 2003); 68 Fed. Reg. 44,840-44,841 (July 30, 2003); 69 Fed. Reg. 61,906-61,907 (Oct. 21, 2004); 69 Fed. Reg. 61,910-61,911 (Oct. 21, 2004). For 2004, 631 names were published; 69 Fed. Reg. 61,907-61,908 (Oct. 21, 2004); 69 Fed. Reg. 61,908-61,909 (Oct. 21, 2004); 69 Fed. Reg. 61,909-61,910 (Oct. 21, 2004); 70 Fed. Reg. 5511-5513 (Feb. 2, 2005). For 2005, 762 names were published; 70 Fed. Reg. 23,295-23,297 (May 4, 2005); 71 Fed. Reg. 68,901-68,906 (Nov. 28, 2006); 70 Fed. Reg. 68,511-68,512 (Nov. 10, 2005); 71 Fed. Reg. 6312-6314 (Feb. 7, 2006). For 2006, 278 names were published; 71 Fed. Reg. 25,648-25,649 (May 1, 2006); 71 Fed. Reg. 50,993-50,994 (Aug. 28, 2006); 71 Fed. Reg. 63,857-63,858 (Oct. 31, 2006); 72 Fed. Reg. 5103-5105 (Feb. 2, 2007). For 2007, 470 names were published; 72 Fed. Reg. 26,687-26,688 (May 10, 2007); 72 Fed. Reg. 44,228-44,230 (Aug 7, 2007); 72 Fed. Reg. 63,237-63,238 (Nov. 8, 2007); 73 Fed. Reg. 7631-7633 (Feb. 8, 2008). For 2008, 231 names were published; 73 Fed. Reg. 26,190-26,192 (May 8, 2008); 73 Fed. Reg. 43,285 (July 24, 2008); 73 Fed. Reg. 65,036 (Oct. 31, 2008); 74 Fed. Reg. 6219-6220 (Feb. 5, 2009). For 2009, 742 names were published; 74 Fed. Reg. 20,105 (April 30, 2009); 74 Fed. Reg. 35,911 (July 21, 2009); 74 Fed. Reg. 60,039 (Nov. 19, 2009); 75 Fed. Reg. 9028-9031 (Feb. 26, 2010). For 2010, 1,536 names were published; 75 Fed. Reg. 28,853-28,856 (May 24, 2010); 75 Fed. Reg. 69,158-69,160 (Nov. 10, 2010); 75 Fed. Reg. 69,160-69,163 (Nov. 10, 2010); 76 Fed. Reg. 7907-7913 (Feb. 11, 2011). For 2011, 1,781 names were published; 76 Fed. Reg. 27,175-27,182 (May 10, 2011); 76 Fed. Reg. 46,898-46,905 (Aug. 3, 2011); 76 Fed. Reg. 66,361-66,367 (Oct. 26, 2011); 77 Fed. Reg. 5308-5313 (Feb. 2, 2012).

[355] I.R.C. § 6039G(d).

for the five years preceding the date of expatriation are not included.[356] Similarly, LPRs who relinquish their LPR status and who are not long-term LPRs are not included.[357] These numbers, which may be significant, are unreported. Third, and perhaps most important, the lists do not include what might be termed "silent relinquishers," those individuals who have simply ceased to file taxes or otherwise associate with the United States without formally renouncing their U.S. citizenship or relinquishing their LPR status. Relinquishments by LPRs are likely to be particularly high, as they gain little benefit from their LPR status while living outside the United States and with the passage of time abroad are unlikely to be able to show the maintenance of U.S. residence required to maintain their LPR status. They therefore tend effectively to abandon their LPR status without formally relinquishing their Green Card.

Even if the numbers of renunciations and relinquishments are increasing, as some believe they are,[358] sections 877 and 877A address a situation that is unimportant in real terms, namely the relatively small number of individuals who renounce U.S. citizenship or relinquish their LPR status.[359] The true importance of sections 877 and

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[356] *See id.*

[357] *See id.*

[358] *See, e.g.*, Andrew Mitchel, *Q2 of 2011 Had the Second Highest Number of "Published Expatriates*", INT'L TAX BLOG (Aug. 17, 2011), http://intltax.typepad.com/intltax_blog/2011/08/q2-of-2011-had-the-second-highest-number-of-published-expatriates.html; Andrew Mitchel, *U.S. Citizens Continue to Renounce*, INT'L TAX BLOG (June 10, 2011), http://www.intltax.typepad.com/intltax_blog/2011/06/us-citizens-continue-to-renounce.html. For 2010 and 2011, 1,536 and 1,781 names were published, respectively. Both of these numbers exceed the totals for any year since publication began, except 1997, when there was a reaction to major changes in the law on expatriation. For the first two quarters of 2012, 460 and 189 names were published, respectively. 77 Fed. Reg. 25,538-25,545 (April 30, 2012); 77 Fed. Reg. 44,310-44,311 (July 27, 2012). There are reports of long queues at U.S. diplomatic posts abroad for those seeking to renounce U.S. citizenship or relinquish their Green Card; *see, e.g.*, Wright, *supra* note 237.

[359] To date, less than 12,000 names have been published in the Federal Register although, as noted, the actual number of renunciations of U.S. citizenship and relinquishments of LPR status may be considerably higher. As renunciation of citizenship can only be done outside the United States, and because the Department of State generally does not accept and international law discourages loss of citizenship that would result in statelessness, the pool of U.S. citizens who are able to renounce their citizenship is limited to those abroad who are dual nationals. *See* 8 U.S.C. § 1481(a)(5) (2011). The number of U.S. dual citizens overseas is unknown, but undoubtedly far exceeds the number who have renounced thus far. Similarly, presumably only LPRs overseas would relinquish their Green Card; the number of individuals who have done so formally is likely a small fraction of the number of

877A lies in their symbolism. Allegedly tax-motivated renunciation of U.S. citizenship has long elicited strong reactions, particularly in Congress where expatriates are an easy target,[360] and these provisions are designed to punish allegedly tax-motivated renunciations of citizenship and relinquishments of LPR status.

However, this understanding reverses reality. In most cases, renunciation is driven not by a desire to escape taxation unjustly, but by the unjust imposition of taxation. U.S. taxation of long-term expatriates and accidental, nominal, and unaware citizens is unjustified; they should not have to renounce their U.S. citizenship in order to escape U.S. tax and reporting burdens. Similarly, the taxation of "LPRs" who no longer have the right to reside in the United States is unjustified. Furthermore, loss of citizenship or residence has real non-tax motivations and consequences, and a decision to renounce U.S. citizenship or relinquish LPR status should be respected in the tax sphere as well, i.e., without the imposition of section 877 and 877A type penalties.[361] More fundamentally, the use of citizenship as a jurisdictional basis for taxation of nonresidents is unsound because it distorts and devalues citizenship.[362] Worldwide taxation of, and the ever-increasing compliance burden on, nonresident U.S. citizens constitute a real and increasing citizenship penalty. As the cost of U.S. citizenship rises, and the perceived benefits decrease, many are likely to see the U.S. passport as a passport of inconvenience.[363]

individuals overseas who are, or at least left the United States as, LPRs.

[360] For example, during the 1995 Finance Committee hearings, Sen. Baucus referred to those who expatriate, supposedly to avoid taxes, as "freeloaders . . . [and] greedy, unpatriotic people that FDR called malefactors of great wealth . . . [who] are skipping town, evading taxes, and making us cut Medicare and student loans to make up the difference." *Unofficial Transcript of July 11 Finance Hearing on Expatriates*, 95 TAX NOTES INT'L 140-10 (July 11, 1995). Sen. Mosely-Braun drew an analogy between so-called tax expatriates and those who expatriated to avoid having to serve in the armed forces during the Vietnam War. *Id.*

[361] *See* Abreu, *The Difference Between Expatriates and Mrs. Gregory: Citizenship Can Matter*, *supra* note 299, at 2; Abreu, *Taxing Exits*, *supra* note 299.

[362] On the other hand, attaching tax obligations to citizenship could be seen as a statement about the value of citizenship; *see* Kirsch, *supra* note 2, at 501 n.257.

[363] If proposals to allow the Service to have the Department of State deny or revoke U.S. passports due to tax delinquencies are enacted, some U.S. citizens abroad may discover that they do not have a U.S. passport at all. *See* S. 1813, 112th Cong. § 40304 (2012); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-272, POTENTIAL FOR USING PASSPORT ISSUANCE TO INCREASE COLLECTION OF UNPAID TAXES (2011).

IX. PROPOSED DEPARTURE TAX REGIME

Having established that the worldwide taxation of long-term expatriates and accidental, nominal, and unaware citizens is unjustified, and that it is unfair and unwise to force U.S. citizens overseas to give up their citizenship to avoid a tax regime that should not apply to them, there are various alternatives to the perpetual worldwide taxation of expatriates. The simplest approach, which is the one followed by most countries, is not to tax nonresident citizens and to treat a departure from the country as a nonevent for tax purposes. Given the history of U.S. taxation of nonresidents, the attitude of Congress, and the unjustified perception that U.S. persons abroad are not "paying their fair share," this option is clearly not politically viable.

Another option is to continue to impose worldwide taxation on nonresidents for a limited period of time after their departure, and then impose an exit tax if they remain abroad.[364] This alternative creates a reasonable distinction between short-term and long-term expatriates, and it has the advantage of avoiding any change in taxpaying status for short-term expatriates. However, it is unfair to long-term expatriates because they would arbitrarily be subject to worldwide taxation for longer than they should be. It would also necessitate maintaining the current complex set of rules necessitated by the worldwide taxation of expatriates.

Other alternatives can also be discarded. It has been proposed that citizens and LPRs be allowed to elect to remain U.S. tax residents.[365] This proposal would perpetuate the current complexity without the advantage of consistent treatment of all overseas taxpayers. Alternatively, changes in domicile could be made the

[364] *See, e.g.*, Blum & Singer, *supra* note 15, at 719 et seq. (three year transition period with possibility to elect for longer or to terminate tax residency on departure; the "coherent proposal" of the title is in fact not that coherent); Paula N. Singer, *A Common-Sense Solution for Taxing U.S. Citizens and Immigrants Abroad*, 52 TAX NOTES INT'L 555, 564 (Nov. 17, 2008) (three year transition period); Paula N. Singer, *Tax Reform for Americans Abroad*, 54 TAX NOTES INT'L 673, 674 (May 25, 2009) (at least a three year transition period); Paula N. Singer, *Tax Policy for Citizens and Immigrants Living Abroad Merits a Closer Look*, 35 TAX NOTES INT'L 283, 295 (July 19, 2004) (five year transition period). The range of proposed transition periods demonstrates the difficulty of determining a rational cut-off point for taxing expatriates.

[365] Singer, *A Common-Sense Solution for Taxing U.S. Citizens and Immigrants Abroad*, *supra* note 364, at 564; Singer, *Tax Reform for Americans Abroad*, *supra* note 364, at 674.

determining factor instead of changes in residence. This proposal would require the introduction of the concept of domicile, and its inherent complexities, into the U.S. income tax system.

The best, and conceptually cleanest, approach is to follow broadly the approach of Canada[366] and other countries, which was partially relied upon in creating the section 877A exit tax regime,[367] and treat all changes in U.S. residence as resulting in a deemed disposition.[368] Under this approach, the Service would consider an individual to have disposed of most of his or her property at its fair market value on the day he or she emigrated and then re-acquired the property for the same amount immediately thereafter. This approach is similar to the one in section 877A. The taxpayer would receive a step up in basis for all gain recognized due to the deemed disposition. During the period of nonresidence, the taxpayer would not be taxed by the United States on non-U.S. source income. As a corollary, all those entering the U.S. tax net, upon naturalization, acquisition of LPR status, or becoming a U.S. tax resident, would receive a step up in basis on all taxable property so that unrealized gain or loss that accrued prior to the beginning of U.S. tax residency would be disregarded.[369]

Accidental and nominal citizens who are nonresidents at the time

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[366] *See* Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), §§ 128.1-128.3 (Can.); Canada Revenue Agency, Interpretation Bulletin IT-451R, *Deemed Disposition and Acquisition on Ceasing to Be Or Becoming Resident in Canada* (2002). The author would like to thank Wayne Bewick for his comments regarding the Canadian departure tax.

[367] The Canadian departure tax is the clear antecedent of the U.S. exit tax, even though it applies to changes in residence, not citizenship or immigration status. It is mentioned in the academic literature; *see, e.g.,* Patton, *supra* note 15, at 733; Colón, *supra* note 15, at 7, 43 (referring to the Canadian and Australian systems in his discussion of proposed mark-to-market regime for individuals naturalizing or relinquishing U.S. citizenship; the Canadian system predates the Australian one); Blum & Singer, *supra* note 15, at 732; Gann, *supra* note 82, at 68; Papahronis, *supra* note 258, at 599.

[368] An exit tax on change in residence (not renunciation or relinquishment) is mentioned in Gann, *supra* note 82, at 67-68; it is mentioned in passing in Charles I. Kingson, *A Somewhat Different View*, 34 TAX LAW. 737, 738 (1980-1981); it is also mentioned by John Papahronis, who refers to it as "severance taxation" but dismisses it on the grounds that it would not aid in the promotion of exports to justify discriminating between taxpayers; Papahronis, *supra* note 258, at 599.

[369] The need for this is pointed out by Prof. Patton, *supra* note 15, at 733 n.116. Prof. Colón, in connection with his proposal for an exit tax on renunciation or relinquishment, points out that such a change is necessary to ensure parallel treatment on entry into and exit from the U.S. tax system; Colón, *supra* note 15, at 32. Such a step up in basis is provided for in the expatriate exit tax regime. I.R.C. § 877(h)(2).

of enactment of the new departure tax regime and who were not resident in the United States after the age of 16 would not be taxed and would receive a step up in basis to the value of their assets as of the date of enactment. Unaware citizens would not be covered by the departure tax regime. If they became aware of and asserted their status as U.S. citizens, for example by applying for a U.S. passport, they would receive a step up in basis to the value of their assets as of the date of enactment. Other nonresident taxpayers would be covered by the departure tax regime. Long-term expatriates, defined as anyone not resident in the United States for three full tax years at the time of enactment, would be given a two-year grace period to pay any tax due without the imposition of an interest charge.[370]

With the end of citizenship and LPR-based taxation, the obnoxious "savings clauses" in U.S. tax treaties[371] that allow the United States to tax U.S. citizens and LPRs in treaty countries as if the treaty was not in force would be unnecessary and could be eliminated.[372] Instead, it would be necessary to negotiate provisions for the recognition of a foreign tax credit for any U.S. tax paid due to the deemed disposition that is subsequently taxed abroad upon an actual disposition.[373] In addition, the tax definition of citizenship in section 7701(n), which is different from the nationality law definition of citizenship,[374] would be repealed. For the purposes of consistency, the continuing contribution parts of Social Security treaties[375] should also be eliminated, so that U.S. citizens overseas are subject to social security contributions only in their country of residence. In addition, the WEP should not apply to retirees who receive a foreign pension.

[370] Singer proposes a one-off payment based on the exit tax for noncompliant U.S. taxpayers who have lived abroad for at least six years; *see* Singer, *A Common-Sense Solution for Taxing U.S. Citizens and Immigrants Abroad*, *supra* note 364, at 564; Singer, *Tax Reform for Americans Abroad*, *supra* note 364, at 674.

[371] *See, e.g.*, US-Canada Tax Treaty, *supra* note 73, art. XXIX, para. 2; US-UK Tax Treaty, *supra* note 73, art. 1, para. 4.

[372] *See* Avi-Yonah, *supra* note 14, at 684.

[373] The model for this could be the provision in the US-Canada Tax Treaty on this point; US-Canada Tax Treaty, *supra* note 73, art. XIII, para. 7 (as amended Sept. 21, 2007).

[374] *See* Michael S. Kirsch, *The Tax Code as Nationality Law*, 43 HARV. J. ON LEGIS. 375 (2006).

[375] *See, e.g.,* Agreement with Respect to Social Security, U.S.-Can., arts. V, VI, Mar. 11, 1981, 35 U.S.T. 3403; Agreement on Social Security, U.S.-U.K., arts. 4-6, Feb. 13, 1984, T.I.A.S. 11086.

A. Definition of Departure and Entry

Departure from the United States would be defined as departing the United States to take up foreign residence. Entry would be defined as departing a foreign country to take up U.S. residence. There are two main possibilities for the definition of residence, either of which would operate satisfactorily, and both of which are modifications of rules already in existence in the U.S. income tax system. The first definition follows the approach of the bona fide residence test under the FEIE and of the Canadian departure tax.[376] Nonresidence would require physical departure from the United States and a determination of residence on the basis of all the facts and circumstances, considering the following factors:

- Real property in the United States that is available for use as a home;
- Location of a spouse and/or dependents;
- Major items of personal property in the United States, such as a car or furniture;
- Social ties to the United States;
- Economic ties to the United States;
- A U.S. driver's license; and
- U.S. bank accounts or credit cards.

These factors would be considered in light of residential ties to the other country. U.S. government employees and military personnel would be considered U.S. tax residents regardless of the number of days spent in the United States.

Generally, individuals would become tax nonresidents on the last date that (i) they left the United States; (ii) their spouse and dependents, if applicable, left the United States; or (iii) they became a resident of the country to which they are moving. Entry into the United States would be determined based on the same principles. Under this approach, the deemed disposition would take place as of the date of the termination of U.S. residence or the commencement or resumption of foreign residence. Thus, most persons entering or exiting the United States would be subject to split-year treatment. However, anyone becoming a LPR or naturalizing as a U.S. citizen would be treated as a tax resident as of the first day of the tax year, regardless of whether they otherwise satisfied the residence

[376] *See* Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), § 250 (Can.); Canada Revenue Agency, Interpretation Bulletin IT-221R3, *Determination of an Individual's Residence Status* (2002).

determination, and anyone renouncing U.S. citizenship or relinquishing or losing LPR status[377] would be considered a tax nonresident beginning on the first day of the tax year following the tax year in which they renounced, relinquished, or lost that status.

This approach would establish a residence requirement between the ordinary definitions of residence and domicile. Lest this be considered impractical, it should be kept in mind that these determinations already need to be made to some extent to determine bona fide residence for the application of the FEIE provisions, and that these factors are often looked at under state tax law to make determinations regarding income and estate tax residency or domicile.[378] In most cases, the application of the rules is fairly clear. In addition, there is ample Canadian, British, and other Common Law case law on these points should state court case law be considered insufficient.[379]

The second approach would determine residence using the substantial presence rules currently found in section 7701(b)(3). These rules would operate for U.S. citizens and LPRs as they currently do for non-LPR noncitizens. Thus, anyone in the United States for 183 days in the tax year or who satisfied the three-year trailing presence test would be a U.S. tax resident. U.S. citizens and LPRs would not have the option of claiming nonresidence under the greater connection rules available to noncitizens, and U.S. government employees and military personnel would be considered U.S. tax residents regardless of the number of days spent in the United States. Anyone becoming a LPR or naturalizing as a U.S. citizen would be treated as tax resident as of the first day of the tax year, regardless of whether they otherwise satisfied the residence test, and anyone renouncing U.S. citizenship or relinquishing or losing LPR status would be considered a nonresident starting with the tax year following the tax year in which they renounced, relinquished, or lost that status.

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[377] It can be expected that the number of individuals renouncing U.S. citizenship would decrease sharply if the specter of worldwide taxation and financial reporting was eliminated.

[378] *See, e.g.*, NEW YORK STATE DEP'T OF TAXATION & FINANCE, PUB. 80, GENERAL INCOME TAX INFORMATION FOR NEW YORK STATE RESIDENTS 5-8 (2012). Prof. Zelinsky's argument that citizenship is justified as a basis for taxation as an administrable proxy for domicile, and his equation of the two, are unwarranted; *see* Edward A. Zelinsky, *Citizenship and Worldwide Taxation: Citizenship as an Administrable Proxy for Domicile*, 96 IOWA L. REV. 1289 (2011).

[379] *See, e.g.*, Kadrie v. The Queen, [2001] D.T.C. 967 (Can. Tax Ct.); McFadyen v. The Queen, [2008] D.T.C. 4513 (Can. Tax Ct.).

This means that most emigrating U.S. taxpayers would not be subject to tax as a resident the year after their departure, unless they spent extensive time in the United States. Short-term expatriates who continued to spend lengthy periods of time in the United States would not be considered nonresident and would thus not trigger the departure tax regime.

The deemed disposition would take place on the final day of the last tax year of residence in the case of departures and on the first day of the tax year of the beginning or resumption of residence. There would be no part-year returns, but there would be a section on Form 1040 to indicate arrival or departure.

Under either approach, in order to prevent abuse, individuals who departed the United States to take up residence in Canada or Mexico but then commuted daily to their work in the United States from their new home would not be covered by the departure tax regime and would continue to be liable for tax on a worldwide basis. This is justifiable on the grounds that they continue to benefit from the United States. If most of their income was U.S. source earned income, there would probably be little additional tax cost to them in any case.

B. Emigration or Departure from the United States

In the year of departure, the individual would tick a new "departing" box, similar to those found on many state tax returns, on a departing or part-year Form 1040. The individual would list all property on a newly designed schedule and calculate and include in income the capital gain or capital loss that resulted from the deemed disposition. Items of personal use property valued at less than $1,000 would be excluded. To simplify the system, anyone with foreign source property of less than $10,000, indexed to inflation, would only be required to list their properties. Alternatively, an emigrating individual could defer the tax with interest as under the current exit tax regime.

C. Immigration or Return to the United States

To make the system parallel and consistent, on immigration or return to the United States, an individual would be treated as disposing and immediately reacquiring any property. This would provide a step up in basis so that pre-immigration or pre-return gains are not taxed by the United States, whether or not the departure tax was applied or applies later.

The individual would tick a new "arriving" box on an arriving or a part-year Form 1040 and file a schedule listing worldwide properties. The exceptions and minimums applicable on departure would apply.

D. Treatment after Departure

After departure, U.S. citizens and LPRs who are subject to the departure tax would be treated as tax nonresidents. They would be required to notify U.S. financial institutions and other payors of FDAP income of their nonresident status and their new country of residence, and they would be subject to withholding of tax on that income. This would protect U.S. tax revenue, as the Service would no longer be dependent on voluntary filing to collect tax. They would be subject to tax at the rate applicable to noncitizen residents of the country.[380] If they were required or needed to file a tax return, for example if they had U.S. source employment income, income from when still a U.S. resident under the first approach requiring split years, or capital gains from the disposition of U.S. property not subject to the deemed disposition rules, they would file Form 1040NR, which would be modified to ask about citizenship and immigration status. They would continue to use their Social Security Number as their Taxpayer Identification Number.

The FBAR requirements would be eliminated for nonresidents while abroad; outbound transfers of funds from the United States are in any case reported if they exceed $10,000.[381] Other tax rules and reporting requirements, including the FATCA rules, would be eliminated for nonresident U.S. citizens and LPRs.

It is difficult to estimate likely compliance with the proposed departure tax regime. Currently, section 6851 allows the Service to make immediate assessments of tax on U.S. taxpayers leaving the United States, if it finds that the collection of tax is jeopardized by the departure.[382] The assessment is currently waived in certain circumstances[383] and for U.S. citizens in general,[384] but is otherwise required for LPRs and other departing aliens.[385] Pursuant to regulations, aliens are required to file Form 1040-C or Form 2063,

380 *See* Patton, *supra* note 15, at 731.

381 *See* DEP'T OF THE TREASURY, FINCEN FORM 104, CURRENCY TRANSACTION REPORT (2011).

382 I.R.C. § 6851.

383 *See, e.g.*, Treas. Reg. § 1.6851-2(c)(iii)(f) (1994) (short visits to Canada or Mexico do not constitute departures).

384 *See* I.R.C. § 6851(c).

385 *See* I.R.C. § 6851(d).

after which a Departing Alien Clearance, better known as a "Sailing Permit," is issued. Compliance with the regime is widely recognized to be poor.[386] Nonetheless, compliance with a departure tax regime can be expected to be better, after an initial period of education, because it would be seen as fairer than the current system. Furthermore, those emigrants who maintain connections and expect to return to the United States would likely comply with the new rules to avoid problems on an ongoing basis and on their return.[387] Compliance with the departure tax is likely to be poor where the individual has few connections or does not expect to return to the United States, but these are precisely the individuals who see little risk in not complying with the current tax regime.

E. Other Changes to the Law in the Case of LPRs

The notion of long-term expatriate LPRs is a contradiction in terms that should be eliminated. Under the immigration law, LPR status is dependent on continued intent to reside in the United States.[388] Currently, the tax and immigration definitions and treatment of LPRs are inconsistent and contradictory. Section 7701(b)(6) and regulation 301.7701(b)-1(b) provide that expatriate LPRs remain subject to worldwide taxation until they relinquish their status or are adjudicatively determined to have lost it, even though they may have lost the right to reside permanently in the United States under the immigration laws.[389] One suspects that this contradiction, and the very existence of long-term expatriate LPRs, are currently tolerated in large part because expatriate LPRs remain liable for U.S. taxes (although many do not file or pay), and in fact nonfiling is grounds for demonstrating abandonment of intent.[390] However, this anomalous

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[386] *See* George Guttman, *The Sailing Permit: Tax Compliance and Departing Aliens*, 94 TNT 64-70 (Apr. 4, 1994); George Guttman, *Few Heed Obscure U.S. Requirement for Tax Clearance Certificate*, 28 TAX NOTES INT'L 819 (Nov. 25, 2002).

[387] Based on the Canadian experience, as discussed by the author with Wayne Bewick.

[388] 8 U.S.C. § 1101(a)(20) (2011) ("The term 'lawfully admitted for permanent residence' means the status of having been lawfully accorded the privilege of residing permanently in the United States as an immigrant in accordance with the immigration laws, such status not having changed.")

[389] *See* TREASURY PAPER ON INCOME TAX COMPLIANCE, *supra* note 30, at 42-44.

[390] 8 C.F.R. § 316.5 (2011) provides that LPRs who voluntarily claim nonresident alien status to qualify for exemptions from income tax liability (e.g. under a tax treaty), or who fail to file a federal or state return because they consider themselves to be nonresident aliens, raise a rebuttable presumption that they have relinquished

situation distorts both the tax and immigration systems and should be eliminated. Because the fundamental issue is entitlement to reside in the United States, and not U.S. tax liability, residence status should be determined under the immigration laws, and section 7701(b) should be amended to have the definition of LPR for tax purposes reflect the immigration law definition. Instead of the current lack of clarity as to what constitutes maintaining U.S. residence and the inconsistent nature of LPR determinations, often by a border official at an airport or a border crossing, a bright line test should be established in the immigration law. Again, the Canadian system, which requires that permanent residence status is reviewed and permanent resident cards are reissued every five years, is instructive.[391] LPR status should be subject to review and approval every five years, based on verification of continued residence in the United States or short-term absence from the United States.[392] At the point of review of LPR status, any LPRs who do not satisfy a physical presence test similar to the substantial presence test in Code section 7701(b)(3) should bear the burden of proof in establishing that they have not abandoned their permanent residence in the United States. A deemed abandonment would trigger the departure tax as of the first day of the year following

LPR status.

[391] Canadian Permanent Resident cards are valid for a maximum of five years and can only be issued in Canada. Immigration and Refugee Protection Regulations, SOR/2002-227, §§ 54, 55 (Can.). To be eligible for the card, applicants must establish that they have satisfied the residence requirements for the preceding five year period. Immigration and Refugee Protection Act, S.C. 2001, c. 27, § 28 (Can.); Immigration and Refugee Protection Regulations, SOR/2002-227, § 56(2) (Can.). If they have not been physically present in Canada for at least 730 days during the preceding five year period, they must provide evidence that they were accompanying a Canadian citizen spouse, were employed by a Canadian business or on public service for Canada or a province abroad, or were accompanying a permanent resident so employed. Immigration and Refugee Protection Act, S.C. 2001, c. 27, § 28 (Can.).

[392] It would be possible in principle to use foreign addresses on income tax returns as a check on LPRs who may have lost their LPR status. However, use of data in this way would require circumventing section 6103. Furthermore, by creating a disincentive to file returns, such a matching system would undermining the voluntary compliance that the confidentiality requirements of section 6103 were designed to encourage. GAO REPORT DATA SHARING AND ANALYSIS MAY ENHANCE TAX COMPLIANCE, *supra* note 65, at 6, 9; U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-06-100, OPTIONS EXIST TO ENABLE DATA SHARING BETWEEN IRS AND USCIS BUT EACH PRESENTS CHALLENGES 8 (2005). The Service has noted that the Department of State and the Social Security Administration cite the Privacy Act, Pub. L. No. 93-579, 88 Stat. 1896 (1974) (codified at 5 U.S.C. § 552a (2011)), in restricting the Service's access to their data. GAO REPORT ON IRS ACTIVITIES TO INCREASE COMPLIANCE OF OVERSEAS TAXPAYERS, *supra* note 33, at 8.

the third year of nonresidence. Parallel to their status as U.S. tax residents under the departure tax, LPR employees of the U.S. government and military personnel posted abroad should be considered not to have abandoned their permanent residence in the United States. Additionally, to ease the potential hardship on LPR spouses of U.S. citizens, an expedited procedure for reacquiring LPR status should be established for LPR spouses of U.S. citizens who lose their LPR status under these rules. Border officials would continue to have the discretion to make a determination of abandonment at any time. Under this system, no LPR could remain a "nonresident permanent resident" for longer than eight years. The anomalous situation of so-called permanent residents living abroad for extended periods of time would thus be largely eliminated.

X. ADVANTAGES OF THE PROPOSED DEPARTURE TAX REGIME

There are many advantages to the proposed departure tax regime. The first and most important is that it would make the U.S. tax system more equitable. It would correlate the payment of taxes to the United States with the receipt of benefits from residence in the United States. Income, in its broadest sense, including gains, earned by individuals while resident, would be subject to tax. Income earned before becoming a resident would not be taxed, nor would foreign source income earned after becoming a nonresident. The proposed regime would also eliminate the taxation of accidental, nominal, and unaware citizens whose taxation by the United States is the least justified taxation of nonresident citizens.

The proposed regime would improve the structure of and compliance with U.S. tax laws. It would eliminate the complexity of and problems involved in justifying the FEIE/FHE regime, which is seen as an unfair and unwarranted exception to the worldwide taxation of U.S. citizens and LPRs. It would eliminate the troubling compliance and regulatory rules, such as the PFIC, FBAR, and FATCA regimes, which interfere with or impugn the legitimate actions and operations of U.S. persons living abroad. It would also avoid the difficulties of trying to enforce U.S. tax laws in a situation of large-scale inadvertent and deliberate noncompliance.

In terms of immigration and nationality law, the proposed regime would eliminate the taint of worldwide taxation and the exit tax that currently devalue U.S. citizenship. It would also end the current conflict between the tax and immigration laws by aligning much more closely residence for tax and immigration purposes, thus largely eliminating the anomalous taxation of individuals who have lost their right to reside permanently in the United States but who are still considered to be U.S. tax residents.

Finally, the proposed regime would improve U.S. international tax policy by bringing the U.S. tax system in line with the reality of global mobility and the large numbers of U.S. persons overseas. It would also bring the U.S. rules on the taxation of nonresidents in line with international tax norms and the tax systems of the United States's major trading partners and competitors.