HEARING
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
ONE HUNDRED FOURTH CONGRESS
FIRST SESSION
ON
S. 453, S. 700, H.R. 831, H.R. 981,
H.R. 1535, and H.R. 1812

JULY 11, 1995

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(III)
TAX TREATMENT OF EXPATRIATED CITIZENS

TUESDAY, JULY 11, 1995

U.S. Senate,
Committee on Finance,
Washington, DC.

The hearing was convened, pursuant to notice, at 2:30 p.m., in room SD–215, Dirksen Senate Office Building, Hon. Bob Packwood (chairman of the committee) presiding.
Also present: Senators Grassley, Simpson, D'Amato, Nickles, Moynihan, Baucus, Bradley, Breaux, Graham, and Moseley-Braun.

OPENING STATEMENT OF HON. BOB PACKWOOD, A U.S. SENATOR FROM OREGON, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will come to order, please.

This is the hearing that we promised we would do after the Joint Committee had finished its study of expatriate taxes. This is an issue I find that has created much more heat than light.

One, no one wants anyone to leave this country for the sole purpose of avoiding paying taxes. I have not run across any defender of that position yet.

Two, I run across great disparity between the numbers. There are some people who say one thing, some who say other things. There are big differences in numbers and big differences in estimates.

Three, I think you have a legitimate issue as to what happens when somebody leaves and it is not for tax avoidance reasons. And there any number of people who leave for legitimate reasons, or people who may have been American citizens but they were born abroad and have hardly ever lived here, or people with dual citizenship. This is common in most of the world. It is usually only in the Anglo-Saxon or common law countries that you do not have dual citizenship. What happens in that situation?

So I hope this hearing will help us shed some light on that and, in addition, on the widely disparate estimates between Treasury and the Joint Tax Committee.

Max?

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator Baucus. Mr. Chairman, I would like to say that I think that Montanans are like most Americans and do not like paying taxes, but, like most Americans, we are willing to pay taxes so long as everyone else is paying his fair share. That is what this really comes down to.
Yet today we find that a fairly small number of Americans are not paying their fair share. They are going to great lengths, thousands of miles to other countries, to avoid paying their fair share. In a metaphorical sense, burning the flag; giving up what should be their most sacred possession, their American citizenship, to find a tax loophole.

Last year alone, the Treasury reports that at least 10 wealthy individuals turned their backs on our country, and the poorest of them owed $700,000 in income tax. Forbes Magazine found one attorney who claims that "I talk to a new client interested in expatriating every week."

These are precisely the sort of greedy, unpatriotic people that FDR called malefactors of great wealth. If we made sure these fellows paid their full share we would collect $1.9 billion over 10 years. That is approximately $200 million a year.

And, at a time when the Majority is cutting away at education, at agriculture, at Medicare, we should remember that $200 million could mean preserving college loans for thousands of American kids, Medicare reimbursements that keep some rural hospitals from closing, and essential health services for old people.

Now, some people seem to think that this is a trivial or back burner type of problem. The Joint Tax Committee report on the expatriation issue contains a Joint Committee Staff finding: "Although there is some anecdotal evidence that a small number of U.S. citizens may be expatriating to avoid continuing to pay U.S. tax, and the amount of potential tax liability involved in any individual case could be significant, the Joint Committee Staff found no evidence that the problem is either widespread, or growing."

Well, that does not sound so bad. But take it from certified public accountant English to regular English and it will not sound so reassuring. Essentially, they say that a number of extremely rich people are skipping town, evading taxes, and making us cut Medicare and student loans to make up the difference.

There are no so many of them, and the number is about the same every year, so we can twiddle a bit with existing law and see if it works.

I do not think that is all right. It is like saying, yes, well, there is a fire in the house but it is not a very big fire and it only burns up a little bit of the house in a given hour, so we can take our time and experiment rather than calling the fire department.

This is a simple issue; it should be easy to solve. Senator Moynihan has a very good solution. There is no reason for delay. Let us not allow more of these rich freeloaders to get away. Let us stop fooling around, pass a good, tough bill, and move ahead.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Moynihan.

OPENING STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, A U.S. SENATOR FROM NEW YORK

Senator MOYNIHAN. Thank you, Mr. Chairman. Thank you, Senator Baucus.

Mr. Chairman, I would bring us up to date on a question that arose when we first addressed this matter in the committee, which
was whether there was some violation of human rights implicit in addressing the tax treatment of expatriation.

The issue was raised and Secretary Samuels and I, and our able staffs, have, in turn, asked a number of legal scholars involved in international law what their view on the matter is, particularly with the amendments which I offered to the administration bill.

We have not a unanimous, but an overwhelming assessment from the legal community that we have no problem here. Anthony D'Amato, who is the Layton Professor of Law at Northwestern University School of Law, states it most emphatically in great detail, but provides a brief conclusion.

"After careful study and research, I believe the administration's expatriation tax proposal does not violate, even minimally, the human rights that all persons enjoy under international law. Indeed, a case can be made that the average American taxpayer's rights are infringed under current law if wealthy Americans can expatriate themselves and avoid paying their fair share of capital gains tax." Professor D'Amato goes on to say he personally opposes the capital gains tax, but, while it is law, it is law.

At the Harvard Law School, Anne-Marie Slaughter, Professor of Law, writes to you, Mr. Secretary, with the same view. She says, "I understand that Senator Moynihan is offering an amendment to the administration proposal that will allow individuals seeking to renounce their citizenship to choose either to pay capital gains tax on gains in excess of $600,000 or to continue to be treated as a U.S. citizen for tax purposes.

I conclude that, with the addition of this amendment, the administration proposal is consistent with international law and with the U.S. commitment to the protection and promotion of human rights," she goes on to say, "as has been ably analyzed by the Office of Legal Advisor and by various other experts in international law consulted by your office. The proposed tax violates neither the right to emigrate, nor the right to expatriate."

I think that is useful for the record. Mr. Chairman, if I could, I would like to place these materials in the record.

The CHAIRMAN. Without objection.

[The information appears in the appendix following Secretary Samuels' prepared statement.]

The CHAIRMAN. Senator Bradley?

OPENING STATEMENT OF HON. BILL BRADLEY, A U.S. SENATOR FROM NEW JERSEY

Senator Bradley. Mr. Chairman, I am anxious to hear the testimony of the witnesses. If what I have heard about what the House has proposed is true, it seems to me we have kind of done a circle and ended up at the same place we were before we did it because all of the tools of avoidance are still available, as I understand it.

I mean, if I have to wait 10 years I can actually borrow against my assets for 10 years. So I have some reservations about what I have heard. But, of course, we are here to learn and that is what I hope to do in the course of these discussions.

I think that the point has to be made that there has been a very serious abuse and the abuse is very clear. It is understood in every town meeting that I have had in the last 6 months since this issue
arose, and that is, there are some Americans who avoid tax by giving up their American citizenship. That was offensive on a lot of different grounds to a lot of different people and that is why we corrected it. And I do think we did correct it, and the administration supported it.

I certainly do not want to provide, instead of what we did, a fig leaf claiming we have accomplished that objective, and now everyone has to pay the tax and cannot avoid it by giving up their U.S. citizenship and then find that the law we have passed is riddled with a whole series of loopholes and that all of the steps that we have taken on previous occasions are still available.

So, Mr. Chairman, I will be holding a very high standard to this and trying to have people be very clear about what they are proposing.

The CHAIRMAN. Senator Breaux.

Senator BREAUX. I have no statement, Mr. Chairman.

The CHAIRMAN. Mr. Secretary, we will take you first.

STATEMENT OF HON. LESLIE B. SAMUELS, ASSISTANT SECRETARY FOR TAX POLICY, U.S. DEPARTMENT OF TREASURY, WASHINGTON, DC

Secretary SAMUELS. Mr. Chairman and members of the committee, I am pleased today to testify on the taxation of U.S. citizens and certain long-term residents who expatriate by renouncing their U.S. citizenship or abandoning their residency.

In March of this year, the Senate Finance Committee reported out a bill similar to the administration's proposal that would have effectively dealt with the problems of tax avoidance through expatriation. The entire Senate then approved that bill.

The administration supports these efforts because we believe that U.S. persons should pay their fair share of U.S. tax. Recent media interest, as well as the attention devoted by the Congress and its staffs, demonstrate a keen interest in this problem.

We believe that the public confidence in our tax system is eroded by the perception that some wealthy individuals are able to escape paying taxes through devices that are not generally available to all taxpayers.

Our existing laws generally subject individuals to income tax when assets are sold or subject estates to estate tax when the individual dies. Certain wealthy people have found that they can completely avoid paying U.S. tax on their gains by renouncing their U.S. citizenship. Consequently, the experience of the last 29 years has shown that current law is not working.

In February of this year, the administration offered a proposal to deal with this issue. Under the administration's proposal if a U.S. citizen relinquishes U.S. citizenship, property held by that person would be treated as sold at fair market value immediately before such expatriation. However, no tax would be imposed on gains up to $600,000, U.S. real estate or interest in certain retirement plans.

Senator Moynihan's version of the expatriate proposal, S. 700, is similar in many ways to the administration's proposal except that it allows expatriates who post adequate security to delay paying U.S. tax on gains from identified assets until the gains are realized.
The House Ways and Means Committee proposal, H.R. 1812, takes a different approach to the taxation of expatriates, one based on existing law. H.R. 1812 imposes income tax on certain expatriates generally on their U.S.-source income for a period of 10 years.

We have examined and compared S. 700 and H.R. 1812. Based on this evaluation, we support S. 700 because it does not interfere with an individual's right to renounce U.S. citizenship and it appropriately ensures that the expatriate will pay tax on all gains earned while subject to U.S. tax jurisdiction.

In contrast, we oppose H.R. 1812. First, H.R. 1812 retains the loophole in current law that allows individuals to pay no tax on gains accrued while subject to U.S. tax if they have sufficient resources to wait for 10 years to recognize those gains. In contrast, S. 700 does not reward patient expatriates.

The second reason that we support S. 700 is that it taxes gains from all sources, as does our regular income tax. However, under current Section 877, gains from foreign assets that accrue during U.S. citizenship are not subject to U.S. tax after expatriation. H.R. 1812 generally retains this structural flaw of current law, with modest modifications.

In addition, we believe that as long as a class of assets is exempt from taxation after expatriation and there is a waiting period for exemption from U.S. tax, tax advisors will constantly discover new methods to avoid tax.

The third reason that we support S. 700 is that it does not create a favored class of U.S. citizens. We agree with H.R. 1812's premise that the tax motivation requirement of current law is very difficult to administer.

However, H.R. 1812 provides special exceptions for certain U.S. citizens by exempting them from tax unless tax avoidance can be proven. These special preferences apply to U.S. citizens who, (1) were born with dual citizenship; (2) have a family member that was born in another country; or (3) have lived outside of the United States for 10 years.

The creation of classes of U.S. citizens with special tax benefits raises issues of fairness. U.S. citizens of foreign birth and their children should certainly not be discriminated against, but nor should they be provided with special benefits.

The fourth reason that we support S. 700 is that it is more administrable. Like current law, H.R. 1812 continues the very difficult to administer requirement that the IRS monitor an expatriate's activities for 10 years after departure.

In contrast, information should be available to enforce the provisions of S. 700 more effectively, since the tax is generally fixed at the time of expatriation and a tax return is due within 90 days of expatriation.

Finally, we support S. 700 because it respects international law. There are two ways in which expatriation proposals may affect international law: international human rights obligations and tax treaties.

Some expressed initial concerns about whether the administration's expatriation proposal would violate international law regarding human rights. It is now clear that those concerns are unfounded. A multitude of experts indicate that the expatriation pro-
posals that have been introduced do not violate international human rights law.

Today I would like to add, in addition to the two letters that Senator Moynihan mentioned in his opening remarks, the letter of a prominent international human rights organization, the Minnesota Advocates for Human Rights.

[The letter appears in the appendix following Secretary Samuels' prepared statement.]

Secretary SAMUELS. Now I would like to turn to tax treaties. H.R. 1812 will unnecessarily cause the United States to violate its international obligations because it is intended to override U.S. tax treaties for a 10-year period.

Although U.S. domestic law allows legislative overrides of tax treaties, these overrides violate U.S. obligations under international law. While a legislative override of tax treaties may occasionally be required by compelling circumstances, expatriation tax avoidance is not one of those cases.

We strongly urge Congress not to override tax treaties when alternative means of achieving our tax policy objectives can be accomplished without violating our international obligations.

Now I would like to turn to revenue estimates for the various proposals. Over 5 years, we estimate that S. 700 will raise $1.68 billion, and H.R. 1812, $450 million. Other relevant figures are in my written statement.

These estimates are based on the premise that tax avoidance through expatriation is a growing problem. Therefore, we used the most recent information on expatriation to project future expatriation.

If a proposal deters expatriation, the United States will collect both estate and gift taxes and income taxes from the individuals who would have expatriated. In contrast, those who expatriate under current law generally pay very modest levels of U.S. tax as non-resident taxpayers.

Because these estimates are based on the specific financial situations of a relatively small number of taxpayers, they are subject to more uncertainty than many other revenue estimates.

Therefore, it is reasonable that two groups could come to different conclusions about the precise magnitude of the revenues attributable to each bill, but one might normally expect more agreement on the relative magnitude of the estimates for the various proposals.

In our view, the administration's proposal should raise the most revenue, S. 700 should rank second, and H.R. 1812 should be expected to raise the smallest amount of revenue.

To explain this ranking of the revenue-generating potential of the three proposals, consider the effect of each of these proposals on an extremely wealthy U.S. citizen holding a diverse portfolio of appreciated assets who is planning to expatriate to avoid income and estate tax under current law.

The administration's proposal will substantially remove the individual's tax incentives to expatriate because, if he expatriates, he will have to pay tax on unrealized gains immediately. Generally, we assume that S. 700 will also deter this type of wealthy individual from expatriating.
Although S. 700 allows taxpayers to defer the payment of tax on their gains, when the asset is eventually sold tax is due on the entire gain. Thus, on a present value basis an expatriate would generally pay tax on accrued capital gains under S. 700. It is at least as great as the administration's proposal.

In contrast, H.R. 1812 is unlikely to deter many individuals from expatriating. The wealthy individual's tax would almost always be lower if the taxpayer expatriates because only certain types of income will continue to be taxed, and no tax is due after the 10-year waiting period. In contrast, he would be taxed on all income if he remained a U.S. citizen.

In the last few months, extraordinary attention has been focused on tax avoidance through expatriation. We stand firm in our view that Americans who avoid their tax responsibilities by expatriating should not be rewarded. Instead, they should be asked to pay the same tax on income they accrued while subject to U.S. tax laws that those who remain will pay sooner or later. We believe that Congress should enact an expatriation tax avoidance provision that is based on S. 700.

Mr. Chairman, this concludes my remarks. I would be pleased to answer any questions that the committee may have.

The CHAIRMAN. We will take Mr. Kies first, and then we will question you both.

[The prepared statement of Secretary Samuels appears in the appendix.]

The CHAIRMAN. Ken?

STATEMENT OF KENNETH J. KIES, CHIEF OF STAFF, JOINT COMMITTEE ON TAXATION, WASHINGTON, DC

Mr. KIES. Thank you, Mr. Chairman.

It is my pleasure to present the testimony of the Joint Committee at this hearing on the tax treatment of individuals who relinquish their U.S. citizenship or residency.

I will provide a summary of the findings of the Joint Committee study on this matter, describe the pending proposals, and discuss the revenue estimates with respect to these proposals.

In the course of analyzing the expatriation proposals, the Joint Committee staff reached the following findings and conclusions in its June 1, 1995 report.

Since 1980, an average of 781 U.S. citizens expatriated each year. Although there is some anecdotal evidence that a small number of U.S. citizens may be expatriating for tax avoidance purposes, the Joint Committee staff found no evidence that the problem is either widespread or growing.

The study identified certain problems with the present law expatriation provisions. Specifically, there are legal methods to avoid some or all taxation under the current law provisions. The administration proposal to impose a new tax regime of much broader scope than present law raises a number of issues, including the following.

First, the Administration proposal would impose tax on all expatriates without regard to taxpayer motivation. Thus, the Administration proposal would impose tax on U.S. citizens or residents who are expatriating for purely non-tax reasons, those who have long-term dual citizenship with another country to which they are re-
turning, or have tenuous ties to the United States, as in the case of individuals who did not even realize that he or she was a U.S. citizen.

Second, a number of practical problems are raised by the Administration proposal to tax unrealized gain upon expatriation. These issues may be summarized as: (1) identifying the owner of interest in property, or identity problems; (2) raising sufficient funds from interests in property to pay tax, or liquidity problems; and (3) valuing the interest in property, valuation problems.

These problems are often related. Something that makes it difficult to determine who owns an interest in property often makes that interest very illiquid, which, in turn, may make valuing the interest more difficult.

These problems are especially difficult in the case of interests held through trust because expatriating beneficiaries would be subject to a tax liability determined by reference to the unrealized appreciation in the value of the trust assets, notwithstanding the fact that the beneficiary has no access to the assets of the trust.

This particular aspect of the proposal raises potential constitutional issues, at least under certain circumstances. Moreover, under certain circumstances the tax might inappropriately interfere with the right to expatriate, which is recognized by U.S. and international law, and could result in substantial double and triple taxation possibilities.

Third, the administration proposal may retroactively impose tax on former U.S. citizens who lost their U.S. citizenship years ago. It is unclear whether the United States would have any legal basis for attempting to collect tax in such a case, since the individual has lost all rights and responsibilities of U.S. citizenship many years earlier.

Finally, enactment of the administration proposal may create an incentive to expatriate which does not exist under current law for individuals who either have recently inherited wealth or expect to inherit wealth in the near future.

I will not repeat a description of the administration proposal. Mr. Samuels has already done that. The Senate amendment to H.R. 831 modified the administration proposal in several ways.

First, it applied the expatriation tax only to U.S. citizens who relinquished their U.S. citizenship, not to long-term residents who terminate their U.S. residency.

Second, it modified the date when an expatriating citizen is treated as relinquishing U.S. citizenship, such that most expatriating citizens are treated as relinquishing their citizenship at the time a Certificate of Loss of Nationality is applied for rather than when the certified is issued, as under the administration bill.

The result of this change in the effective date was to exempt at least 183 individuals from the potential effects of the legislation, as compared to the effective date of the administration proposal.

Senator Moynihan introduced S. 700 on April 6, 1995. Congressman Gibbons has introduced an identical bill. These bills make several changes to the administration proposal, as incorporated in the Senate amendment to H.R. 831, as follows:
First, the modified bills would apply the tax on expatriation to long-term residents who terminate their residency in a manner similar to the provision in the administration proposal.

Second, a non-resident alien individual who becomes a citizen or resident of the United States would be required to utilize a fair market value basis rather than an historical cost basis in determining any subsequent gain or loss on a disposition of any property held on the date the individual became a U.S. citizen or resident. The fair market value basis would apply for purposes of computing gain or loss on actual or deemed dispositions, not just for purposes of the tax on expatriation.

Third, the modified bills would allow an expatriating individual to irrevocably elect, on an asset-by-asset basis, to continue to be taxed as a U.S. citizen with respect to such assets.

Fourth, tax on expatriation would not apply to an individual who relinquishes U.S. citizenship before attaining age 18 and a half, if the individual lived in the United States for less than five taxable years before the date of relinquishment.

The Ways and Means Committee bill, H.R. 1812, would expand and substantially strengthen in several ways the present law provisions that subject U.S. citizens who lose their citizenship for tax avoidance purposes to special tax rules for 10 years after such loss of citizenship.

First, the bill would extend the expatriation tax provisions to apply not only to U.S. citizens who lose their citizenship, but also to long-term residents who terminate their residency.

Second, the bill generally would subject individuals to the expatriation tax provisions without inquiry as to their motive for losing their U.S. citizenship or residency, but would allow certain categories of citizens to show an absence of tax avoidance motives if they request a ruling from the Secretary of the Treasury as to whether the loss of citizenship had a principal purpose of tax avoidance.

Third, the bill would expand the categories of income and gain subject to expatriation tax and would eliminate the ability to engage in certain transactions that, under current law, circumvent the 10-year reach of Section 877.

Further, the bill would provide relief from double taxation in circumstances where another country imposes tax on items that would be subject to U.S. tax under the expatriating tax provisions.

The final issue I will address is the issue of revenue estimating, Mr. Chairman. The one principle guiding the Joint Committee staff revenue estimates with respect to the expatriating proposals is that potential expatriates tend to have relatively unique profiles.

A second principle is that an individual who desires to sever direct economic ties to the U.S. would be able to circumvent all of the expatriation proposals advanced to date.

The final principle is that there will be no enforcement of present law Section 877 in the current budget baseline. There are significant disparities between the revenue estimates of the proposals by the Joint Committee and the Treasury Department. We have been able to identify several differences between the Joint Committee and Treasury Department analyses. They are as follows:
First, we believe that our assessment of the scope of the expatriation problem is somewhat smaller than that which has been assumed by the Treasury Department.

Second, our early analysis of the expatriation proposal assumed that expatriating individuals incurred no U.S. tax liability following the act of expatriation.

As a result of our study, we have concluded that expatriating individuals in certain circumstances continue to incur U.S. tax liabilities. We believe that the Treasury Department may assume that expatriating individuals incur little or no U.S. tax following the act of expatriation.

Third, the Joint Committee did not account for estate tax effects of any of the proposals because of the lack of reliable data on expatriate wealth, the inaccuracy inherent in applying general mortality tables to a small group of expatriates, and the complexity of forecasting the outcomes of estate settlements.

It is the understanding of the Joint Committee staff that the estimates made by the Treasury Department do incorporate changes in estate and gift tax receipts.

Finally, we believe that the analysis of the Treasury Department of H.R. 1812 does not adequately take into account the various items of income which would be subject to tax under H.R. 1812 that would not be reached by either the administration proposal or other pending proposals.

The categories of income which would be taxed only under H.R. 1812 include all income from U.S. property for the 10-year period after expatriation which the expatriate owned at the time of expatriation, and all future acquired U.S. property for the same 10-year period.

The administration proposal and the modified bills both impose tax on unrealized gain at the time of expatriation. The Joint Committee staff estimated that the administration proposal would deter target expatriates with substantial unrealized gains or would extract significant tax payments in the event expatriation occurred.

Taxpayers with low unrealized gains who, under present law, would be in no hurry to make an expatriation decision might find expatriation attractive given their current low-gain status.

Expatriates who have low unrealized gains could find it advantageous to expatriate sooner under the administration proposal, or any other proposal that would impose a toll charge on unrealized gains at the time of departure.

The modified bills, Senator Moynihan's bill, allow an asset-by-asset election. Under this election, taxpayers would be able to treat high gain assets, throwing off little current income as taxable by the United States following expatriation, while they would treat low-gain assets throwing off substantial income as subject only to U.S. tax on unrealized gains at the time of expatriation. In other words, they would pick the winners and not the losers.

Under the administration proposal, a former U.S. citizen would be subject to estate tax provisions for expatriates only if tax avoidance was the principle purpose for the individual's loss of citizenship.
Under the Ways and Means bill, former wealthy citizens generally would be subject to the estate tax provisions for expatriates without regard to their motive for expatriating.

Accordingly, a wealthy expatriate who transfers all of his or her assets to a foreign corporation he or she controls and who dies within 10 years of expatriation generally generally pay no estate tax under the administration proposal, but generally would be subject to the estate tax under the Ways and Means bill.

Mr. Chairman, that completes my oral statement and I will be happy to accept any questions.

The CHAIRMAN. Thank you.

[The prepared statement of Mr. Kies appears in the appendix.]

The CHAIRMAN. Now, that I understand.

Secretary SAMUELS. Mr. Chairman, we believe that is an appropriate policy. Those individuals who have retained their U.S. citizenship have, over the years, had the benefit of U.S. citizenship.

I remember, I lived abroad for 2 years after law school. I valued my passport. I met a lot of U.S. expatriates who spent significant time abroad. They all valued their passports. They thought it was a very important thing. It kind of goes to their identity.

So if someone has lived outside the United States for their entire lives and they have kept their U.S. passport, they are keeping it for a reason.

The United States is a little unusual in the fact that we tax citizens on their worldwide income no matter where they live.
that has been our law since the beginning. We think the benefits of having U.S. citizenship are such that when a citizen renounces citizenship, then in fairness to everyone who has stayed here paying their taxes, that those expatriates should pay tax on the unrealized gains that they accumulated while they were a citizen.

We are not asking, like current law and like H.R. 1812 does, to tax U.S. income that arises after someone expatriates. So we think that the law should try to create a parity between people who stay here and people who leave. And it is very difficult, as current law has shown us, to determine why people leave.

The CHAIRMAN. Well, it almost appears as if we have never tried to enforce current law. Am I right or not?

Secretary SAMUELS. When you look back over the last 29 years, there have been cases where the Internal Revenue Service has attempted to enforce current law. I think the experience, and I do not think there is any real dispute about this, is that current law has not worked, and that it is very difficult to prove intent. And I would say, based on the enormous amount of work done in the last couple of months, that there is agreement on this issue.

And, looking back over time, it seems to me, the Internal Revenue Service has appropriately allocated their resources on this issue. When they found some expatriates, a small number, they have gone after them. But it is very difficult to find them and it is very difficult to keep track of them after they have left.

I am sure you know that there is a cottage industry of tax advisors who advise expatriates. There is a fairly thick book on how to do it under current law. So I do not think that the IRS has devoted insufficient resources, given the flaws and loopholes in the current system.

The CHAIRMAN. When you were here testifying on the 25 percent health deduction you said, approximately two dozen, or 24 taxpayers expatriate, $2.2 billion in taxes over five years. I do not know if Joint Committee disputes that, they just cannot seem to find it. Do you have information they do not have?

Secretary SAMUELS. No. We have provided them with all the information. Now, remember, in talking about these estimates we are talking about estimating how many taxpayer's would be——

The CHAIRMAN. It is a pretty specific estimate, 24.

Secretary SAMUELS. We said we thought approximately 24. Actually, we were trying to be conservative. We think, based on anecdotal evidence, the amount might be higher. It seems to me that, given all the debate, whatever the group is, whatever the number, they seem to be generating a lot of heat on this issue. So there must be something there because there is certainly a lot of heat.

The CHAIRMAN. Mr. Kies, do you want to respond just on that figure? You did not seem to have the same figures. Not estimates, but numbers.

Mr. KIES. Well, Mr. Chairman, we, in the course of our study, among other things, asked the State Department, for example, to review the list of the Forbes 400 richest people for the past 10 years and to tell us how many of the people on that list expatriated, because there were statements that 24 billionaires were leaving the country. They were only able to identify four people.
I believe the State Department did a very good faith effort of going back and reviewing all of their files on the people that had expatriated in the past 10 years. We are talking about a relatively small group, because the number per year is around 800 people.

So there clearly are some people doing it, but the number, I believe, is relatively modest in terms of actual numbers of people.

The CHAIRMAN. Senator Moynihan?

Senator MOYNIHAN. Well, an issue arises as to how many persons might be involved with these efforts and they cannot be inconsiderable because they have a monthly journal. It is called “The International Journal of Rodent Control.” I am asked why that is. It is rodent, as in rat, as in bureaucrat.

They will tell you there are meetings at the London Hilton. A green card gets you into the United States, but you need a red card to get out. There was a meeting, the 4th Annual Passport Tax Exile Conference, at the London Hilton on the 28th and 29th of April, 1995. Did we have anybody there, Mr. Samuels? It cannot be that far from Grosvenor Square.

Secretary SAMUELS. Senator Moynihan, as I recall, at least from that advertisement, the press and government officials are barred from the meeting because secrets were supposed to be divulged that were only for the—

Senator MOYNIHAN. You are quite right. You are quite right, it so states. There is now a book by a gentleman—I do not think it is useful to advertise his name—but it is entitled the “Tax Exile Report.” It is a pretty good book. It tells you how to avoid all this. Yes, sir. The Tax Exile Report.

Senator BRADLEY. You were saying that was the London meeting, not the Monte Carlo meeting? Monte Carlo is this summer.

Senator MOYNIHAN. Monte Carlo advertises to stay here, particularly if you are a U.S. citizen. It is not that hard. I do not want to get into matters beyond the immediate purview of the Committee on Finance, but one of the personals here says, “Lady offers U.S. citizen marriage; generous dowry. Box 1187.” I will not go any further. I mean, people will offer U.S. citizenship, as Mr. Samuels knows. And anybody who held a dual citizenship for a long time knew why he or she held it. You might need the Marines 1 day, you might need an U.S. embassy to get into one day.

As I understand it, sir, since 1913, if I can ask Mr. Samuels—Mr. Kies, I am sure, will agree—it has been American law that U.S. citizens owe taxes on their income wherever they may live. That has been our rule since the beginning of the income tax.

We now find a certain number trying to avoid this and people making a profession out of helping them do, and we think they ought not. I know what we think. I am just asking you to see if you will agree.

Getting into the question of motivation, why did you do this, is no great business of the U.S. Government. I mean, if people want to do it they have a right to do it under international law, under our law. But you also owe your taxes. Just pay your taxes and we will leave your own personal concerns to yourself. Is that not right, Mr. Secretary?

Secretary SAMUELS. Yes, Senator Moynihan. That is correct.
Senator MOYNIHAN. And the Treasury knows something about this. You have samples, you have access to returns. Well, Joint Tax does, too. On your revenue estimates, S. 700, through the year 2005, 10 years, would bring in almost $5 billion.

The House bill, if there is no treaty override, would bring in $300 million over 10 years. If we want to break some tax treaties—and we could do that, as Senator D'Amato knows, who is an attorney—then you get $1.1 billion. You pay something for that. But before us we have a 15:1 ratio in terms of revenue gain in favor of the Senate bill, and I think that should be dispositive.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Baucus.

Senator BAUCUS. Mr. Chairman, thank you.

Mr. Kies, what is wrong with Secretary Samuels' analysis is that Americans' income is taxed worldwide and if an American renounces citizenship, why should he or she not still pay taxes on unrealized gains?

What is wrong with that, particularly from the point of view of the average, ordinary American citizen, who may has a small business, or a housewife who has probably got a job as well, trying to make ends meet, the car payment, the mortgage payment, and save a little money for the kids to go to college, and maybe a little bit left over for vacation. Why should an American who renounces his or her citizenship, particularly the wealthy ones we are talking about here, not have to have pay taxes?

Mr. Kies, what is wrong with Secretary Samuels' analysis is that Americans' income is taxed worldwide and if an American renounces citizenship, why should he or she not still pay taxes on unrealized gains?

Senator BAUCUS. I thought the basic principle, say, as in Senator Moynihan's or Senator Bradley's bill, is from a point of basic fairness, the point of view of the middle income American.

Mr. Kies. The point I am trying to make, Senator Baucus, is the administration proposal would impose a tax liability that other people do not have. People are not taxed on unrealized appreciation as a general proposition under our tax system, so it would impose a tax regime

Senator BAUCUS. But Americans are taxed on gain of appreciated assets.

Mr. Kies. No, they are not, until they realize that gain, if they realize that gain. If they hold it until death, they are not taxed at all. So the administration proposal would impose a tax that is not imposed on other citizens.
Now, it is a policy decision as to what additional tax you want to impose on someone at the point they expatriate. H.R. 1812 takes an approach of saying they want to tax them for 10 years after they expatriate; the administration proposal takes an approach of treating them as if they had sold all their assets. But it is imposing a tax that is not imposed on citizens, generally.

Looking at the proposal, you have to get into some of the problems of how you treat interests in trusts. It is extremely complicated. It has the potential of double and triple taxing people because they could be taxed on the value of the trust assets and then taxed again when they actually receive distribution.

So the study examined a number of problems with those approaches and found that there were some serious concerns and suggested that maybe a better approach to discouraging expatriation is to impose a 10-year tax regime.

Senator BAUCUS. Your response, Mr. Secretary, to that basic point?

Secretary SAMUELS. Senator Baucus, there has been a lot of discussion about this issue.

As the discussions have progressed, some of the issues that Mr. Kies has raised have been dealt with. I would particularly say that Senator Moynihan's bill, which is the bill before us, says if a U.S. citizen expatriates the person has the choice of either paying the tax on unrealized gain at the time of expatriation or making an election to continue to be subject to tax on all of the income from those assets without regard to the time. So you cannot kind of beat Senator Moynihan's bill by waiting 10 years. Thus, that person does not have the problems that Mr. Kies raised, and that provision was put in specifically by Senator Moynihan to deal with that issue.

So I think that the bill that is before the committee deals with that issue. Some of these issues have deserved serious consideration and have been addressed.

Senator BAUCUS. What about that, Mr. Kies, has the bill dealt with those issues? S. 700, not the bill you are talking about.

Mr. KIES. Senator Baucus, I think the problem with S. 700 is the problem I alluded to of potential for double and triple taxation, because an individual that expatriates to a country that also taxes that income will probably not—

Senator BAUCUS. That person has that election.

Mr. KIES. No. If somebody makes the election to continue to be taxed on these assets and they are a citizen of another country that also taxes the same income, they are going to owe income tax in both countries. And, under the tax treaties that we have, it is unlikely that the country to which they have expatriated will give them a foreign tax cut, so it is paying tax on the same income.

Senator BAUCUS. But does S. 700 not deal with the tax treaty problem by allowing the Secretary to renegotiate where possible, and where renegotiation is not possible that the tax treaty prevails?

Mr. KIES. As Mr. Samuels has suggested with respect to H.R. 1812, renegotiation of all of the tax treaties is a formidable task.
Senator BAUCUS. But you did not answer my question. There is another part of that which says, in those cases where renegotiation is not possible, as I understand S. 700, the treaty would prevail.

Mr. KIES. No, that is incorrect. They cannot deem the treaty to prevail. There is substantial potential for double taxation under S. 700.

Senator BAUCUS. With all due respect, I think you are avoiding the basic point which is, from the average American's perspective, it does not seem fair, does not seem right, that a wealthy American citizen can avoid paying tax, as a person can today, by expatriating. That is basically it, pure and simple. It is not that complicated, it is pretty simple.

With all due respect, you talk a lot like a tax attorney, trying to minimize taxes of a client. That is fine, that is interesting, but from the point of just plain, ordinary, simple tax fairness, I think most Americans would think that anybody who expatriates basically ought to pay taxes.

Thank you.

Senator MOYNIHAN. Mr. Chairman, may I just interrupt?

The CHAIRMAN. Yes. Before Senator Bradley, Senator Moynihan has an interjection.

Senator MOYNIHAN. Yes. For this dread problem of double taxation, all you need is the manual. You look up Item 38, Cape Verde. You may not want to live in the Cape Verde Islands, but you, your spouse, and your children under 18 can all obtain citizenship and passports there if you make a single, $35,000 donation to a foundation established by the Cape Verde government. So $35,000 gets you out.

I will turn it over to Senator Bradley.

Mr. KIES. Senator Moynihan, actually, I think Mr. Samuels answered that particular point because, as he pointed out, all countries other than the United States and the Philippines tax on the basis of residency, not citizenship. So having citizenship in the Cape Verde Islands would not cause you to not be subject to tax where you are a resident. That is—

Senator MOYNIHAN. It deals with that question later on.

The CHAIRMAN. Senator Bradley.

Senator BRADLEY. Thank you very much, Mr. Chairman. While I do not know about Cape Verde, I know about Cape May. That is really the only cape I want to know about at the moment.

Let me get a sense of what S. 700 proposes and what the House bill proposes. As I understand it, Mr. Samuels, there is a $600,000 exemption on any assets that would be taxed; is that correct?

Secretary SAMUELS. Under S. 700 there is an exemption for $600,000 for a person, and then if it is a married couple it is $1.2 million.

Senator BRADLEY. $1.2 million. So that if you were someone who held a dual passport and you came here from Greece, or Italy, or wherever many years ago, you lived here, you worked hard all your life, and for some reason you want to go home, you want to die in your own country. For some reason you do not want to be an American, you want to be an Italian, or a Greek, or a Polish resident, or whatever. You can do that if you have assets that total $1.2 million or less for you and your wife, right?
Secretary Samuels. That is correct, Senator.

Senator Bradley. And without incurring any taxable event at all; is that correct?

Secretary Samuels. That is correct.

Senator Bradley. Now, Mr. Kies, as I understand what the administration is proposing, and what the House has proposed is that when someone renounces their citizenship they still incur a tax liability on income for 10 years; is that correct?

Mr. Kies. That is correct, Senator Bradley. On income from U.S.-source assets for a 10-year period.


Mr. Kies. That is correct.

Senator Bradley. So if I renounced my citizenship and went to Monaco and got a big payment by a casino there of a couple hundred grand a year, that is foreign-source income, and I would not pay any tax on that?

Mr. Kies. Service income was not taxed under any of these proposals after expatriation. That is correct.

Senator Bradley. Right. But if I retained my citizenship I would be taxed on that income; is that correct?

Mr. Kies. That is correct.

Senator Bradley. So that I am successfully avoiding tax on any foreign-source income that I would not be able to avoid had I been a U.S. citizen; is that right?

Mr. Kies. That is true under all of the proposals, yes.

Senator Bradley. All right. Now, let me ask you, in terms of, let us say that I inherited several billion dollars in stock and I am getting on, I have to start thinking about my own estate planning. I am 50 and I am truly a billionaire. Now, I renounce my U.S. citizenship, I go to Ireland or wherever, I wait 10 years, and then I sell those assets. Under the House bill, I pay no American tax on the sale of those assets, right?

Mr. Kies. That is correct.

Senator Bradley. If I, on the other hand, had sold them in year seven I would incur a capital gains tax in America; is that correct?

Mr. Kies. Do you mean if you had renounced your citizenship?

Senator Bradley. Yes.

Mr. Kies. Under H.R. 1812, you would pay a tax; under the administration proposal you would not.

Senator Bradley. In year seven, right?

Mr. Kies. Right. Under H.R. 1812, you would pay a tax; under the administration proposal and Senator Moynihan's proposal you would not pay any tax.

Senator Bradley. But on the capital gains.

Mr. Kies. Correct.

Senator Bradley. Because I would have paid it when I renounced my citizenship. See, that is the difference.

Mr. Kies. No. You would have no tax if you inherited it because you obtain a basis equal to its fair market value.

Senator Bradley. No. But let us assume that I had the asset under my control. Forget the inheritance. I have owned the asset and I sell the asset. Under your proposal, I pay no capital gains tax after 10 years. Under the administration proposal and under Senator Moynihan's and my proposal, at the moment I renounce
my citizenship I then have a taxable event on the gain from the
time I bought it in the United States to the time I renounced my
American citizenship. Is that correct?

Mr. KIES. Under those facts, that is correct.

Senator BRADLEY. And that is not taxed under H.R. 1812. In fact,
under H.R. 1812, I can keep that for 10 years and sell it and pay
no capital gains tax. So, under this proposal, I could accomplish all
of my objectives, which is to save all billion dollars from taxation
in America, by renouncing my citizenship, borrowing against this
giant asset, living well in Monaco or wherever for 10 years, and
then thumbing my nose at the American taxpayer and saying, "I
am not paying tax." I can do that, can I not, under your proposal?

Mr. KIES. It is the House bill.

Senator BRADLEY. Under the House bill, can I do that?

Mr. KIES. Under those facts, that is correct.

Senator BRADLEY. All right.

Mr. KIES. Under your original facts, it works the opposite way.

Senator BRADLEY. All right. But I can do that. It seems to me
that is what we were trying to correct here. It is clear under the
House bill we not only do not correct it, but we give them a road
map that they can go to to avoid paying the tax and put a stamp
of approval on it by the U.S. Government. It does not sound to me
like that is a wise thing to do.

Mr. KIES. Senator Bradley, one other clarification in your exam-
ple, and it is important because estate tax is a major consideration
here. Under the House bill, if the individual does what you have
described and dies during that 10-year period, it is very likely he
would be subject to the U.S. estate tax, whereas, under the admin-
istration proposal, he would probably not be subject to the estate
tax. The estate tax is 55 percent, versus the 28 percent income tax.

Senator BRADLEY. Well, you are interested in protecting all these
trusts. You would put the assets in trusts so you do not pay any
estate tax, Mr. Kies. Certainly someone who was smart enough to
set this thing up would have avoided any estate tax years ago
while setting up a whole series of interlocking trusts, generation-
skipping trusts. It is just another way to dodge the issue here.

The issue is, when you renounce your United States citizenship,
then a taxable event or should you be able to flip your nose at
the rest of the country and walk away laughing while the rest of
us end up paying tax? That is the issue.

The CHAIRMAN. Senator Breaux.

Senator BREAUX. Thank you, Mr. Chairman. Thanks to the wit-
nesses. All of this is really horribly, horribly complicated regarding
when things apply, when they do not, what applies, what does not.

The only question I would like to ask, because I think we ought
to make changes in the current law, is whether there is a retro-
active effort of the proposal. I think when Congress decides to do
something we should move forward and do it. I do not like making
tax changes retroactively unless people were on notice that we
were going to make some major changes.

So the general question I have is, are the bills prospective in na-
ture, do they start at a reasonable time when people knew or
should have known that Congress was contemplating changes in
this area?
There are all kinds of tax policies that are on the books that are of questionable value, but they are legal, correct, and right. They are the law of the United States, and people comply with those laws and they rely on those laws for certain decisions, whether the policy is good or not. The Congress can come back and change that policy, and that is what we are involved in now, but I think some changes are necessary.

The questions I have to both of you on the two bills that we are talking about are: are they retroactive; are they prospective; are they prospective from a date certain that is fair across the board; do they apply about when citizenship is renounced; and are those definitions consistent with immigration policy and the laws of the country? And I would like some general comment on that from both of you.

Mr. Samuels?

Secretary SAMUELS. Senator Breaux, I will try to summarize briefly our understanding of the two bills. First, both bills apply to expatriations basically after February 5th. February 6th was the date the administration announced the changes to current law.

We strongly urge that that date be maintained. We think that, if we had announced a later effective date, you would have seen a rush of people expatriate who have been reading that guide book. It does not really take that long to accomplish everything necessary to expatriate. Therefore, we would have seen an unfortunate expansion of this activity. So we think that it is very important to keep that date.

Senator BREAUX. So someone who had expatriated prior to February the 5th, or February 6th, is not covered by the changes as someone who expatriates after that date.

Secretary SAMUELS. Under S. 700, the expatriation event is usually when you go to a U.S. embassy or consulate and indicate that you are renouncing your citizenship.

That was picked because, if you use some other event—for example, someone just says, in my mind I am now no longer a U.S. citizen—it is impossible, in our view, to prove when somebody actually expatriated. So we think that the right event is when they have come into a U.S. Government office and indicated that they are renouncing their citizenship. So that is the event in S. 700.

In H.R. 1812, as I understand it, the event is when some act is taken which does not necessarily have to be the act of going into a consulate. Therefore, under H.R. 1812, we have to determine the intent of a person who takes an allegiance to a foreign government or asks for foreign citizenship. Then we would have to determine what was really in their mind when they did those acts. That is a difference between the two bills.

As I understand it, there is a transition rule in H.R. 1812 that says if somebody comes to a consulate after February 6th and they had taken the position that they were an expatriate at some point in the previous year, then H.R. 1812 would apply to that person from the date the person came into the U.S. embassy. However, they would not be taxed under H.R. 1812 for the period between the time they took their action and the time they came in.

As a consequence, someone thinks they expatriated, say, last year, can just wait around and decide when they want to come into
the consulate. Until that time they would not be subject to 1812. H.R. 1812 only starts, as I understand it, when the person comes into a consulate or embassy.

The other issue of retroactively is that, under H.R. 1812, the Treasury is given the authority to write regulations for acts that occur within 5 years prior to expatriation. This regulatory authority was given to try to catch people who were planning tax avoidance techniques before they expatriated.

Under the regulatory authority, as I understand it, we are supposed to write regulations that would tax someone on a transaction that took place within 5 years of expatriation.

And at least the way we read H.R. 1812, that means we would be able to write regulations that would tax someone on transactions that took place back to 1991. We have concerns about that because that tax year could be closed by now.

Senator BREAUX. That is incredible.

Mr. Kies, can you comment on the same question? I know my time has expired, but I would like to have both of you comment on my question.

Mr. KIES. Yes, Mr. Breaux. There are a couple of important pieces of U.S. law that you need to consider.

First, a person gives up their U.S. citizenship under current law by taking a number of potential acts. For example, becoming naturalized in another country, formally declaring allegiance to another country, serving in a foreign army, serving in certain types of foreign government employment.

If you do any of those things with the intent to renounce your citizenship, you lose it as of that point in time whether or not you ever get a Certificate of Loss of Nationality from the State Department, so your U.S. citizenship terminates for all purposes at that point.

One of the problems with the Administration proposal in terms of retroactivity is that a person could have taken one of those acts in 1957 and if they go and seek a Certificate of Loss of Nationality next week they would be subject to worldwide income tax all the way back to 1957 as a result of coming and asking for the Certificate of Loss of Nationality. So that is one of the issues raised in the study, that there is a potential for significant retroactivity under those circumstances.

In terms of how the two bills work, the administration proposal originally worked off of when a CLN was issued. That would have been the key date, so if a Certificate of Loss of Nationality was issued after February 6, 1995 you would be subject to the new proposal.

The Moynihan bill works off of the date of—

Senator MOYNIHAN. Mr. Kies, Moynihan-Bradley.

Mr. KIES. Excuse me. Senator Moynihan's and Senator Bradley's bill, and Congressman Gibbons' bill.

Senator MOYNIHAN. And Graham.

Mr. KIES. And Senator Graham. Uses the date that the Certificate of Loss of Nationality was applied for. As I said in my statement, the difference between the administration bill and the bill of Senators Moynihan, Bradley, and Graham, is that it would exempt
183 people that would otherwise be caught by the administration bill, so there is that difference in there.

But the significant issue of retroactivity relates to this fact that somebody could have ceased being a U.S. citizen many years ago but not have asked for a Certificate of Loss of Nationality. Under both the administration bill and Senators Moynihan, Bradley, and Graham's bill, that person would be brought into the worldwide income tax system retroactively.

Secretary SAMUELS. Senator Breaux, can I just add to that? We think that that scenario is highly unlikely. But, let us assume for discussion purposes, that it took place. We think that the Internal Revenue Service and the Treasury, could be given authority administratively to deal with those cases.

It has happened in the past where the Supreme Court has rendered decisions on citizenship. We would look forward to working with the committee to have appropriate statutory language, so that there would be authority to deal with those cases. So we think that it is a situation that can readily be dealt with if, in fact, it occurs, which we think is highly unlikely.

The CHAIRMAN. Senator Grassley.

Senator GRASSLEY. I think we should all remember that we are not talking about whether or not we should pass a bill to tax expatriates, because we have voted on this twice in the Senate and I believe everybody here has voted in support of it. What we are talking about is not whether or not we are going to tax them, but how we are going to do it and to do it in the right way.

My first question would be to both of you, because versions of this bill have been introduced by Senate and House Democrats that would exclude from taxation up to $600,000 of income on an expatriate's deemed sale of assets at expatriation date.

Now, my question is to both of you. Why should Congress grant any exemptions to these persons denying their citizenship, and how much revenue might be generated if no exemption were granted?

Mr. KIES. Senator Grassley, I think the amount of additional revenue that would be raised from not granting those exemptions would be relatively modest, only because the number of total people that are expatriating each year generally is a relatively small number.

It would pick up some money but it would not be a significant revenue impact because the majority of the revenue in all of these proposals is for the wealthy individuals that are either contemplating or engaging in acts of expatriation.

Senator GRASSLEY. Well, why should we grant the $600,000 exemption?

Mr. KIES. I think that was a proposal that was included in the administration bill, so they would probably be in a better position to answer that.

Senator GRASSLEY. Mr. Secretary?

Secretary SAMUELS. Senator Grassley, I would like to confirm, in our view, that eliminating the $600,000 exemption would really have no material effect on the revenue estimate. There are not that many taxpayers involved and it is a relatively small amount.

Mr. KIES. So we are in agreement on that one.

Senator GRASSLEY. So then we would not do it to raise revenue.
Secretary SAMUELS. It is basically for administrative convenience. It is like a small business exemption. We do not think that we should deal with taxpayers with very small amounts of assets.

One, those taxpayers generally would not have a tax avoidance purpose because the amounts involved are not significant. Two, and I think more importantly, we do not think that it would be administratively efficient to have to deal with that group.

The amount last year, I think, was roughly 800 or 900 people who expatriated. They are not the ones that I think are causing the problem. I do not think there is any disagreement on that.

Senator GRASSLEY. I guess the only comment I would make before I go on to my next question would be the extent to which most Americans would not consider $600,000 to be an insignificant amount or a small amount.

Secretary SAMUELS. Senator Grassley, I would agree with that. We actually picked that number because it is the estate tax exemption.

Senator BRADLEY. How big a farm would that be?

Senator GRASSLEY. No, wait. We are talking about people who renounce their citizenship, not people who are living in the United States.

Senator BRADLEY. Yes. But it is a little, small farm.

Senator GRASSLEY. If you are trying to make a case against farmers getting an increase in their exemption. [Laughter.]

Secretary SAMUELS. Senator Grassley, we had to pick a diminimus amount. We picked that number because it was the estate tax exemption.

Senator GRASSLEY. All right. Then I guess, Mr. Kies, you would be the one that should give a point of view for the Congress on this. Treasury has given us their estimates on the proposals. Joint Tax provides the numbers that we have to go by, and your estimates differ from those of Treasury. We have been over the problems with how many people this affects, but we have not really pointed out the difference in revenue estimates. Are there differences?

Mr. KIES. Senator Grassley, there are some rather significant differences. We estimate that the administration proposal would raise $600 million over the 5-year period, that H.R. 1812, the House bill, would raise $800 million, that H.R. 831, which was the provision previously considered by the Senate Finance Committee, would raise $500 million, and that Senator Moynihan, Bradley, and Graham's bill would raise $200 million. So, there are some differences.

In my testimony, and I think Mr. Samuels also commented in his testimony, there are differences in assumptions about the extent of the current problem of current law, and also about the way in which people will react to these various proposals.

Our analysis is that H.R. 1812 will be a more significant deterrent than some of the other proposals, but I think both we and the Treasury Department would acknowledge that we are estimating in an area that is extremely difficult.

Senator GRASSLEY. At least, based upon your estimates, you have concluded then that the House bill raises more revenue than any of the other bills.

Mr. KIES. That is correct, Senator Grassley.
Senator GRASSLEY. All right. You mentioned, Mr. Kies, that the administration’s proposal actually gives an incentive to expatriates for some individuals. Could you describe how the incentive would work and, therefore, how the proposal would fail? You mentioned those with low-gain assets would be better off expatriating sooner than later.

Mr. KIES. Well, Senator Grassley, I think the original example that Senator Bradley was positing of somebody who inherits significant wealth or who is on the verge of inheriting significant wealth, those people, if they expatriated, under the administration proposal, would have no tax liability, whereas, under H.R. 1812 they would be taxed on their U.S.-source income for 10 years.

So if you are inheriting, for example, a significant ownership interest in a U.S. corporation that you want to continue owning, under H.R. 1812 you would be subject to tax on the stream of dividend income that would come from that and, indeed, if you later on sold those assets, all of the appreciation would be subject to tax. That is just one example of how there is a difference. The two bills do differ in a variety of respects.

Secretary SAMUELS. Senator Grassley, can I just add to that?

Senator GRASSLEY. Yes.

Secretary SAMUELS. As I mentioned in my oral testimony, and it is more fully described in my written testimony, we understand that reasonable people can differ about the level of revenue estimates. We have explained why we think there are differences.

Where I think we have some difficulty is in the ranking of the estimates. We rank the estimates quite differently than the Joint Committee. We do not see how either the administration’s proposal or Senator Moynihan and Senator Bradley’s proposal would raise less revenue than H.R. 1812.

H.R. 1812 has the same problems of current law. They allow people to expatriate free of tax by just waiting 10 years. It does not tax expatriates on their foreign-source income. And that there are a variety of ways still available to plan around the law. On this question of someone who just inherits a vast amount of wealth and whether they would be more inclined to expatriate under one or the other bill, we think that the incentive to expatriate under all three is about the same.

Attached to my testimony is a letter from three professors at Harvard Law School who wrote to give us their views on this issue. They concluded that they did not think that there was any incentive, under any of these bills, which would cause that particular hypothetical person to expatriate. By the way, we have not been able to identify any person who meets this profile in the people who have expatriated. In fact, the Harvard professors think that under certain circumstances you can have an incentive under H.R. 1812 to expatriate. If you were planning to sell your business when you are 65, under H.R. 1812 you might expatriate at age 55 so you would avoid U.S. tax. You had waited the 10 years.

So we think that the ranking is where we should not have differences with the Joint Committee. We can understand why we would come to different estimates, but it is the ranking where we have concerns. We have tried to address our reasons for our ranking in our testimony.
The CHAIRMAN. Senator D'Amato, then Senator Moseley-Braun. Senator D'AMATO. Thank you, Mr. Chairman.

I just would touch on the point that you made, Mr. Samuels. It seems to me rather difficult to think that somebody who is an expatriate who does this, gives up their citizenship to save money, is not going to take advantage and hold out for 10 years. If you are talking about wealthy, wealthy people, I mean, they are not dumb. It would just seem to me that H.R. 1812 overrates the revenue incredibly.

As it relates to the $600,000, there are a lot of people in this country who still have a strong attachment, they love this country, but they are older, they have worked here, they want to go back to, whether it is Greece, or Italy, et cetera, some are resident aliens. They are not wealthy people, by any means. They sell their home, their business—you give them up to $600,000—and they can go on back.

We are not trying to stop migration, we are not trying to stop people from meeting that which is in their heart to live with their families, their brothers and sisters, maybe. But I think all of us seek the goal of seeing that people do not try to beat the system.

Wealthy people who have made billions of dollars or hundreds of billions of dollars and who now have come up with the schemes that Senator Moynihan has alluded to in this little book about, come on over here and pay $35,000 in the trust, and you can run out on it.

I might also add, it seems to me that, under the present law, Section 877, is something called intent, and we probably not have been as vigorous in going after those who are using these ruses in terms of finding against them, because it is quite clear that, where their intent is to evade the payment of taxes, they have not, for all purposes, escaped the liability. So there is always the question of, can we do a better job.

I would have to say that it seems to me that the provisions advanced by my friend and colleague, Senator Moynihan, and Senator Bradley, I think, at least strikes a balance. I do not want to open the door because, let me tell you, if these guys want to they will not sell those assets over $10 billion, and they do have the estates that they place in trust.

So I think, if you look at those revenue estimates, it will be a lot different if you look at the Moynihan-Gibbons-Bradley bill as opposed to H.R. 1812. But I do think we should do something. If we feel that the intent in the present law opens this loophole, and obviously there are some who share that concern, then let us close the loophole for most of them.

Let us not, though, in so doing, deny people the ability to go back to their ancestral homes and die in peace and take something because, after all, they have been paying taxes all along.

This is not a question that they are escaping taxes; they are not. You keep a reasonable limit. You do not want to impoverish people. It seems to me that that is correct and that is proper.

I thank the Chair.

The CHAIRMAN. Senator Moseley-Braun, then Senator Graham. Senator MOSELEY-BRAUN. Thank you very much, Mr. Chairman.
It is funny how things sometimes get circular in this life. There is an expression that God made the world round so we could not see what was down the road. I was really tickled to find, as part of the case law in this area having to do with expatriations, one of the first cases that I tried as an Assistant U.S. Attorney, what became later Vance vs. Terrazas, which was an expatriation case. I was a junior lawyer. We had a Mexican national who renounced his U.S. citizenship in order to avoid going to the war. It was one of the first trials that I had to try from scratch and go through every step of the process involved with expatriation, and it was not a simple process.

You could not just go and say, I do not want to be a U.S. citizen anymore, you had to fill out forms, you had to go to the embassy. I mean, it was a complicated process and, frankly, the embassies went to great lengths to see to it that people did not mistakenly renounce their U.S. citizenship.

And in the case of Vance vs. Terrazas, which is referenced in some of the underlying documentation here, the Supreme Court went to great lengths to go through what was involved—and I do not have my glasses—but the holding was, in sum, "we hold that in proving expatriation, an expatriating act and an intent to relinquish citizenship must be proved by a preponderance of the evidence. We also hold that when one of the statutory expatriating acts is proved, it is constitutional to presume it would have been a voluntary act until and unless otherwise proved by the actor."

If he succeeds, that is to say, if you prove that you have made a mistake, there can be no expatriation. If he fails, the question remains whether on all the evidence the government has satisfied its burden of proof that the expatriating act was performed with the necessary intent to relinquish citizenship."

I raise that, not just to talk about a case that I tried when I first was a baby lawyer in the U.S. Attorney's Office in Chicago, but to talk about what I think is one of the underlying issues in this entire debate, and that is one of fairness, fairness to the people who are left at home.

In the Terrazas case that I tried, I remember being more than a little outraged that the individual who had renounced his citizenship was doing so at the expense of all those other young men who were having to go off to Viet Nam.

And, in this situation, I think the fairness issue is one of all those citizens who renounce their citizenship to go off at the expense of the folks who are left here at home paying taxes.

So, in that regard, it really does become a really fundamental issue of fairness and one in which, quite frankly, again, the voluntariness issue is not an issue because the court—and the President makes it very clear—you really have to go out of your way to do this. This is not something that just happens by accident, you have to knowingly do so, it has to be proved by a preponderance of the evidence. So it is a set of steps.

I also would like to reference to Senator D'Amato, particularly, Anthony D'Amato, at the Northwestern University School of Law, which I also claim from Chicago, talked about the fact that, indeed, a case can be made that the average American taxpayers' rights are infringed under current law if wealthy Americans can expatri-
ate themselves and avoid paying their fair share of capital gains tax. So that becomes an issue.

So if we are talking about the fairness issues here and what is involved in trying to fix this, a lot of the debate this afternoon has been over the differences in the report, Mr. Kies, that your department came up with and the Treasury Department, and the difference in revenue estimates. They differ widely, with Joint Tax apparently saying, well, this is not a whole lot of money involved, or at least it is a whole lot less money involved than Treasury says is involved with this expatriation issue.

So my question to you, Mr. Kies, in terms of the way that the issue was ranked, in terms of administration and the points having to do with administration, to what extent did you, before doing your report on this issue, consult with the Treasury and go over the various points with having to do with how this law works?

Mr. KIES. Senator, we have spent an extensive amount of time reviewing information which we requested from the Treasury Department in connection with our study, both in terms of looking at the raw data that they used for purposes of doing their estimates, and we also obtained substantial information from the State Department, which I do not even think the Treasury Department previously had.

In terms of our revenue analysis, we, too, are showing that there is significant potential revenue. H.R. 1812, we predict, would raise $2.4 billion over a 10-year period. That compares with the $1.9 billion that we think the administration proposal would raise. Now, that is a smaller number than the administration predicts, but it is still a substantial amount of money. In excess of $1 billion is not an insignificant sum.

But the specific answer to your question is, we have reviewed extensively the information which Treasury used to do their own estimate, and we have also done extensive analysis of State Department data about people who have expatriated.

We have compared it with the lists of the wealthiest people in American to try and determine what the incidence of expatriation by wealthy people is, to then try and get a reasonable estimate of how much money can be raised from an effective legislative change here that provides additional deterrent beyond what is available under current law.

Senator MOSELEY-BRAUN. Mr. Chairman, if I may, the question I asked had to do with consulting with Treasury, not just obtaining information from different sources.

Mr. KIES. We met with them on a number of occasions in the process of preparing the study.

Senator MOSELEY-BRAUN. Thank you.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman.

Senator Grassley raised the issue of the basis of exemptions within the various proposals. Apparently there is also an exemption in the House bill that relates to your place of birth, your spouse's place of birth, or one of your parent's place of birth, that if you repatriate to a country which meets one of those tests, that you are exempt from the application of this law. Is that a correct statement?
Mr. KIES. Senator Graham, that is actually not correct. What the House bill does is it says, as a general proposition, anybody who expatriates is presumed to do it for tax avoidance. It then says that under certain circumstances, including the one that you alluded to, an individual has the opportunity to ask the Treasury Department for a ruling that he or she is not doing it for tax avoidance, and if he or she is able to prove that he or she is not doing it for tax avoidance, they then would not be subject to the tax regime.

But just returning to the country of your parents' birth or your birth does not grant you an exemption, you then have to carry the burden of proof of showing that you are not doing it for tax avoidance. Indeed, you do not even get the ability to do that unless you submit a ruling request to the Treasury Department within a year of your expatriating event.

Senator GRAHAM. Can I ask a question, and then I would like to ask Mr. Samuels to comment on that. What are some of the other categories that would raise the potential of challenging the motivation?

Mr. KIES. The other categories are if you are a long-time non-resident of the United States, so somebody who has not been resident in the United States for a substantial period of time. Another category is if you give up your citizenship prior to 18 and a half. I think those are the other categories.

H.R. 1812 would also give the Treasury Department the authority to promulgate, under regulations, other situations that might be viewed as sympathetic that would permit taxpayers to then be able to prove that they are not doing it for tax avoidance purposes.

Now, the Treasury Department has raised a concern about whether or not the proof of tax avoidance is a difficult thing. H.R. 1812, by requiring a taxpayer to come forward and actually present he or she to the Treasury Department, I think, puts them in a different situation from current law where basically the IRS has to chase the person down in order to be able to pursue them. But that is the way H.R. 1812 works.

Senator GRAHAM. Mr. Samuels?

Secretary SAMUELS. Senator Graham, we have a somewhat different view of the impact of this provision in H.R. 1812. We think H.R. 1812 creates a favored class of citizens, those with connections to another country. I think that you have to apply for a ruling under H.R. 1812, but there is no requirement that you actually get a ruling.

And, the issue of the ruling request is the matter of intent. The question of intent has dogged us over the last 29 years. So if an expatriate comes in who is in one of these categories, they will file for a ruling. The IRS may conclude that the expatriate had a bad intent. The expatriate may say: "too bad, come after me." Then the IRS has to go through all of its assessment procedures, and wind up in court. I think that it is fair to say that the very wealthy are also very well-advised, and that has been the problem with proving intent.

So we think that H.R. 1812 forces you back to current law, in effect, with this ruling procedure. Therefore, we think that this group of citizens who happen to have some connections in one way or an-
other with foreign countries should not be treated in any different way than citizens who have been living here.

Senator MOSELEY-BRAUN. Senator Graham, would you yield just for a second on that, without coming out of his time? Would that be possible?

Senator GRAHAM. If that is satisfactory with the Chair.

Senator MOSELEY-BRAUN. Thank you very much. Just to make the point Mr. Samuels is making. The intent issue is a very difficult issue in this whole area and the trial back in 1980 that I was involved with in this Terrazas case, that trial took almost a month, just the trial. I am sorry. Thank you very much for your courtesy, Senator Graham.

Mr. KIES. Senator Graham, could I just mention one thing about the intent issue, and that is, I think the facts are really not exactly consistent with what Mr. Samuels has said.

The Treasury Department has only litigated the issue of intent twice in 29 years; they won one of those cases, and they lost one. So there is not a long history of them not succeeding in proving intent, those are the facts in terms of what has actually happened.

Senator GRAHAM. Let me use this discussion as a bridge to a basic question. I would like each of your opinions on this question. As a matter of tax policy, do you think that persons who are renouncing their United States citizenship and expatriating should have either an exit obligation or a continuing tax liability for a period of years, or some combination of financial obligation to the U.S. Treasury?

Mr. KIES. Senator Graham, I think that, as a matter of tax policy, the Congress has long ago decided that—

Senator GRAHAM. I am asking you your opinion, yes or no. Should there be such a policy?

Mr. KIES. Well, I think there ought to be some penalty for people expatriating for tax avoidance and I think that that is an appropriate policy of our tax system.

Senator GRAHAM. Mr. Samuels?

Secretary SAMUELS. Senator Graham, in light of our experience over the last 29 years and all the discussion over the last several months, I think it is absolutely clear in terms of the public's perception of the tax system, that it is extremely important that the public feel that when someone expatriates they are settling up with their tax liability.

I think that when a very wealthy person expatriates and says it is because of a non-tax reason, I do not think the average person would believe that. One of the published reports quotes a lawyer who is involved in advising U.S. citizens who expatriate. He says that there are always reasons to expatriate but there is also always money. I think that the public knows that.

So we think that there ought to be settling up, as a policy matter, at the time someone leaves. Alternatively, they can make this election as provided in Senator Moynihan and Senator Bradley's bill. That is the appropriate policy to deal with this issue.

Senator GRAHAM. Mr. Chairman, I would like to ask permission to insert in the record at this point an article from the New York Times of July 10th on this issue.

The CHAIRMAN. Without objection.
The CHAIRMAN. Senator Simpson.

Senator SIMPSON. Thank you, Mr. Chairman.

Mr. Samuels, I have been impressed with your testimony. How long now have you been with the Department?

Secretary SAMUELS. Senator Simpson, I was confirmed in May of 1993.

Senator SIMPSON. All right. But you have been a follower of the scene. You speak as if you have been.

Secretary SAMUELS. I was in private practice for almost 25 years.

Senator SIMPSON. Were you helping these guys? [Laughter.]

No. From where does your vast reservoir of knowledge come? I mean, really.

Secretary SAMUELS. I spent a lot of time in corporate and international practice and this was—Senator Moynihan has the book—a little cottage industry that most people who are involved in international tax practice know about. It is not a surprise. Actually, we have spent a lot of time in the last couple of months—

Senator SIMPSON. I see the Professor has gone to his book. What do you have?

Senator MOYNIHAN. When the coast is clear.

Senator SIMPSON. That is it.

Secretary SAMUELS. This proposal is based in large part on anecdotal evidence. We got interested in this problem about a year ago.

Senator SIMPSON. I have a very short period of time. With your background, and both of you sharing your thoughts, because I think when we started this, obviously it was a great pot of gold at the end of the rainbow that we had suddenly found. That is the way we looked upon it, it seemed to me.

Obviously, when you get into issues of intent and proving intent, we all know, lawyers or non-lawyers, that that is obviously very, very difficult. Then there is how much it will raise. Very, very difficult. We are looking for money. We are searching the country for money. Wait till we get to the tough votes. The Budget Resolution was nothing compared to when we get to the tough votes, and the entitlements, and all have heard that.

My question is, of all the proposals that you two have heard of in your time, recently or in the past, and your experience and background, what is the biggest hammer that we could use, what would be the most effective deterrent here, from Americans renouncing their citizenship; what would that be?

Mr. KIES. Well, Senator, our conclusion was that an approach that imposed a continuing tax regime for a substantial period of time was more effective than one that only taxed appreciation at the particular point of renunciation, so our conclusion was, one, it provided continuing taxation. If you want it to be even more aggressive you would tax not only U.S.-source income, but foreign-source income, if you were looking for an even more strenuous deterrent.

Senator SIMPSON. But do treaties not prevent us from doing a lot of that kind of activity when you get into taxation among citizens of countries and expatriates? I mean, there are some serious issues.

Mr. KIES. As has been pointed out, Senator Simpson, a number of the people that are expatriating are going to places where we do
not even have U.S. tax treaties, for example, Belise, and some of those tax haven countries. So it depends on what countries they are actually expatriating to as to whether or not there is any treaty protection.

Senator Simpson. Do you have any thoughts, Mr. Samuels?

Secretary Samuels. Senator Simpson, we believe that the time to settle up with an expatriate is the time they expatriate. They either pay their tax or, under Senator Moynihan's bill, they will enter into an agreement with the IRS to pay their continuing tax obligations on the assets that they elect to be subject to tax.

The problem with H.R. 1812 is that it is basically built on the foundation of current law. We think that foundation is basically crumbled. Everybody agrees that current law is too easy to get around, and that is why Senator Moynihan has that book.

So we think that any provision that allows people to wait out some time period will not encourage confidence in the tax system because, inevitably, there will be people who beat the system by waiting whatever period of time you set.

So that is how we have approached this issue. As I say, I know that the need for funding is extreme. We just have a difference in ranking these proposals vis-a-vis the Joint Committee.

Senator Simpson. But it is going to be a very difficult thing for us, that is what is obvious. Very difficult before, and very difficult now.

One of the persons involved was a resident of the State of Wyoming, the heir of the Campbell Soup fortune, John Dorrance, a very fine person. He was seeking to fence a great portion of his property to raise exotic animals and people of that area did not think that it would be good to blend the red deer of Africa with the elk, or whatever, or the dik-dik with the deer, and so on. He was denied that opportunity to have a game farm in the State filled with wild game animals, and then apparently went to Ireland, and then has holdings in other places around the world.

Apparently, is it under the law of the United States or under the law of Ireland, where a person can return to the United States for what period of time? That is of some interest here, to me, at least.

Secretary Samuels. Senator Simpson, it is under U.S. tax law. A non-resident alien, which would include an expatriate, can return for up to 120 days a year without being subject to U.S. tax as a resident.

Senator Simpson. Without any limitations on what type of habitation or where they would go, or anything else?

Secretary Samuels. There are no limitations.

Senator Simpson. Well, I think we have a tough one there, that is for sure.

Thank you very much, Mr. Chairman.
The Chairman. Senator Moynihan?

Senator Moynihan. Well, I just wanted to read this.

Senator Simpson. Yes.

Senator Moynihan. The "Tax Exile Report. Citizenship, Secondary Passports, and Escaping Confiscatory Taxes." It is now already in its second edition and I think probably there will be a third unless we get this bill passed.

Senator Simpson. And when was that book done?

Senator SIMPSON. Perhaps an autographed copy would be good.

Senator MOYNIHAN. A green card gets you into the United States, but you need a red card to get you out. That is what they are talking about, this legislation. The answer is, yes.

Senator SIMPSON. I have been messing with green cards too long. [Laughter.]

The CHAIRMAN. Senator Moseley-Braun.

Senator MOSELEY-BRAUN. Well, thank you very much, Mr. Chairman. I do not really have any further questions. I think that pretty much concludes it. I just want to thank the Chairman for this hearing, and the witnesses, and I hope we can reach closure on this issue.

Certainly, at a time when we are talking about cutting job training programs for disadvantaged youth and closing educational opportunities and trying to get this budget in some balance, and deal with the entitlements issues, Medicare, Medicaid, what to do about senior citizens and health care funding, we have got all of these issues and it just does not make any sense at all, it seems to me, for us to fool around in this area and not have something that is clear, consistent, understandable, and fair. It is for that reason I hope, Mr. Kies, that you and the folks over at Joint Tax might take a kindly look at the Moynihan approach to this issue.

Thank you.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. Mr. Kies, how much money did the Treasury receive in F.Y. 1994 from the current expatriates tax?

Mr. KIES. Senator Graham, we do not have the specific numbers on that. Some of the information that we do have is taxpayer privileged and cannot be disclosed in a public hearing.

Senator GRAHAM. I am not asking about any individual person. But your estimate is that the House proposal would raise $2.4 billion over the next 10 years.

Mr. KIES. Correct.

Senator GRAHAM. Just dividing that by 10, that would be $240 million per year. What are we raising today?

Mr. KIES. Well, Senator Graham, the only information that we have is taxpayer-specific, so I cannot talk about that in public. But let me just mention, the $2.4 billion, as in the case of the administration's estimates, is substantially attributable to discouraging people from expatriating so they stay here and pay tax on their worldwide income, not from collecting the tax under the provision of 877. So a good deal of revenue pick-up is attributable to discouraging people from expatriating at all, and that is true of all of the proposals, I think.

Senator GRAHAM. Mr. Samuels, are you at liberty to comment as to what the range of current collections would be under the current law?

Secretary SAMUELS. Senator Graham, it is an extremely small amount. I do not have a number.

Senator GRAHAM. Less than $50 million?
Secretary SAMUELS. My staff here is giving me some advice. It is very difficult to decide how to define how much one is collecting. As Mr. Kies says, part of it is people who are not expatriating. But the data for 1994 is not yet in because people are still filing their returns. We think it is quite small.

Senator GRAHAM. I do not want to get off on this side issue, bit it seems to me it is a little difficult to be asked to evaluate changes for the future unless you have some context of what it is you are doing now.

The next question I was going to ask is, you both agree that, as a matter of tax policy, it was appropriate to have a special tax for these expatriates. What is the problem with the law that we have had in place for 29 years that it is not accomplishing a policy objective that both of you share?

Mr. KIES. The principal problem of current law is that there are a number of legal methods of eliminating any income from being treated as U.S.-source.

Senator GRAHAM. Well, what would be the three major means of evasion under current law?

Mr. KIES. A taxpayer can transfer all of their U.S.-source assets into a foreign corporation and, as a consequence, the income they then receive from that foreign corporation is treated as foreign-source, not U.S.-source, and, therefore, not subject to the current law provisions.

That is probably one of the more significant ways to avoid, legally, the reach of the current law provision, even if you have been proven to have expatriated for tax avoidance purposes.

Senator GRAHAM. And how would the House bill deal with that issue?

Mr. KIES. The House bill would treat that as continuing as U.S.-source income if it is transferred into a foreign corporation in a non-recognition event. So if the taxpayer does not enter into an agreement type like the agreement in Senator Moynihan's and your bill under which you pay tax currently on the gain, then the income of that foreign corporation would continue to be treated as U.S.-source income.

Senator GRAHAM. Do you agree, Mr. Samuels, that that is the principal means of avoidance today, and if so, how would the administration's proposal deal with that?

Secretary SAMUELS. Senator Graham, that is certainly one of the principal methods that is most widely used. By the way, I would just add that while H.R. 1812 tries to follow the U.S. asset when it is dropped into the foreign holding company, they limit the U.S. tax on any gain at the time it is dropped in.

There is a difference between people who drop in assets in a foreign corporation and hold them directly for 10 years. Thus, under H.R. 1812 there will be the same incentive for expatriates who are trying to beat the 10 years. To give them the most flexibility they will drop their assets into a foreign holding company as soon as possible.

We think that once you exempt certain categories of assets like foreign-source income producing assets, and as soon as you have a time period, the cottage industry of tax advisors are going to think up ways of getting around it.
That is why we think you have to fix the liability when you leave, or make this election as provided in Senator Moynihan and Senator Bradley's bill. So that is how we think you have to deal with the problem. Otherwise, we are going to be forever chasing the next tax planning idea, and it is very difficult to keep track of people for 10 years.

Once someone leaves under H.R. 1812, they have to file a piece of paper when they leave but there is no continuing obligation to file, so it is hard for the IRS to keep track. It is going to be hard for the IRS to keep up and know what is going on. That is another concern that we have.

Senator GRAHAM. In the Moynihan bill——
Senator MOYNIHAN. The Graham bill.

Senator GRAHAM. I think it was President Kennedy who said that victory always has a hundred parents, defeat is an orphan. Let us see how this child will do before we claim the parentage. [Laughter.]

Senator GRAHAM. But in the Moynihan-Bradley-Graham-Gibbons bill, if the taxpayer, at the point of expatriation, elects not to make a settlement but rather to be subject to 10 years of payment, they post some type of security. Does the House bill have a similar posting of security?

Mr. KIES. Senator Graham, it does not contain that type of proposal. I just might point out that all of these proposals, including the House bill and the administration proposal, presume a level of voluntary compliance because the payment of tax in all cases comes after the taxpayer has expatriated. So there is a presumption of some voluntary compliance for all of these proposals.

Senator GRAHAM. But I think it was President Reagan—to stay in the mode of quoting Presidents—who said, trust, but verify. We might trust everyone to be voluntarily complying, but would it not be helpful to also get some security up front in case they disappointed us?

Mr. KIES. I think, Senator Graham, that is something that ought to be looked at relative to H.R. 1812 if it is considered.

The CHAIRMAN. Senator Moynihan?

Senator MOYNIHAN. Thank you, Mr. Chairman. Thank our distinguished witnesses.

The CHAIRMAN. Gentlemen, thank you very much.

[Whereupon, at 4:21 p.m., the hearing was concluded.]
APPENDIX
ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

WRITTEN TESTIMONY
OF THE STAFF OF THE JOINT COMMITTEE ON TAXATION
REGARDING ISSUES RELATING TO PROPOSALS TO MODIFY
THE TAXATION OF INDIVIDUALS WHO RELINQUISH
U.S. CITIZENSHIP OR RESIDENCY

FOR A HEARING
OF THE
SENATE COMMITTEE ON FINANCE
ON
JULY 11, 1995

PRESENTED
BY
KENNETH J. KIES
CHIEF OF STAFF
JOINT COMMITTEE ON TAXATION
U.S. CONGRESS

JCX-30-95
JULY 11, 1995

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I. INTRODUCTION

My name is Ken Kies. I am the Chief of Staff of the Joint Committee on Taxation. It is my pleasure to present the testimony of the Joint Committee at this hearing on the tax treatment of individuals who relinquish their U.S. citizenship or residency.

The President's fiscal year 1996 budget proposals submitted on February 6, 1995, included a proposal to impose income tax on unrealized gains of U.S. citizens who relinquish their U.S. citizenship and certain long-term residents of the United States who relinquish their U.S. residency. This proposal was included as section 201 of S. 453 (introduced by Senators Daschle and Moynihan on February 16, 1995).

On March 15, 1995, the Committee on Finance approved an amendment to H.R. 831 to adopt a modified version of the Administration proposal with respect to the taxation of U.S. citizens who relinquish their citizenship. The Senate amendment was not included in the bill as enacted; rather, the enacted legislation included a requirement that the staff of the Joint Committee on Taxation complete a study on expatriation tax issues by June 1, 1995.

On April 6, 1995, Senator Moynihan introduced a bill (S. 700) that further modified the Administration proposal with respect to the taxation of U.S. citizens and residents who relinquish their citizenship or residency. 1

On June 9, 1995, following the completion of the Joint Committee staff's study on expatriation tax issues, Representative Archer and Representative Johnson of Connecticut introduced a bill (H.R. 1812) that would expand and strengthen the present-law expatriation tax provisions. The House Committee on Ways and Means approved two amendments to H.R. 1812 on June 13, 1995.

First, this testimony describes the present-law tax treatment of U.S. citizens, residents, and nonresident aliens, including the tax treatment of U.S. citizens who relinquish their citizenship. Second, a summary of the findings of the Joint Committee staff's study on expatriation tax issues is provided. Third, the proposals with respect to the taxation of individuals who relinquish their U.S. citizenship or residency are described in detail. Finally, the testimony discusses the revenue estimates with respect to such proposals and explains the estimating methodology of the Joint Committee staff.

1 Representative Gibbons introduced an identical bill (H.R. 1535) on May 2, 1995.
II. PRESENT LAW

A. Taxation of United States Citizens, Residents, and Nonresidents

1. Individual income taxation

   a. Income taxation of U.S. citizens and residents

      In general

      A United States citizen generally is subject to the U.S. individual income tax on his or her worldwide taxable income. All income earned by a U.S. citizen, whether from sources inside or outside the United States, is taxable, whether or not the individual lives within the United States. A non-U.S. citizen who resides in the United States generally is taxed in the same manner as a U.S. citizen if the individual meets the definition of a "resident alien," described below.

      The taxable income of a U.S. citizen or resident is equal to the taxpayer's total income less certain exclusions, exemptions, and deductions. The appropriate tax rates are then applied to a taxpayer's taxable income to determine his or her individual income tax liability. A taxpayer may reduce his or her income tax liability by any applicable tax credits. When an individual disposes of property, any gain or loss on the disposition is determined by reference to the taxpayer's cost basis in the property, regardless of whether the property was acquired during the period in which the taxpayer was a citizen or resident of the United States.

      If a U.S. citizen or resident earns income from sources outside the United States, and that income is subject to foreign income taxes, the individual generally is permitted a foreign tax credit against his or her U.S. income tax liability to the extent of foreign income taxes paid on that income. In addition, a United States citizen who lives and works in a foreign country generally is permitted to exclude up to $70,000 of annual compensation from being subject to U.S. income taxes, and is permitted an exclusion or deduction for certain housing expenses.

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2 The determination of who is a U.S. citizen for tax purposes, and when such citizenship is lost, is governed by the provisions of the Immigration and Nationality Act, 8 U.S.C. section 1401, et seq. See Treas. Reg. section 1.1-1(g).

3 See Internal Revenue Code sections ("sections") 901-907.

4 Section 911.
Resident aliens

In general, a non-U.S. citizen is considered a resident of the United States if the individual (1) has entered the United States as a lawful permanent U.S. resident (the "green card test"); or (2) is present in the United States for 31 or more days during the current calendar year and has been present in the United States for a substantial period of time—183 or more days during a 3-year period weighted toward the present year (the "substantial presence test").¹

If an individual is present in the United States for fewer than 183 days during the calendar year, and if the individual establishes that he or she has a closer connection with a foreign country than with the United States and has a tax home in that country for the year, the individual generally is not subject to U.S. tax as a resident on account of the substantial presence test. If an individual is present for as many as 183 days during a calendar year, this closer connections/tax home exception is not available. An alien who has an application pending to change his or her status to permanent resident or who has taken other steps to apply for status as a lawful permanent U.S. resident is not eligible for the closer connections/tax home exception.

For purposes of applying the substantial presence test, any days that an individual is present as an "exempt individual" are not counted. Exempt individuals include certain foreign government-related individuals, teachers, trainees, students, and professional athletes temporarily in the United States to compete in charitable sports events. In addition, the substantial presence test does not count days of presence of an individual who is physically unable to leave the United States because of a medical condition that arose while he or she was present in the United States, if the individual can establish to the satisfaction of the Secretary of the Treasury that he or she qualifies for this special medical exception.

In some circumstances, an individual who meets the definition of a U.S. resident (as described above) could also be defined as a resident of another country under the internal laws of that country. In order to avoid the double taxation of such individuals, most income tax treaties include a set of "tie-breaker" rules to determine the individual's country of residence for income tax purposes. In general, a dual resident is deemed to be a resident of the country in which such person has a permanent home. If the individual has a permanent home available in both countries, the individual's residence is deemed to be the country with which his or her personal and economic relations are closer, i.e., the "center of vital interests." If the country in which such individual has his or her center of vital interests cannot be determined, or if such individual does not have a permanent home available in either country, he or she is deemed to be a resident of the country in which he or she has an habitual abode. If the individual has an habitual abode in both

¹ The definitions of resident and nonresident aliens are set forth in section 7701(b). The substantial presence test compares 183 days to the sum of (1) the days present during the current calendar year, (2) one-third of the days present during the preceding calendar year, and (3) one-sixth of the days present during the second preceding calendar year. Presence for 122 days (or more) per year over the 3-year period would be sufficient to trigger the test.
countries or in neither of them, he or she is deemed to be a resident of the country of which he or
she is a citizen. If each country considers the person to be its citizen or if he or she is a citizen of
neither of them, the competent authorities of the countries are to settle the question of residence
by mutual agreement.

b. Income taxation of nonresident aliens

Non-U.S. citizens who do not meet the definition of "resident aliens" are considered to be
nonresident aliens for tax purposes. Nonresident aliens are subject to U.S. tax only to the extent
their income is from U.S. sources or is effectively connected with the conduct of a trade or
business within the United States. Bilateral income tax treaties may modify the U.S. taxation of a
nonresident alien.

A nonresident alien is taxed at regular graduated rates on net profits derived from a U.S.
business. Nonresident aliens also are taxed at a flat rate of 30 percent on certain types of passive
income derived from U.S. sources, although a lower treaty rate may be provided (e.g., dividends
are frequently taxed at a reduced rate of 15 percent). Such passive income includes interest,
dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments,
and other fixed or determinable annual or periodical gains, profits and income. There is no U.S. tax imposed, however, on interest earned by nonresident aliens with respect to
deposits with U.S. banks and certain types of portfolio debt investments. Gains on the sale of
stocks or securities issued by U.S. persons generally are not taxable to a nonresident alien because
they are considered to be foreign source income.

Nonresident aliens are subject to U.S. income taxation on any gain recognized on the
disposition of an interest in U.S. real property. Such gains generally are subject to tax at the

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6 Section 871.

7 See sections 871(h) and 871(i)(3).

8 Section 865(a).

9 Sections 897, 1445, 6039C, and 6652(f), known as the Foreign Investment in Real
Property Tax Act ("FIRPTA"). Under the FIRPTA provisions, tax is imposed on gains from the
disposition of an interest (other than an interest solely as a creditor) in real property (including an
interest in a mine, well, or other natural deposit) located in the United States or the U.S. Virgin
Islands. Also included in the definition of a U.S. real property interest is any interest (other than
an interest solely as a creditor) in any domestic corporation unless the taxpayer establishes that
the corporation was not a U.S. real property holding corporation ("USRPHC") at any time during
the five-year period ending on the date of the disposition of the interest (sec. 897(c)(1)(A)(ii)). A
USRPHC is any corporation, the fair market value of whose U.S. real property interests equals or
exceeds 50 percent of the sum of the fair market values of (1) its U.S. real property interests, (2)
same rates that apply to similar income received by U.S. persons. If a U.S. real property interest is acquired from a foreign person, the purchaser generally is required to withhold 10 percent of the amount realized (gross sales price). Alternatively, either party may request that the Internal Revenue Service ("IRS") determine the transferor's maximum tax liability and issue a certificate prescribing a reduced amount of withholding (not to exceed the transferor's maximum tax liability).10

2. Estate and gift taxation

The United States imposes a gift tax on any transfer of property by gift made by a U.S. citizen or resident,11 whether made directly or indirectly and whether made in trust or otherwise. Nonresident aliens are subject to the gift tax with respect to transfers of tangible real or personal property where the property is located in the United States at the time of the gift. No gift tax is imposed, however, on gifts made by nonresident aliens of intangible property having a situs within the United States (e.g., stocks and bonds).12

The United States also imposes an estate tax on the worldwide "gross estate" of any person who was a citizen or resident of the United States at the time of death, and on certain property belonging to a nonresident of the United States that is located in the United States at the time of death.13

Since 1976, the gift tax and the estate tax have been unified so that a single graduated rate schedule applies to cumulative taxable transfers made by a U.S. citizen or resident during his or her lifetime and at death. Under this rate schedule, the unified estate and gift tax rates begin at 18 percent on the first $10,000 in cumulative taxable transfers and reach 55 percent on cumulative taxable transfers over $3 million.14 A unified credit of $192,800 is available with respect to taxable transfers by gift and at death. The unified credit effectively exempts a total of $600,000 in cumulative taxable transfers from the estate and gift tax.

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its interests in foreign real property, plus (3) any other of its assets which are used or held for use in a trade or business (sec. 897(c)(2)).

10 Section 1445.
11 Section 2501.
12 Section 2501(a)(2).
13 Sections 2001, 2031, 2101, and 2103.
14 Section 2001(c).
Residency for purposes of estate and gift taxation is determined under different rules than those applicable for income tax purposes. In general, an individual is considered to be a resident of the United States for estate and gift tax purposes if the individual is "domiciled" in the United States. An individual is domiciled in the United States if the individual (a) is living in the United States and has the intention to remain in the United States indefinitely; or (b) has lived in the United States with such an intention and has not formed the intention to remain indefinitely in another country. In the case of a U.S. citizen who resided in a U.S. possession at the time of death, if the individual acquired U.S. citizenship solely on account of his birth or residence in a U.S. possession, that individual is not treated as a U.S. citizen or resident for estate tax purposes.\(^{13}\)

In addition to the estate and gift taxes, a separate transfer tax is imposed on certain "generation-skipping" transfers.

3. Special tax rules with respect to the movement of persons and property into or out of the United States

a. Individuals who relinquish U.S. citizenship with a principal purpose of avoiding U.S. tax

An individual who relinquishes his or her U.S. citizenship with a principal purpose of avoiding U.S. taxes is subject to an alternative method of income taxation for 10 years after expatriation under section 877.\(^{14}\) Under this provision, if the Treasury Department establishes that it is reasonable to believe that the expatriate's loss of U.S. citizenship would, but for the application of this provision, result in a substantial reduction in U.S. tax based on the expatriate's probable income for the taxable year, then the expatriate has the burden of proving that the loss of citizenship did not have as one of its principal purposes the avoidance of U.S. income, estate or gift taxes. Section 877 does not apply to resident aliens who terminate their U.S. residency.

The alternative method modifies the rules generally applicable to the taxation of nonresident aliens in two ways. First, the expatriate is subject to tax on his or her U.S. source income at the rates applicable to U.S. citizens rather than the rates applicable to other nonresident

\(^{13}\) Section 2209.

\(^{14}\) Treasury regulations provide that an individual's citizenship status is governed by the provisions of the Immigration and Nationality Act, specifically referring to the "rules governing loss of citizenship [set forth in] sections 349 to 357, inclusive, of such Act (8 U.S.C. 1481-1489)." Treas. Reg. section 1.1-1(c). Under the Immigration and Nationality Act, an individual is generally considered to lose U.S. citizenship on the date that an expatriating act is committed. The present-law rules governing the loss of citizenship, and a description of the types of expatriating acts that lead to a loss of citizenship, are discussed more fully below.
aliens. (Unlike U.S. citizens, however, individuals subject to section 877 are not taxed on any foreign source income.) Second, the scope of items treated as U.S. source income for section 877 purposes is broader than those items generally considered to be U.S. source income under the Code. For example, gains on the sale of personal property located in the United States, and gains on the sale or exchange of stocks and securities issued by U.S. persons, generally are not considered to be U.S. source income under the Code. However, if an individual is subject to the alternative taxing method of section 877, such gains are treated as U.S. source income with respect to that individual. The alternative method applies only if it results in a higher U.S. tax liability than would otherwise be determined if the individual were taxed as a nonresident alien.

Because section 877 alters the sourcing rules generally used to determine the country having primary taxing jurisdiction over certain items of income, there is an increased potential for such items to be subject to double taxation. For example, a former U.S. citizen subject to the section 877 rules may have capital gains derived from stock in a U.S. corporation. Under section 877, such gains are treated as U.S. source income, and are, therefore, subject to U.S. tax. Under the internal laws of the individual’s new country of residence, however, that country may provide that all capital gains realized by a resident of that country are subject to taxation in that country, and thus the individual’s gain from the sale of U.S. stock also would be taxable in his or her country of residence. If the individual’s new country of residence has an income tax treaty with the United States, the treaty may provide for the amelioration of this potential double tax.

Similar rules apply in the context of estate and gift taxation if the transferor relinquished U.S. citizenship with a principal purpose of avoiding U.S. taxes within the 10-year period ending on the date of the transfer. A special rule is applied to the estate tax treatment of any decedent who relinquished his or her U.S. citizenship within 10 years of death, if the decedent’s loss of U.S. citizenship had as one of its principal purposes a tax avoidance motive. Once the Secretary of the Treasury establishes a reasonable belief that the expatriate’s loss of U.S. citizenship would result in a substantial reduction in estate, inheritance, legacy and succession taxes, the burden of proving that one of the principal purposes of the loss of U.S. citizenship was not avoidance of U.S. income or estate tax is on the executor of the decedent’s estate.

In general, the estates of such individuals are taxed in accordance with the rules generally applicable to the estates of nonresident aliens (i.e., the gross estate includes all U.S.-situs property held by the decedent at death, is subject to U.S. estate tax at the rates generally applicable to the estates of U.S. citizens, and is allowed a unified credit of $13,000, as well as credits for State death taxes, gift taxes, and prior transfers). However, a special rule provides that the individual’s gross estate also includes his or her pro-rata share of any U.S.-situs property held through a foreign corporation in which the decedent had a 10-percent or greater voting interest, provided that the decedent and related parties together owned more than 50 percent of the voting power of the corporation. Similarly, gifts of intangible property having a situs within the United States (e.g., stocks and bonds) made by a nonresident alien who relinquished his or her U.S.

7 Section 2107.
citizenship within the 10-year period ending on the date of transfer are subject to U.S. gift tax, if the loss of U.S. citizenship had as one of its principal purposes a tax avoidance motive.\

b. **Aliens having a break in residency status**

A special rule applies in the case of an individual who has been treated as a resident of the United States for at least three consecutive years, if the individual becomes a nonresident but regains residency status within a three-year period. In such cases, the individual is subject to U.S. tax for all intermediate years under the section 877 rules described above (i.e., the individual is taxed in the same manner as a U.S. citizen who renounced U.S. citizenship with a principal purpose of avoiding U.S. taxes). The special rule for a break in residency status applies regardless of the subjective intent of the individual.

c. **Transfers to foreign corporations**

Certain transfers of property by shareholders to a controlled corporation are generally tax-free if the persons transferring the property own at least 80 percent of the corporation after the transfer. Also, in certain corporate reorganizations, including qualifying acquisitions and dispositions, shareholders of one corporation may exchange their stock or securities for stock or securities of another corporation that is a party to the reorganization without a taxable event except to the extent they receive cash or other property that is not permitted stock or securities. In these cases, a corporation may also transfer property to another corporation that is a party to the reorganization, without a taxable event except to the extent of certain non-permitted consideration. A liquidation of an 80-percent owned corporate subsidiary into its parent corporation is also generally tax-free.

Under the rules applicable to these types of transfers, property transferred to a corporation retains its basis, to the extent the transfer was tax-free, so that any appreciation (i.e., built-in gain) will be subject to tax if the property is subsequently sold by the recipient corporation. Similarly, a shareholder who exchanges stock of one corporation for stock of another retains his or her original basis so that a subsequent sale of the acquired stock can produce a taxable gain.

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\[1\] Section 2501(a)(3).

\[19\] Section 7701(b)(10).

\[20\] Section 351.

\[31\] Sections 368, 354, 356, and 361. (See also sec. 355.)

\[32\] Section 332.
Section 367 applies special rules, however, if property is transferred by a U.S. person to a foreign corporation in a transaction that would otherwise be tax-free under these provisions. These special rules are generally directed at situations where property is transferred to a foreign corporation, outside of the U.S. taxing jurisdiction, so that a subsequent sale by that corporation could escape U.S. tax notwithstanding the carryover basis of the asset. In some instances, such a transfer causes an immediate taxable event so that the generally applicable tax-free rules are overridden. In other instances, the taxpayer may escape immediate tax by entering a gain recognition agreement ("GRA") obligating the taxpayer to pay tax if the property is disposed of within a specified time period after the transfer. The GRA rules generally require the taxpayer to agree to file an amended return for the year of the original transfer if the property is disposed of by the transferee (including payment of interest from the due date of the return for the year of the original transfer to the time the additional tax under the agreement is actually paid following the disposition).

Section 367 also imposes rules directed at situations where a U.S. person has an interest in a foreign corporation, such as a controlled foreign corporation ("CFC") meeting specific U.S. shareholder ownership requirements, that could result in the U.S. person being taxed on its share of certain foreign corporate earnings. These rules are designed to prevent the avoidance of tax in circumstances where a reorganization or other nonrecognition transaction restructures the stock or asset ownership of the foreign corporation so that the technical requirements for imposition of U.S. tax on foreign earnings under the CFC or other rules are no longer met, which would result in potential for removing the earnings of the original CFC from current or future U.S. tax or changing the character of the earnings for U.S. tax purposes (e.g., from dividend to capital gain).

The rules of section 367 do not generally apply unless there is a transfer by a U.S. person to a foreign corporation, or unless a foreign corporation of which a U.S. person is a shareholder engages in certain transactions. Because an individual who expatriates is no longer a U.S. person, section 367 has no effect on actions taken by such individuals after expatriation. The Treasury Department has considerable regulatory authority under section 367 to address situations that may result in U.S. tax avoidance. For example, section 367(b) provides that any of certain tax-free corporate transactions that do not involve a transfer of property from a U.S. person (described in section 367(a)(1)) can be recharacterized as taxable "to the extent provided in regulations prescribed by the Secretary which are necessary or appropriate to prevent the avoidance of Federal income taxes." The legislative history of this provision suggests that it was directed principally at situations involving avoidance of U.S. tax on foreign earnings and profits, however the statutory language is quite broad and was provided in conjunction with the general rules taxing certain transfers by U.S. persons. Under the existing section 367 regulations and the relevant expatriation sections of the Code, a U.S. person who expatriates, even for a principal purpose of avoiding U.S. tax, may subsequently engage in transactions that involve the transfer of

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property to a foreign corporation without any adverse consequences under section 367, since expatriation (even for a principal purpose of tax avoidance) is not an event covered by section 367 or the current regulations under that section. Similarly, a U.S. person who has expatriated would not be considered a U.S. shareholder for purposes of applying the rules that address restructurings of foreign corporations with U.S. shareholders. By engaging in such a transaction, a taxpayer that has expatriated could transfer assets that would otherwise generate income which would be subject to tax under section 877 into a foreign corporation, thus transforming the income into non-U.S. source income not subject to tax under section 877. For example, under section 877, if a principal purpose of tax avoidance existed, an expatriate would be taxed for 10 years on any sale of U.S. corporate stock. However, after expatriation, the person would no longer be a U.S. person for purposes of section 367, and thus could transfer U.S. corporate stock to a foreign corporation controlled by the expatriate under section 351 without any section 367 effect. The foreign corporation could then sell the U.S. corporate stock within the 10-year period, but the gain would not be subject to U.S. tax.

In addition, the IRS or the Treasury Department might encounter difficulties enforcing a gain recognition agreement if a U.S. person who has entered into such an agreement to pay tax on a later disposition of an asset subject to the agreement and then expatriates. The GRA regulations contain provisions requiring security arrangements if a U.S. natural person who has entered an agreement dies (or if a U.S. entity goes out of existence) but these provisions do not apply if a U.S. natural person expatriates.24

Even if an individual is subject to the alternative taxing method of section 877 (because the person expatriated with a principal purpose of avoiding U.S. tax), section 877 does not impose a tax on foreign source income. Thus, such an individual could expatriate and subsequently transfer appreciated property to a foreign corporation or other entity beyond the U.S. taxing jurisdiction, without any U.S. tax being imposed on the appreciation under section 877.

Similar issues exist under section 1491. Section 1491 imposes a 35-percent tax on otherwise untaxed appreciation when appreciated property is transferred by a U.S. citizen or resident, or by a domestic corporation, partnership, estate or trust, to certain foreign entities in a transaction not covered by section 367. In some cases, taxpayers may elect to enter into a gain recognition agreement (rather than pay immediate tax) pursuant to section 1492.25 As in the case of section 367, an individual who has expatriated is no longer a U.S. citizen and may also no longer be a U.S. resident, thus a transfer by such a person would be unaffected by section 1491.

24 See, e.g., Temp. Treas. Reg. section 1.367(a)-3T(g)(9) and (10); Notice 87-85, 1987-2 C.B. 395.

25 See, e.g., PLR 9103033.
26 8 U.S.C. section 1481.

loss of citizenship has occurred to establish, by a preponderance of the evidence, that the loss occurred. Similarly, if a CLN has been issued, but the State Department later discovers that such issuance was improper (for example, because fraudulent documentation was submitted, or the requisite intent appears to be lacking), the State Department could initiate proceedings to revoke the CLN. If the recipient is unable to establish beyond a preponderance of the evidence that citizenship was lost on the date claimed, the CLN would be revoked. To the extent that the IRS believes a CLN was improperly issued, the IRS could present such evidence to the State Department and request that revocation proceedings be commenced. If it is determined that the individual has indeed committed an expatriating act, the date for loss of citizenship will be the date of the expatriating act.

A child under the age of 18 cannot lose U.S. citizenship by naturalizing in a foreign state or by taking an oath of allegiance to a foreign state. A child under 18 can, however, lose U.S. citizenship by serving in a foreign military or by formally renouncing citizenship, but such individuals may regain their citizenship by asserting a claim of citizenship before reaching the age of eighteen years and six months.

A naturalized U.S. citizen can have his or her citizenship involuntarily revoked if a U.S. court determines that the certificate of naturalization was illegally procured, or was procured by concealment of a material fact or by willful misrepresentation (for example, if the individual concealed the fact that he served as a concentration camp guard during World War II). In such cases, the individual's certificate of naturalization is cancelled, effective as of the original date of the certificate; in other words, it is as if the individual were never a U.S. citizen at all.

2. United States immigration and visas

In general, a non-U.S. citizen who enters the United States is required to obtain a visa. An immigrant visa (also known as a "green card") is issued to an individual who intends to relocate to the United States permanently. Various types of nonimmigrant visas are issued to individuals who come to the United States on a temporary basis and intend to return home after a certain period of time. The type of nonimmigrant visa issued to such individuals is dependent upon the purpose of the visit and its duration. An individual holding a nonimmigrant visa is

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28 8 U.S.C. sec. 1481(b).


30 Under the Visa Waiver Pilot Program, nationals of most European countries are not required to obtain a visa to enter the United States if they are coming as tourists and staying a maximum of 90 days. Also, citizens of Canada, Mexico, and certain islands in close proximity to the United States do not need visas to enter the United States, although other types of travel documents may be required.
prohibited from engaging in activities that are inconsistent with the purpose of the visa (for example, an individual holding a tourist visa is not permitted to obtain employment in the United States).

Foreign business people and investors often obtain "E" visas to come into the United States. Generally, an "E" visa is initially granted for a one-year period, but it can be routinely extended for additional two-year periods. There is no overall limit on the amount of time an individual may retain an "E" visa. There are two types of "E" visas: an "E-1" visa, for "treaty traders" and an "E-2" visa, for "treaty investors". To qualify for an "E-1" visa, an individual must be a national of a country that has a treaty of trade with the United States, and must be coming to the United States solely to engage in substantial trade principally between a U.S. entity and a foreign-based company (i.e., over 50 percent of the individual's business must be between the United States and the foreign country). Trade includes the import and export of goods or services. At least 50 percent of the foreign-based company must be owned by nationals of that country, and at least 50 percent of the shareholders must either live abroad, or have an "E-1" visa and live in the United States (thus, an individual holding a "green card" would not be counted). To qualify for an "E-2" visa, an individual (and, if the individual is not himself making the investment, the major shareholders of the company of which he is an executive, manager, or essential employee) must be a national of a country that has a treaty investor agreement with the United States, and the individual (or the company) must be coming to the United States solely to develop and direct the operations of an enterprise in which the individual (or the company) has invested, or is actively in the process of investing, a substantial amount of capital.

3. Relinquishment of green cards

There are several ways in which a green card can be relinquished. First, an individual who wishes to terminate his or her permanent residency may simply mail his or her green card back to the INS. Second, an individual may be involuntarily deported from the United States (through a judicial or administrative proceeding), and the green card must be relinquished at that time. Third, a green card holder who leaves the United States and attempts to re-enter more than a year later may have his or her green card taken away by the INS border examiner, although the individual may appeal to an immigration judge to have the green card reinstated. A green-card holder may permanently leave the United States without relinquishing his or her green card, although such individuals would continue to be taxed as U.S. residents.31

31 Section 7701(b)(6)(B) provides that an individual who has obtained the status of residing permanently in the United States as an immigrant (i.e., an individual who has obtained a green card) will continue to be taxed as a lawful permanent resident of the United States until such status is revoked, or is administratively or judicially determined to have been abandoned.
III. SUMMARY OF THE JOINT COMMITTEE ON TAXATION STUDY OF EXPATRIATION TAX ISSUES

In the course of analyzing the Administration and other proposals relating to the tax treatment of U.S. citizens who relinquish their citizenship and long-term U.S. residents who give up their U.S. residency, the Joint Committee staff reached the following findings and conclusions in its June 1, 1995 report:

- Since 1980, an average of 781 U.S. citizens expatriated each year. Since 1962, the average number of U.S. citizens expatriating each year has been 1,146. In 1994, 858 U.S. citizens expatriated. Although there is some anecdotal evidence that a small number of U.S. citizens may be expatriating to avoid continuing to pay U.S. tax and the amount of potential tax liability involved in any individual case could be significant, the Joint Committee staff found no evidence that the problem is either widespread or growing. However, certain practitioners have indicated that they believe that present law is not a significant impediment to expatriation even if minimizing U.S. taxes is a purpose of such expatriation. Certain changes could be made to present law to strengthen its impact on those expatriating for tax avoidance purposes without also negatively impacting those Americans who expatriate for nontax reasons.

- Present-law section 877 imposes U.S. income tax on the U.S. assets of U.S. citizens who expatriate for tax avoidance purposes. The Joint Committee staff has identified certain problems with the present-law provisions, including the following:
  - There are legal methods to avoid some or all taxation under section 877 through proper tax planning.
  - Section 877 is ineffective with respect to individuals who relocate to certain countries with which the United States has a tax treaty because these treaties may not permit the United States to impose a tax on its former citizens who are residents in such other countries.
  - Section 877 only applies to U.S. source assets and careful tax planning can be used to relocate appreciated assets outside the United States and, therefore, outside the scope of section 877.

- The Administration believes that section 877 is unadministrable because it is difficult to demonstrate that tax avoidance is a principal reason for expatriation. However, it appears that neither the current Administration nor past administrations has ever undertaken any systematic effort to enforce the provisions of section 877. No regulations have been issued under section 877 since its enactment in 1966. The IRS has litigated the tax avoidance motive issue under section 877 in only two cases and has won one of those cases.
The Administration proposal would eliminate the intent test currently applicable under section 877 and would apply an objective test that would impose tax on U.S. citizens who expatriate as if the expatriating individual had sold all of his or her assets.

The Administration proposal to impose a new tax regime of much broader scope than present-law section 877 raises a number of issues, including the following:

- The Administration proposal affects more individuals than intended. The Administration proposal has been justified on two grounds. First, the Administration has stated that it is appropriate to collect U.S. tax with respect to those individuals who have enjoyed the benefits of U.S. citizenship (e.g., traveling on a U.S. passport) or with respect to U.S. citizens and long-term residents whose assets have enjoyed the protection of being within U.S. borders. Second, some have argued that certain U.S. citizens are relinquishing their citizenship, but are maintaining a significant continuing relationship with the United States. However, the Administration proposal would affect U.S. citizens who have lived abroad their entire lives and have very tenuous ties to the United States. In addition, it would affect expatriates who sever all ties with the United States.

- The Administration proposal would require all U.S. citizens to pay a tax on unrealized gains on their assets upon expatriation. Gains would be taxed to the extent they are in excess of $600,000 ($1.2 million in the case of married individuals filing a joint return, both of whom expatriate). This tax on unrealized gains is inconsistent with the normative U.S. income tax system of imposing tax only on recognized gains. Although the Administration has stated that the tax would be imposed generally in the case of U.S. citizens with assets in excess of $5 million, the key determinant of whether the tax is imposed is the amount of the taxpayer's unrealized gains; thus, taxpayers with low-basis assets would pay the tax even if their total assets are well below $5 million, while taxpayers with high basis assets may pay little or no tax even though they own assets worth substantially more than $5 million.

- The Administration proposal would impose tax on all expatriates and long-term residents who relinquish their U.S. residence without regard to a taxpayer's motivation. Thus, the Administration proposal would impose tax on U.S. citizens or residents who (1) are expatriating for purely nontax reasons, (2) have long-term dual citizenship with another country (e.g., their country of birth or ancestry) to which they are returning, or (3) have tenuous ties to the United States (e.g., an individual who did not even realize that he or she was a U.S. citizen).

- The Administration proposal would apply to long-term U.S. residents who relinquish their U.S. residence. It will be difficult to determine when U.S.
residence is relinquished because there are no specific acts that must be taken to give up U.S. residency status.

- A number of practical problems are raised by the Administration proposal to tax unrealized gains (i.e., effectively to mark to market interests in property) upon expatriation. These issues may be summarized as (1) identifying the owner of the interest in property (identity problems), (2) raising sufficient funds from the interests in property to pay the tax (liquidity problems), and (3) valuing the interests in property (valuation problems). The problems are often related -- something that makes it difficult to determine who owns an interest in property often makes that interest very illiquid, which, in turn, may make valuing the interest more difficult. These problems are especially difficult in the case of interests held through trusts because expatriating beneficiaries would be subject to a tax liability determined by reference to the unrealized appreciation in value of the trust's assets notwithstanding the fact that the beneficiary has no access to the assets of the trust. This particular aspect of the proposal raises potential constitutional issues at least under certain circumstances. Moreover, under certain circumstances, the tax might inappropriately interfere with the right to expatriate which is recognized by U.S. and international law.

- The Administration proposal may retroactively impose tax on former U.S. citizens who lost their citizenship years ago. U.S. citizenship is lost by performing certain acts of expatriation (for example, by formally renouncing U.S. citizenship or by being naturalized in a foreign country). These acts of expatriation may have occurred many years prior to announcement of the Administration proposal, but the individual might have never gone through the process of recording that loss with the U.S. government through acquisition of a certificate of loss of nationality from the State Department. If such an individual were to apply for a certificate of loss of nationality on or after February 6, 1995, the Administration proposal would subject such an individual to the proposed tax. It is unclear whether the United States would have any legal basis for attempting to collect tax in such a case since the individual has lost all rights and responsibilities of U.S. citizenship many years earlier.

- The Administration proposal would have a retroactive effect on U.S. long-term residents who have been in the United States for more than 8 years and who have had no notice that they would be taxed on unrealized gains upon departure from the United States.

- The Administration proposal may subject to tax assets that have no relationship with the United States. For example, the proposal would subject to tax assets held by long-term residents of the United States that were acquired outside the United States and were never brought into the United States. Under the Administration
proposal, the tax imposed not only would apply to the appreciation in value of an asset during the period of U.S. residence, but could also apply to all appreciation in value. (The proposal does permit an individual to elect for all assets to use fair market value on the date an individual became a resident of the United States solely for purposes of determining gain upon the deemed disposition of such assets.)

- Enactment of the Administration proposal may create an incentive to expatriate which does not exist under current law for individuals who either have recently inherited wealth or who expect to inherit wealth in the near future, because the basis of inherited assets is stepped up to the fair market value of the assets on the date of the decedent's death, and thus there would be little or no expatriation tax imposed on such assets. At the same time, the long-term tax savings from eliminating exposure to the U.S. tax system could be extraordinary. This problem may be particularly significant because certain anecdotal evidence suggests that the limited class of wealthy U.S. citizens who may have expatriated for tax avoidance purposes involves, in large part, second and third generation wealth.

- The Senate amendment to H.R. 831 and the bills introduced by Senator Moynihan (S. 700) and Representative Gibbons (H.R. 1535) address some, but not all, of the issues raised by the Administration proposal.

- If the Congress determines that present-law section 877 should be modified, there are alternatives to the Administration proposal that may be more appropriate. In evaluating such alternatives, the following issues should be considered:

  - What is the underlying rationale for the proposal? In other words, is the proposal intended to collect U.S. taxes that would otherwise be paid by individuals who do not really sever their ties with the United States? If so, is it intended to collect the equivalent amount of income taxes, estate taxes, or both? Or, is the proposal intended to impose a tax to recoup the benefits of U.S. citizenship or residence?

  - What is the appropriate class of individuals to whom the proposal should be applied given the rationale for the proposal?

  - How can the proposal be structured so as not to impose a new tax regime retroactively on individuals who structured their holdings of assets in reliance upon present law?
Does the proposal impose a tax that is fair in relation to its goals? Is the tax imposed consistent with the U.S. normative system of taxation or is it an extraordinary tax? If it is an extraordinary tax, are there alternatives that would be more consistent with the way in which the United States taxes its citizens and residents?

Can a modification to present law be structured so as to not create an incentive to expatriate for those with recently inherited wealth?

In the course of studying the issue of the appropriate tax treatment of U.S. citizens and long-term residents who relinquish citizenship or residence, the Joint Committee staff also obtained information from the IRS on the tax return filings of U.S. citizens who reside outside the United States. It is estimated that there are currently 2.5 million U.S. citizens (not including U.S. government employees and U.S. military personnel and their families) who reside outside the United States. The most recent figures indicate that only approximately 1 million taxpayers annually file Form 1040 (U.S. Individual Income Tax Return) and included in this 1 million figure are U.S. government and military personnel residing abroad. Although many U.S. citizens residing outside the United States may be entitled to foreign tax credits that would reduce the amount of U.S. income taxes owed, it appears that the failure of these taxpayers to file annual income tax returns represents a continuing compliance problem that should be explored further.
IV. PROPOSALS TO MODIFY TAX TREATMENT OF U.S. CITIZENS AND RESIDENTS WHO RELINQUISH CITIZENSHIP OR RESIDENCE

A. Administration's Fiscal Year 1996 Budget Proposal (H.R. 981 and S. 453)

In general

The Administration proposal to modify the tax treatment of U.S. citizens and residents who relinquish their U.S. citizenship or residence was transmitted to the Congress in conceptual form in the President's fiscal year 1996 budget proposal on February 6, 1995. The statutory language of the proposal was included in the revenue provisions of the Administration's fiscal year 1996 budget proposal that was introduced (by request) in the House (in H.R. 981) and the Senate (in S. 453) on February 16, 1995. Under the Administration proposal, U.S. citizens who relinquish their U.S. citizenship and certain long-term resident aliens who terminate their U.S. residency generally would be treated as having sold all of their property at fair market value immediately prior to the expatriation or cessation of residence. Gain or loss from the deemed sale would be recognized at that time, generally without regard to other provisions of the Code. Any net gain on the deemed sale would be recognized to the extent it exceeds $600,000 ($1.2 million in the case of married individuals filing a joint return, both of whom expatriate).

Property taken into account

Assets within the scope of the proposal generally would include all property interests that would be included in the individual's gross estate under the Federal estate tax if such individual were to have died on the day of the deemed sale, plus any interest the individual holds as a beneficiary of a foreign or domestic trust that is not otherwise included in the gross estate (see "Interests in trusts", below), and other interests that could be specified by the Treasury Department to carry out the purposes of the provision. U.S. real property interests, which remain subject to U.S. taxing jurisdiction in the hands of nonresident aliens, generally would be excepted from the proposal. An exception would apply to interests in qualified retirement plans and, subject to a limit of $500,000, interests in certain foreign pension plans. The IRS would be authorized to allow a taxpayer to defer, for a period of no more than five years, payment of the tax attributable to the deemed sale of a closely-held business interest (as defined in present-law sec. 6166(b)).

32 See the discussion of the application of the Code's income exclusions under "Other special rules" below.

33 The exception would apply to all U.S. real property interests, as defined in section 897(c)(1), except the stock of a United States real property holding company that does not satisfy the requirements of section 897(c)(2) on the date of the deemed sale.
**Interests in trusts**

Under the Administration proposal, any trust interest held by an expatriating individual would be deemed to be sold immediately prior to the expatriation. This provision would require that trust interests be valued specifically for this purpose. For example, a trust instrument may provide that one individual (the "income beneficiary") is entitled to receive the income from the trust assets for the next 10 years, at which time the trust will terminate and another individual (the "remainderman") will be entitled to receive the assets. If either the income beneficiary or the remainderman expatriates, a value would need to be placed on their respective interests, and the expatriate would be subject to tax on the value of the expatriate's interest. It is unclear in this context what value would be placed on a nontransferable interest in a trust (e.g., a "spendthrift" trust that prohibits the trust beneficiary from assigning or transferring the trust interest). If nontransferable interests were to be valued at zero (because they cannot be sold), they would not be taxed under the proposal, thus rendering the proposal inapplicable with respect to such interests. An additional issue is raised by the fact that the trust instrument is not likely to provide the beneficiaries with access to the trust assets in order to pay the tax. Therefore, in many cases, the resulting tax liability could exceed the assets available to the beneficiary to pay the tax.

A beneficiary's interest in a trust would be determined on the basis of all facts and circumstances. These include the terms of the trust instrument itself, any letter of wishes or similar document, historical patterns of trust distributions, the role of any trust protector or similar advisor, and anything else of relevance. Under the Administration proposal, the Treasury Department would be expected to issue regulations providing guidance as to the determination of trust interests for purposes of the expatriation tax, and such regulations would be expected to disregard de minimis interests in trusts, such as an interest of less than a certain percentage of the trust as determined on an actuarial basis, or a contingent remainder interest that has less than a specified likelihood of occurrence. In the event that any beneficiaries' interests in the trust could not be determined on the basis of the facts and circumstances, the beneficiary with the closest degree of family relationship to the settlor would be presumed to hold the remaining interests in the trust. Each beneficiary would be required to disclose on his or her tax return the methodology used to determine that beneficiary's interest in the trust, and whether that beneficiary knows (or has reason to know) that any other beneficiary of the trust uses a different method.

For purposes of this provision, grantor trusts would continue to be treated as under present law—the grantor of the trust would be treated as the owner of the trust assets for tax purposes. Therefore, a grantor who expatriates would be treated as selling the assets held by the trust for purposes of computing the tax on expatriation. Correspondingly, a beneficiary of a grantor trust who is not treated as an owner of the trust (or any portion thereof) under the grantor trust rules would not be considered to hold an interest in the trust for purposes of the expatriation tax.
Date of relinquishment of citizenship

Under the Administration proposal, a U.S. citizen would be treated as having relinquished his citizenship on the date that the State Department issues a CLN, even though the individual may have ceased to be a U.S. citizen at a substantially earlier date. In cases where a naturalized U.S. citizen has his or her naturalization revoked (e.g., where the naturalization was obtained illegally, through the concealment of a material fact, or by willful misrepresentation), the individual would be treated as relinquishing citizenship on the date that a U.S. court cancels the certificate of naturalization, even though, for all other purposes, the individual would not be considered to have ever been a U.S. citizen. These new definitions of when citizenship is deemed to be relinquished for tax purposes would also apply in determining when an expatriating individual ceases to be taxed as a U.S. citizen. Under the Administration proposal, an expatriating individual would be subject to U.S. tax as a citizen of the United States until a CLN is issued or a certificate of naturalization is revoked, regardless of when citizenship has actually been lost through the commission of an expatriating act.34

Long-term residents who terminate their U.S. residency

Under the Administration proposal, the tax on expatriation would apply to certain "long-term residents" who terminate their residency in the United States. A long-term resident would be any individual who has been a lawful permanent resident of the United States (i.e., a "green card" holder) in at least 10 of the prior 15 taxable years.35 For this purpose, any year in which the individual was taxed as a resident of another country under a treaty tie-breaker rule would not be considered.36 The proposal would not apply to individuals who were treated as U.S. residents under the "substantial presence" test, regardless of the amount of time the individual was present in the United States.

34 As drafted, there is some uncertainty as to how the Administration proposal would affect an individual who had committed an expatriating act prior to February 6, 1995, but who never applies for a CLN. To the extent the State Department eventually does issue a CLN with respect to the individual (whether upon the State Department's initiative or upon the individual's request), the individual clearly would be covered by the new provisions.

35 If a long-term resident surrenders his green card, such a person may still be treated as a resident for U.S. income tax purposes if he has a "substantial presence" within the United States. (See sec. 7701(b)(3).) The proposal would not apply so long as such a person continues to be treated as a tax resident under the substantial-presence test.

36 Most treaties include "tie-breaker" rules for determining the residency of an individual who would otherwise be considered to be a resident of both the U.S. and the treaty partner under the internal laws of each country. In general, these tie-breaker rules provide that an individual will be taxed as a resident of only one country, based on factors such as the country in which the individual has a permanent home or closer personal and economic ties.
Solely for purposes of this provision of the Administration proposal, a special election would permit long-term residents to determine the tax basis of certain assets using their fair market value at the time the individual became a U.S. resident, rather than their historical cost. The election, if made, would apply to all assets within the scope of the proposal that were held on the date the individual first became a U.S. resident and the fair market value would be determined as of such date.

A long-term resident who terminates his or her U.S. residency would be subject to the Administration proposal at the time the individual ceases to be taxed as a resident of the United States (as determined under present law).

Other special rules

Under the Administration proposal, the tax on expatriation generally would apply notwithstanding other provisions of the Code. For example, gain that would be eligible for nonrecognition treatment if the property were actually sold would be treated as recognized for purposes of the tax on expatriation. Also, the exclusions from gross income generally provided to bona fide residents of U.S. possessions or commonwealths (e.g., secs. 931 and 933) would not be applicable for purposes of calculating the expatriation tax.\(^3\)

Other special rules of the Code would affect the characterization of amounts treated as realized under the Administration proposal. For example, in the case of stock in a foreign corporation that was a CFC at any time during the five-year period ending on the date of the deemed sale, the gain recognized on the deemed sale would be included in the shareholder's income as a dividend to the extent of certain earnings of the foreign corporation.\(^3\)

Under the Administration proposal, any period during which recognition of income or gain generally is deferred would terminate on the date of the relinquishment, causing any deferred U.S. tax to become due and payable. For example, where an individual has disposed of certain property in a transaction for which deferral is conditioned on the purchase of certain replacement property (e.g., property that qualifies for like-kind exchange treatment under sec. 1031 or that qualifies as a principal residence under sec. 1034), but has not yet acquired the replacement property, the relevant period in which to acquire any replacement property would be deemed to terminate upon expatriation and the individual would be taxed on the gain from the original sale.

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\(^3\) Native-born residents of U.S. territories and possessions are citizens of the United States, thus it was not intended that the provision be "mirrored" for application in the U.S. territories and possessions that employ the mirror code. However, a rule could be provided to extend the Administration proposal to long-term residents of U.S. territories or possessions who are not citizens of the United States.

\(^3\) See section 1248.
Under the Administration proposal, the present-law provisions with respect to individuals who expatriate with a principal purpose of avoiding tax (sec. 877) and certain aliens who have a break in residency status (sec. 7701(b)(10)) would not apply to any individual who is subject to the new expatriation tax provisions. The special estate and gift tax provisions with respect to individuals who expatriate with a principal purpose of avoiding tax (secs. 2107 and 2501(a)(3)), however, would continue to apply.

The Administration proposal authorizes the Treasury Department to issue regulations necessary to carry out the purposes of the provision.

**Effective date**

The Administration proposal would be effective for U.S. citizens who obtain a CLN, or have a certificate of naturalization cancelled, on or after February 6, 1995 (regardless of when the individual actually lost his or her U.S. citizenship), and for long-term residents who terminate their U.S. residency on or after February 6, 1995. Present law would continue to apply to U.S. citizens who obtained a CLN prior to February 6, 1995, and to long-term residents who terminated their residency prior to February 6, 1995.

**B. Senate Amendment to H.R. 831**

**In general**

The Senate amendment to H.R. 831 ("the Senate bill") adopted a modified version of the Administration proposal with respect to the taxation of U.S. citizens and residents who relinquish their citizenship or residency. The Senate bill modified the Administration proposal in several ways. First, the Senate bill applies the expatriation tax only to U.S. citizens who relinquish their U.S. citizenship, not to long-term resident aliens who terminate their U.S. residency. Second, the Senate bill modifies the date when an expatriating citizen is treated as relinquishing their citizenship, such that most expatriating citizens are treated as relinquishing their citizenship at an earlier date than under the Administration proposal. The Senate bill also makes some technical modifications to the Administration proposal, including a provision to prevent double taxation in the case of certain property that remains subject to U.S. tax jurisdiction.

**Property taken into account: Interests in trusts**

The types of property that would be taken into account in determining the tax liability of an expatriate under the Senate bill generally are the same as under the Administration proposal.

39 The Senate amendment to H.R. 831 was not included in the conference agreement on H.R. 831, nor as the bill was enacted (P.L. 104-7, signed by the President on April 11, 1995). Instead, the enacted legislation included a requirement that the staff of the Joint Committee on Taxation complete a study of the expatriation tax issues by June 1, 1995.
The rules with respect to interests in trusts, however, are modified in the Senate bill. Under the Administration proposal, an individual holding an interest in a trust would be deemed to have sold that trust interest immediately prior to expatriation. Under the Senate bill, a beneficiary's interest in a trust would be determined in the same manner as under the Administration proposal. However, a trust beneficiary would be deemed to be the sole beneficiary of a separate trust consisting of the assets allocable to his or her share of the trust, in accordance with his or her interest in the trust. The separate trust would be treated as selling its assets for fair market value immediately before the beneficiary relinquishes his or her citizenship, and distributing all resulting income and corpus to the beneficiary. The beneficiary would be treated as subsequently recontributing the assets to the trust. Consequently, the separate trust's basis in the assets would be stepped up and all assets held by the separate trust would be treated as corpus. The Senate bill also adds a constructive ownership rule with respect to a trust beneficiary that is a corporation, partnership, trust or estate. In such cases, the shareholders, partners or beneficiaries of the entity that is the trust beneficiary would be deemed to be the direct beneficiaries of the trust for purposes of applying these provisions.

Date of relinquishment of citizenship

Under the Administration proposal, an individual would be deemed to have lost U.S. citizenship on the date that a CLN is issued by the State Department or a certificate of naturalization is canceled by a court. The Senate bill would modify these rules to treat an individual as relinquishing his or her citizenship on an earlier date, specifically, the date that the individual first presents himself or herself to a diplomatic or consular officer of the United States as having voluntarily relinquished citizenship through the performance of an expatriating act. Under the Senate bill, a U.S. citizen who relinquishes citizenship by formally renouncing his or her U.S. nationality before a diplomatic or consular officer of the United States would be treated as having relinquished citizenship on that date, provided that the renunciation is later confirmed by the issuance of a CLN. (For these individuals, the date on which the individual would be deemed to lose his or her citizenship for tax purposes is the same as the date on which the individual has actually lost such citizenship under existing U.S. law.) A U.S. citizen who furnishes to the State Department a signed statement of voluntary relinquishment of U.S. nationality confirming the performance of an expatriating act would be treated as having relinquished his or her citizenship on the date the statement is so furnished (regardless of the date of performance of the expatriating act that caused the actual loss of U.S. citizenship to occur), provided that the voluntary relinquishment is later confirmed by the issuance of a CLN. If neither of these circumstances exist, the individual would be treated as having relinquished citizenship on the date the CLN is issued.

40 Section 349(a)(5) of the Immigration and Nationality Act (8 U.S.C. sec. 1481(a)(5)) provides for the relinquishment of citizenship through renunciation.

41 The Senate bill would apply to any expatriating act specified in section 349(a)(1) - (4) of the Immigration and Nationality Act (8 U.S.C. sec. 1481(a)(1) - (4)).
issued, or a certificate of naturalization is cancelled, regardless of when the individual actually lost U.S. citizenship. Under the Senate bill, it is anticipated that an individual who has formally renounced his or her citizenship or furnished a signed statement of voluntary relinquishment (but has not received a CLN from the State Department by the date on which he or she is required to file a tax return covering the year of expatriation) would file his or her U.S. tax return as if he or she had expatriated.

**Administrative requirements**

Under the Senate bill, an expatriating individual subject to the expatriation tax would be required to pay a tentative tax equal to the amount of tax that would have been due for a hypothetical short tax year ending on the date the individual is deemed to have relinquished his citizenship. The tentative tax would be due on the 90th day after the date of the deemed relinquishment. The individual also would be required to file a tax return for the entire tax year during which he or she expatriated reporting all of his or her taxable income for the year, including gain attributable to the deemed sale of assets on the date of expatriation. The individual's U.S. Federal income tax liability for such year would be reduced by the tentative tax paid with the filing of the hypothetical short-year return.

The Senate bill provides that the time for the payment of the tax on expatriation could be extended for up to 10 years at the request of the taxpayer, using the rules applicable to estate tax payments provided by section 6161. It is expected that a taxpayer's interest in non-liquid assets, such as an interest in a closely-held business interest (as defined in section 6166(b)), would be taken into account in determining reasonable cause for the extension of time to pay the tax on expatriation.

42 As under the Administration proposal, there is some uncertainty as to how the Senate bill would affect an individual who committed an expatriating act prior to February 6, 1995, but who never executed a formal renunciation of citizenship, signed a statement of voluntary relinquishment, or obtained a CLN.

43 Thus, the tentative tax is based on all the income, gain, deductions, loss and credits of the individual for the year through the date of the deemed relinquishment, including amounts realized from the deemed sale of property. The tentative tax is deemed to be imposed immediately before the individual is deemed to have relinquished citizenship.

44 Under these rules, if reasonable cause is shown, the IRS may grant an extension for the payment of estate taxes for a reasonable period, not to exceed 10 years, from the date the payment is due. If such an extension is granted, interest continues to run, but there would be no penalties imposed for late payment. Section 6166 further provides that the estate tax attributable to certain closely-held business interests may be paid over a 14-year period.
If the expatriating individual and the Treasury Department agree to defer payment of the tax on expatriation for a period that extends beyond the filing date for the full-year tax return for the year of expatriation, the individual would not be required to pay a tentative tax. The entire gain on the deemed sale of property on the date of expatriation would be included in the individual's full-year tax return for that year, and would be paid in accordance with the provisions of the deferred-tax agreement under section 6161. It is expected that the Treasury Department would not agree to defer payment of the tax on expatriation unless the taxpayer provides adequate assurance that all amounts due under the agreement will be paid.

**Other special rules**

The "other special rules" included in the Administration proposal are also included in the Senate bill. In addition, the Senate bill clarifies that any portions of a gain that would qualify for the specific income exclusions of sections 101-137 (Subtitle A, Chapter 1B, Part III) of the Code would not be treated as realized under the provisions of the expatriation tax. In addition to giving the Treasury Department general regulatory authority, the Senate bill also provides specific authority to issue regulations to permit a taxpayer to allocate the taxable gain on the deemed sale (net of any applicable exclusion) to the basis of the assets taxed under this provision, thereby preventing double taxation if the assets remain subject to U.S. tax jurisdiction.

**Effective date**

The provision in the Senate bill would be effective for U.S. citizens who are deemed to have relinquished their U.S. citizenship on or after February 6, 1995 (i.e., individuals who first made their loss of U.S. citizenship known to a U.S. government or consular official after this date). The tentative tax would not be required to be paid until 90 days after the date of enactment of the bill.

Present law would continue to apply to U.S. citizens who are deemed to have relinquished their citizenship prior to February 6, 1995 (i.e., individuals who first made their loss of U.S. citizenship known to a U.S. government or consular official prior to this date).

**C. Modified Bills Introduced by Senator Moynihan (S. 700) and Representative Gibbons (H.R. 1535)**

Senator Moynihan introduced S. 700 on April 6, 1995. Representative Gibbons introduced an identical bill, H.R. 1535, on May 2, 1995. These bills (the "modified bills") make several changes to the Administration proposal as incorporated in the Senate amendment to H.R. 831.
Long-term residents who terminate their U.S. residency

The modified bills would apply the tax on expatriation to "long-term residents" who terminate their residency in a manner similar to the provision included in the Administration proposal. Under the modified bills, a long-term resident is an individual who has been a lawful permanent resident of the United States (i.e., a green-card holder) in at least 8 of the prior 15 taxable years. (In contrast, the Administration proposal defines a long-term resident as one who had been a lawful permanent resident for at least 10 of the prior 15 taxable years.) As under the Administration proposal, for purposes of satisfying the 8-year threshold, taxable years for which an individual was a resident of another country under a treaty tie-breaker rule would be disregarded. The tax on expatriation would apply to a long-term resident when (1) the individual is no longer treated as a lawful permanent resident of the United States as that term is defined in section 7701(b)(6), or (2) the individual is treated as a resident of another country under the tie-breaking provisions of a U.S. income tax treaty (and the individual does not elect to waive treaty benefits). Long-term residents who terminate their residency status would be treated as "expatriates" for purposes of applying the tax on expatriation.

Fair market value basis adjustment

Under the modified bills, a nonresident alien individual who becomes a citizen or resident of the United States would be required to utilize a fair market value basis, rather than an historical cost basis, in determining any subsequent gain or loss on the disposition of any property held on the date the individual became a U.S. citizen or resident. The fair market value basis would be equal to the fair market value of the property on the earlier of: (1) the date the individual first became a U.S. citizen or resident, or (2) the date the property first became subject to U.S. tax because it was used in a U.S. trade or business or was a U.S. real property interest. The fair market value basis would apply for all purposes of computing gain or loss on actual or deemed dispositions (not just for purposes of "the tax on expatriation"), but would not apply for purposes of computing depreciation. This provision would apply only to individuals; it would not apply to a foreign trust that becomes a domestic trust.

An individual would be able to make an irrevocable election not to have the fair market value provision apply to any specified property, solely for purposes of determining gain with respect to that property. Thus, for any property with respect to which the election is made, the taxpayer's gain upon disposition would be determined based on the historical cost of the property. This election would not be available to claim a loss on the disposition of the property. These rules could produce anomalous results. For example, assume that an individual purchased a nondepreciable asset for $100, and that when the individual first became a U.S. resident, the fair market value of the asset was $50. If the asset is later sold for $90, the individual would be required to recognize a gain of $40, since the historical cost election cannot be used to claim a loss. If the asset is instead sold for $101, however, the individual could make the historical cost election and recognize a gain of only $1.
Election for expatriate to be treated as a U.S. citizen

The modified bills would allow an expatriating individual to irrevocably elect, on an asset-by-asset basis, to continue to be taxed as a U.S. citizen with respect to such assets. Under such election, the expatriate would continue to pay U.S. income taxes following expatriation on any income generated by the asset and on any gain realized on the disposition of the asset, as well as any excise tax imposed with respect to the asset (see, e.g., sec. 1491). In addition, the asset would continue to be subject to U.S. gift, estate, and generation-skipping transfer taxes. However, the amount of any transfer tax so imposed would be limited to the amount of income tax that would have been due if the property had been sold for its fair market value immediately before the transfer or death, taking into account any remaining portion of the expatriate’s $600,000 exclusion. To make this election, the taxpayer would be required to waive treaty benefits with respect to the specified assets. If an individual elects to be subject to U.S. taxes after expatriation with respect to certain assets, a double taxation issue could arise if the expatriate’s new country of residence also imposes a tax on income realized from those assets; however, in most cases there would be no double taxation because the individual would be entitled to a foreign tax credit with respect to the taxes imposed by the non-source country. An expatriating individual would be required to provide security to ensure payment of the tax under this election in such form, manner, and amount as the Secretary of the Treasury would require.

Interests in trusts

In general, the modified bills use the same rules with respect to determining interests in trusts as those provided in the Senate amendment to H.R. 831. However, the bills would modify the special rule for determining the ownership of an interest in a trust where ownership cannot be determined based on the general facts and circumstances test. In such cases, any remaining interests would be allocated to the grantor, if the grantor is a beneficiary of the trust. Otherwise, the ownership of the trust interest would be based on the rules of intestate succession. (The Administration proposal and the Senate bill provided that, in cases where the beneficiaries’ interests could not be determined based on the facts and circumstances test, they would be determined based on the beneficiary’s degree of family relationship to the settlor.)

Other special rules

Relinquishment of citizenship by certain minors

Under the modified bills, the tax on expatriation would not apply to an individual who relinquishes U.S. citizenship before attaining the age of 18-1/2 years, if the individual lived in the United States for less than five taxable years (as defined under the substantial presence test of sec. 7701(b)(1)(A)(ii)) before the date of relinquishment.
Deferral of tax on expatriation where estate taxes would be deferred

The modified bills provide that the time for the payment of the tax on expatriation could be deferred to the same extent, and in the same manner, as any estate taxes may be deferred under the present-law provisions of section 6161 (without regard to the 10-year limitation of that section). In addition, the tax on expatriation could be deferred on interests in closely-held businesses as provided in present law section 6166. Moreover, the tax on expatriation could be deferred for reversionary or remainder interests in property as provided in section 6153. Finally, payment of tax liability could be deferred under section 6159 to facilitate the collection of tax liabilities.

Method of providing security

The modified bills provide that, if a taxpayer is required to provide security under the expatriation tax provisions, the Secretary of the Treasury could consider the rules with respect to qualified domestic trusts set forth in section 2056A (requiring that assets be contributed to a trust with a responsible U.S. trustee). If an expatriating individual is a beneficiary of a trust, and the beneficiary elects to defer payment of the tax on expatriation with respect to the trust interest, a U.S. trustee of that trust would be required to provide security if the beneficiary provides actual notice of such requirement to the domestic trustee.

Coordination with estate and gift tax imposed upon certain expatriations

Under the modified bills, the tax on expatriation would be allowed as a credit against any U.S. estate or gift taxes subsequently imposed on the same property solely by reason of the special rules imposing an estate or gift tax on property transferred by an individual who relinquished his U.S. citizenship with a principal purpose of avoiding U.S. taxes within 10 years prior to the transfer (i.e., the tax imposed under present-law secs. 2107 and 2501(a)(3)).

"Sailing permits"

The modified bills would repeal the current "sailing permit" requirement of section 6851(d).

Effective date

The effective dates of the modified bills are identical to the effective date of the Senate amendment. The provisions in the modified bills would be effective for U.S. citizens who are deemed to have relinquished their U.S. citizenship on or after February 6, 1995 (i.e., individuals who first made their loss of U.S. citizenship known to a U.S. government or consular official after this date). The tentative tax would not be required to be paid until 90 days after the date of enactment of the bill.
Present law would continue to apply to U.S. citizens who are deemed to have relinquished their citizenship prior to February 6, 1995 (i.e., individuals who first made their loss of U.S. citizenship known to a U.S. government or consular official prior to this date).

The fair market value basis election would apply to any deemed dispositions of property resulting from expatriations occurring on or after February 6, 1995, and any actual dispositions of property after the enactment date, regardless of when the property was acquired.

D. Ways and Means Committee bill (H.R. 1812)

In general

The Ways and Means Committee bill (H.R. 1812) reflects an approach to the taxation of expatriates that is different from the approach of the Administration proposal and the other proposals. The Ways and Means Committee bill would expand and substantially strengthen in several ways the present-law provisions that subject U.S. citizens who lose their citizenship for tax avoidance purposes to special tax rules for 10 years after such loss of citizenship (secs. 877, 2107, and 2501(a)(3)). First, the bill would extend the expatriation tax provisions to apply not only to U.S. citizens who lose their citizenship but also to certain long-term residents of the United States whose U.S. residency is terminated. Second, the bill generally would subject individuals to the expatriation tax provisions without inquiry as to their motive for losing their U.S. citizenship or residency, but would allow certain categories of citizens to show an absence of tax-avoidance motives if they request a ruling from the Secretary of the Treasury as to whether the loss of citizenship had a principal purpose of tax avoidance. Third, the bill would expand the categories of income and gains that are treated as U.S. source income (and therefore subject to U.S. income tax under section 877) if earned by an individual who is subject to the expatriation tax provisions and would eliminate the ability to engage in certain transactions that under current law partially or completely circumvent the 10-year reach of section 877. Further, the bill would provide relief from double taxation in circumstances where another country imposes tax on items that would be subject to U.S. tax under the expatriation tax provisions.

The Ways and Means Committee bill also contains provisions to enhance compliance with the expatriation tax provisions. The bill would impose information reporting obligations on U.S. citizens who lose their citizenship and long-term residents whose U.S. residency is terminated at the time of expatriation. In addition, the bill would direct the Treasury Department to undertake a study regarding compliance by individuals living abroad with their U.S. tax reporting obligations and to make recommendations with respect to improving such compliance.

Individuals covered

The present-law expatriation tax provisions apply only to certain U.S. citizens who lose their citizenship. The Ways and Means Committee bill would extend these expatriation tax provisions to apply also to long-term residents of the United States whose U.S. residency is
terminated. For this purpose, a long-term resident would be any individual who was a lawful permanent resident of the United States for at least 8 out of the 15 taxable years ending with the year in which such termination occurs. In applying this 8-year test, an individual would not be considered to be a lawful permanent resident for any year in which the individual is taxed as a resident of another country under a treaty tie-breaker rule. An individual's U.S. residency would be considered to be terminated when either the individual ceases to be a lawful permanent resident pursuant to section 7701(b)(6) (i.e., the individual loses his or her green-card status) or the individual is treated as a resident of another country under a tie-breaker provision of a tax treaty (and the individual does not elect to waive the benefits of such treaty). Furthermore, a long-term resident could elect to use the fair market value basis of property on the date the individual became a U.S. resident (rather than the property's historical basis) to determine the amount of gain subject to the expatriation tax provisions if the asset is sold within the 10-year period.

Under present law, the expatriation provisions of the income, estate and gift tax regimes are applicable to a U.S. citizen who loses his or her citizenship unless such loss did not have as a principal purpose the avoidance of taxes. Under the Ways and Means Committee bill, for purposes of such income, estate and gift tax provisions, U.S. citizens who lose their citizenship and long-term residents whose U.S. residency is terminated generally would be treated as having lost such citizenship or terminated such residency with a principal purpose of the avoidance of taxes if either: (1) the individual's average annual U.S. Federal income tax liability for the 5 taxable years ending before the date of such loss or termination is greater than $100,000 (the "tax liability test"), or (2) the individual's net worth as of the date of such loss or termination is $500,000 or more (the "net worth test"). The dollar amount thresholds contained in the tax liability test and the net worth test would be indexed for inflation in the case of a loss of citizenship or termination of residency occurring in any calendar year after 1996. An individual who falls below the thresholds specified in both the tax liability test and the net worth test would be subject to the expatriation tax provisions unless the individual's loss of citizenship or termination of residency did not have as a principal purpose the avoidance of tax (as under present law in the case of U.S. citizens).

A U.S. citizen, who loses his or her citizenship and who satisfies either the tax liability test or the net worth test, would not be subject to the expatriation tax provisions if such individual could demonstrate that he or she did not have a principal purpose of tax avoidance and the individual is within one of the following categories: (1) the individual was born with dual citizenship and retains only the non-U.S. citizenship; (2) the individual becomes a citizen of the country in which the individual, the individual's spouse, or one of the individual's parents, was born; (3) the individual was present in the United States for no more than 30 days during any year in the 10-year period immediately preceding the date of his or her loss of citizenship; (4) the individual relinquishes his or her citizenship before reaching age 18-1/2; or (5) any other category of individuals prescribed by Treasury regulations. In all of these situations, the individual would have been subject to tax on his or her worldwide income (as are all U.S. citizens) until the time of expatriation. In order to qualify for one of these exceptions, the former U.S. citizen would be required, within one year from the date of loss of citizenship, to submit a ruling request for a
determination by the Secretary of the Treasury as to whether such loss had as one of its principal purposes the avoidance of taxes. A former U.S. citizen who submits such a ruling request would be entitled to challenge an adverse determination by the Secretary of the Treasury. However, a former U.S. citizen who fails to submit a timely ruling request would not be eligible for these exceptions. It is expected that in making a determination as to the presence of a principal purpose of tax avoidance, the Secretary of the Treasury would take into account factors such as the substantiality of the former citizen's ties to the United States (including ownership of U.S. assets) prior to expatriation, the retention of U.S. citizenship by the former citizen's spouse, and the extent to which the former citizen resides in a country that imposes little or no tax.

The foregoing exceptions would not be available for long-term residents whose U.S. residency is terminated. However, the bill would authorize the Secretary of the Treasury to prescribe regulations to exempt certain categories of long-term residents from the bill's provisions.

Items subject to section 877

Under section 877, an individual covered by the expatriation tax provisions is subject to tax on U.S. source income and gains for a 10-year period after expatriation at the graduated rates

45 The Ways and Means Committee bill has been criticized as inappropriately providing exceptions from the expatriate tax provisions for certain categories of individuals who establish that tax avoidance was not a motive for expatriation. The categories to which these exceptions would apply are individuals who have significant connections to another jurisdiction. Under the bill, an individual who becomes a citizen of the country in which the individual, the individual's spouse or one of the individual's parents was born would not be subject to the expatriation tax provisions if the individual did not have a tax avoidance motive for expatriating. Such an individual must submit a ruling request for a determination as to motive in order to qualify for this exception. While, as pointed out by the critics, such an individual could reside in a tax-haven country rather than the foreign country of citizenship, that fact would be a significant factor strongly weighing in favor of a determination that tax avoidance was a principal purpose for the individual's expatriation.

The bill would provide a similar exclusion for individuals who are long-term foreign residents prior to expatriation. Such an individual would have foregone many of the benefits of U.S. citizenship during his or her extended absence from the United States, but nevertheless would have been subject to U.S. tax as a citizen during such period. Moreover, such an individual would be subject to the expatriation tax provisions of the bill unless he or she demonstrates that tax avoidance was not a principal purpose for his or her expatriation.
applicable to U.S. citizens. The tax under section 877 applies to U.S. source income and gains of the individual for the 10-year period, without regard to whether the property giving rise to such income or gains was acquired before or after the date the individual became subject to the expatriation tax provisions. For example, a U.S. citizen who inherits an appreciated asset immediately before losing citizenship and disposes of the asset immediately after such loss would not recognize any taxable gain on such disposition (because of the date of death fair market value basis accorded to inherited assets), but the individual would continue to be subject to tax under section 877 on the income or gain derived from any U.S. property acquired with the proceeds from such disposition.

In addition, section 877 currently recharacterizes as U.S. source income certain gains of individuals who are subject to the expatriation tax provisions, thereby subjecting such individuals to U.S. income tax on such gains. Under this rule, gain on the sale or exchange of stock of a U.S. corporation or debt of a U.S. person is treated as U.S. source income. In this regard, under current law, the substitution of a foreign obligor for a U.S. obligor is generally treated as a taxable exchange of the debt instrument and, therefore, any gain on such an exchange would be subject to tax under section 877. The Ways and Means Committee bill would extend this recharacterization to income and gains derived from property obtained in certain transactions on which gain or loss is not recognized under present law. An individual covered by section 877 who exchanges property that would produce U.S. source income for property that would produce foreign source income would be required to recognize immediately as U.S. source income any gain on such exchange (determined as if the property had been sold for its fair market value on such date). To the extent gain is recognized under this provision, the property would be accorded the step-up in basis provided under current law. This rule requiring immediate gain recognition would not apply if the individual enters into an agreement with the Secretary of the Treasury specifying that any income or gains derived from the property received in the exchange during the 10-year period after the loss of citizenship (or termination of U.S. residency, as applicable) would be treated as U.S. source income. Such a gain recognition agreement would terminate if the property transferred in the exchange is disposed of by the acquiror, and any gain that had not been recognized by reason of such agreement would be recognized as U.S. source as of such date. It is expected that a gain recognition agreement would be entered into not later than the due date for the tax return for the year of the exchange. In this regard, the Secretary of the Treasury would be authorized to issue regulations providing similar treatment for nonrecognition transactions that

46 Under present law, all nonresident aliens (including expatriates) are subject to U.S. income tax at graduated rates on certain types of income. Such income includes income effectively connected with a U.S. trade or business and gains from the disposition of interests in U.S. real property. For example, compensation (including deferred compensation) paid with respect to services performed in the United States is subject to such tax. Thus, under current law, a U.S. citizen who earns a stock option while employed in the United States and delays the exercise of such option until after such individual loses his or her citizenship would be subject to U.S. tax on the compensation income recognized upon exercise of the stock option (even if the stock received upon the exercise is stock in a foreign corporation)
occur within 5 years immediately prior to the date of loss of citizenship (or termination of U.S. residency, as applicable).

The Secretary of Treasury would be authorized to issue regulations to treat removal of tangible personal property from the United States, and other circumstances that result in a conversion of U.S. source income to foreign source income without recognition of any unrealized gain, as exchanges for purposes of computing gain subject to section 877. The taxpayer could defer the recognition of the gain if he or she enters into a gain recognition agreement as described above. For example, a former citizen who removes appreciated artwork that he or she owns from the United States could be subject to immediate tax on the appreciation under this provision unless the individual enters into a gain recognition agreement.

The foregoing rules regarding the treatment under section 877 of nonrecognition transactions are illustrated by the following examples: Ms. A loses her U.S. citizenship on January 1, 1996, and is subject to section 877. On June 30, 1997, Ms. A transfers the stock she owns in a U.S. corporation, USCo, to a wholly-owned foreign corporation, FCo, in a transaction that qualifies for tax-free treatment under section 351. At the time of such transfer, A's basis in the stock of USCo is $100,000 and the fair market value of the stock is $150,000. Under present law, Ms. A would not be subject to U.S. tax on the $50,000 of gain realized on the exchange. Moreover, Ms. A would not be subject to U.S. tax on any distribution of the proceeds from a subsequent disposition of the USCo stock by FCo. Under the Ways and Means Committee bill, if Ms. A does not enter into a gain recognition agreement with the Secretary of the Treasury, Ms. A would be deemed to have sold the USCo stock for $150,000 on the date of the transfer, and would be subject to U.S. tax in 1997 on the $50,000 of gain realized. Alternatively, if Ms. A enters into a gain recognition agreement, she would not be required to recognize for U.S. tax purposes in 1997 the $50,000 of gain realized upon the transfer of the USCo stock to FCo. However, under the gain recognition agreement, for the 10-year period ending on December 31, 2005, any income (e.g., dividends) or gain with respect to the FCo stock would be treated as U.S. source, and therefore Ms. A would be subject to tax on such income or gain under section 877. Because any future appreciation in the USCo stock would be reflected in an increase in the value of the FCo stock, such appreciation would potentially be subject to tax under section 877. If FCo disposes of the USCo stock on January 1, 2002, Ms. A's gain recognition agreement would terminate on such date, and Ms. A would be required to recognize as U.S. source income at that time the $50,000 of gain that she previously deferred under the gain recognition agreement. (The amount of gain required to be recognized by Ms. A in this situation would not be affected by any changes in the value of the USCo stock since her June 30, 1997 transfer of such stock to FCo.)

The Ways and Means Committee bill also would extend the recharacterization rules of section 877 to treat as U.S. source any income and gains derived from stock in a foreign corporation if the individual losing citizenship or terminating residency owns, directly or indirectly, more than 50 percent of the vote or value of the stock of the corporation on the date of such loss or termination or at any time during the 2 years preceding such date. Such income and gains would be recharacterized as U.S. source only to the extent of the amount of earnings and
profits attributable to such stock earned or accumulated prior to the date of loss of citizenship (or termination of residency, as applicable) and while such ownership requirement is satisfied.

The following example illustrates this rule: Mr. B loses his U.S. citizenship on July 1, 1996, and is subject to section 877. Mr. B has owned all of the stock of a foreign corporation, FCo, since its incorporation in 1991. As of FCo's December 31, 1995, year-end, FCo has accumulated earnings and profits of $500,000. FCo has earnings and profits of $100,000 for 1996 and does not have any subpart F income (as defined in sec. 952). FCo makes a $100,000 distribution to Mr. B in each of 1997 and 1998. On January 1, 1999, Mr. B disposes of all his stock of FCo and realizes $400,000 of gain. Under present law, neither the distributions from FCo nor the gain on the disposition of the FCo stock would be subject to U.S. tax. Under the Ways and Means Committee bill, the distributions from FCo and the gain on the sale of the stock of FCo would be treated as U.S. source income and would be taxed to Mr. B under section 877, subject to the earnings and profits limitation. For this purpose, the amount of FCo's earnings and profits for 1996 is prorated based on the number of days during 1996 that Mr. B is a U.S. citizen. Thus, the amount of FCo's earnings and profits earned or accumulated before Mr. B's loss of citizenship is $550,000. Accordingly, the $100,000 distributions from FCo in 1997 and 1998 would be treated as U.S. source income taxable to Mr. B under section 877 in such years. In addition, $350,000 of the gain realized from the sale of the stock of FCo in 1999 would be treated as U.S. source income taxable to Mr. B under section 877 in that year.

Section 877 applies to income and gains for the 10-year period following the loss of citizenship (or termination of residency, as applicable). For purposes of applying section 877, the Ways and Means Committee bill would suspend this 10-year period for gains derived from a particular property during any period in which the individual's risk of loss with respect to such property is substantially diminished. For example, Ms. C loses her citizenship on January 1, 1996, and is subject to section 877. On that date Ms. C owns 10,000 shares of stock of a U.S. corporation, USCo, with a value of $1 million. On the same date Ms. C enters into an equity swap with respect to such USCo stock with a 5-year term. Under the transaction, Ms. C will transfer to the counter-party an amount equal to the dividends on the USCo stock and any increase in the value of the USCo stock for the 5-year period. The counter-party will transfer to Ms. C an amount equal to a market rate of interest on $1 million and any decrease in the value of the USCo stock for the same period. Ms. C's risk of loss with respect to the USCo stock is substantially diminished during the 5-year period in which the equity swap is in effect, and therefore, under the Ways and Means Committee bill, the 10-year period under section 877 is suspended during such period. Accordingly, under the bill, if Ms. C sells her USCo stock for a gain on January 1, 2010, such gain would be treated as U.S. source income taxable to Ms. C under section 877. Such gain would not be subject to U.S. tax under present law.

The Ways and Means Committee bill has been criticized as continuing to permit expatriates to avoid the expatriation tax provisions by converting U.S. source income and gain to foreign source income and gain and by entering into hedging transactions. As a preliminary matter, it should be noted that complete exit from the U.S. capital markets in order to avoid the
application of the expatriation tax provisions may be neither attractive nor feasible. In particular, many wealthy individuals who hold significant interests in family-controlled businesses may be unwilling to divest of such interests and cede control of the businesses despite the U.S. tax cost of continued ownership after expatriation. Moreover, under the bill, in order to avoid the reach of the expatriation tax provisions, an expatriate would have to remain out of the U.S. capital markets for the entire ten-year post-expatriation period. Under the Administration proposal, however, an expatriate would have access to the U.S. capital markets immediately after expatriation without being subject to any special U.S. tax regime with respect to the income so earned.

The Ways and Means Committee bill contains specific provisions aimed at eliminating the tax-avoidance opportunities through conversion or hedging that are potentially available under the expatriation tax provisions of present law. First, under the bill, immediate gain recognition generally would be required if an expatriate converts U.S. property into foreign property in a transaction or other occurrence that would otherwise not be a recognition event; no such gain recognition would be required if the expatriate enters into an agreement to treat all income and gains from the foreign property as U.S. source income that is subject to tax under section 877. This gain recognition agreement would terminate (and the deferred gain would be recognized) upon a disposition of the U.S. property that was transferred in the conversion transaction. Second, under the bill, the ten-year period for application of section 877 would be suspended with respect to gains from an asset during any period in which the expatriate's risk of loss with respect to the asset is substantially diminished through a hedge, swap or any other transaction. An expatriate could avoid tax on gains under these provisions only by holding the acquired foreign asset completely unhedged until the expiration of the ten-year post-expatriation period (and ensuring that the recipient of the U.S. asset disposed of by the expatriate in the conversion transaction holds such asset for the same period). Ten years is a long period to hold an asset and be at risk with respect to such asset. Moreover, the expatriate would be subject to tax under section 877 on any income generated by the foreign asset during the ten-year period.

**Double tax relief**

In order to avoid the double taxation of individuals subject to the expatriation tax provisions, the Ways and Means Committee bill would provide a credit against the U.S. tax imposed under such provisions for any foreign income, gift, estate or similar taxes paid with respect to the items subject to such taxation. This credit would be available only against the tax imposed solely as a result of the expatriation tax provisions, and would not be available to be used to offset any other U.S. tax liability. For example, Mr. D loses his citizenship on January 1, 1996 and is subject to section 877. Mr. D becomes a resident of Country X. During 1996, Mr. D recognizes a $100,000 gain upon the sale of stock a U.S. corporation, USCo. Country X imposes $20,000 tax on this capital gain. But for the double tax relief provision, Mr. D would be subject to tax of $28,000 on this gain under section 877. However, under the Ways and Means Committee bill, Mr. D's U.S. tax under section 877 would be reduced by the $20,000 of foreign tax paid, and Mr. D's resulting U.S. tax on this gain would be $8,000.
Effect on tax treaties

The Ways and Means Committee found that the expatriation tax provisions, as amended by its bill, would be generally consistent with the underlying principles of income tax treaties to the extent the bill would provide a foreign tax credit for items taxed by another country, but intended that the purpose of the expatriation tax provisions, as amended, not be defeated by any treaty provision. The Treasury Department would be expected to review all outstanding treaties to determine whether the expatriation tax provisions, as revised, potentially conflict with treaty provisions and to eliminate any such potential conflicts through renegotiation of the affected treaties as necessary. Beginning on the tenth anniversary of the enactment of the Ways and Means Committee bill, any conflicting treaty provisions that remain in force would take precedence over the expatriation tax provisions as revised.

Critics of the Ways and Means Committee bill have objected to this override of any contrary treaty provisions. However, it is believed that the provisions of the bill are generally consistent with treaty obligations to the extent that the bill provides a foreign tax credit for items that are taxed both by the expatriation tax provisions and by a foreign country. Moreover, in light of the small number of individuals who expatriate to any given treaty partner coupled with the foreign tax credit provision that cedes primary taxing jurisdiction over such individuals to the treaty partner, it is unlikely that any of our treaty partners will have strong objections to the provisions contained in the bill. In addition, it should be noted that the Administration proposal would also raise issues regarding potential conflicts with treaty provisions because it would tax former citizens and residents of the United States; furthermore, unlike the Ways and Means Committee bill, the Administration proposal does not include a foreign tax credit that would mitigate any such conflicts.

Required information reporting and sharing

In order to facilitate the administration of the expatriation tax provisions, under the Ways and Means Committee bill, a U.S. citizen who loses his or her citizenship would be required to provide a statement to the State Department (or other designated government entity) which includes the individual's social security number, forwarding foreign address, new country of residence and citizenship and, in the case of individuals with a net worth of at least $500,000, a balance sheet. The entity to which such statement is to be provided would be required to provide to the Secretary of the Treasury copies of all statements received and the names of individuals who refuse to provide such statements. A long-term resident whose U.S. residency is terminated would be required to attach a similar statement to his or her U.S. income tax return for the year of such termination. An individual's failure to provide the required statement would result in the imposition of a penalty for each year the failure continues equal to the greater of (1) 5 percent of the individual's expatriation tax liability for such year, or (2) $1,000.

The Ways and Means Committee bill would require the State Department to provide the Secretary of the Treasury with a copy of each CLN approved by the State Department. Similarly,
the bill would require the agency administering the immigration laws to provide the Secretary of the Treasury with the name of each individual whose status as a lawful permanent resident has been revoked or has been determined to have been abandoned.

Further, the Ways and Means Committee bill would require the Secretary of the Treasury to publish in the Federal Register the names of all former U.S. citizens from whom it receives the required statements or whose names it receives under the foregoing information-sharing provisions.

The Ways and Means Committee bill has been criticized as unadministrable because it would rely on voluntary compliance. However, the entire U.S. tax system is based on voluntary compliance. The burden of administration of the expatriation tax provisions would be eased under the bill because of the elimination in many cases of the requirement that tax-avoidance motives for expatriation be proven and the institution in other cases of a ruling request process to determine the motive for expatriation. Under present law, a wealthy individual could take the position that he had not expatriated for tax avoidance purposes and therefore is not subject to the expatriation tax provisions. Under the bill, wealthy individuals who do not establish their eligibility for an exception would be subject to the expatriation tax provisions without regard to the motive for expatriation. For such an individual, failure to pay the expatriation tax no longer would be a matter of an aggressive interpretation of the applicability of the expatriation tax provisions but instead would be a violation of the U.S. tax laws. This change from present law is significant, particularly in light of the evidence of the reluctance of high-profile, wealthy individuals to break the law. In addition, the bill provides for information sharing between the State Department (and other governmental agencies with information regarding expatriates) and the Treasury Department which would facilitate policing of the expatriation tax provisions. Finally, it should be noted that the Administration proposal would impose on expatriates a tax liability to be paid after expatriation, and thus would similarly require voluntary compliance after expatriation. There is no practical mechanism for avoiding reliance on voluntary compliance.

**Treasury report on tax compliance by U.S. citizens and residents living abroad**

In order to address the compliance issues raised during the course of the Joint Committee staff study on the taxation of expatriates, the Treasury Department would be directed to undertake a study on the tax compliance of U.S. citizens and green-card holders residing outside the United States and to make recommendations regarding the improvement of such compliance. The findings of such study and such recommendations would be required to be reported to the House Committee on Ways and Means and the Senate Committee on Finance within 90 days of the date of enactment.

During the course of the Joint Committee staff study, a specific issue was identified regarding the difficulty in determining when a U.S. citizen has committed an expatriating act with the requisite intent, and thus no longer has the obligation to continue to pay U.S. taxes on his or her worldwide income due to the fact that the individual is no longer a U.S. citizen. Neither the
Immigration and Nationality Act nor any other Federal law requires an individual to request a CLN within a specified amount of time after an expatriating act has been committed, even though the expatriating act terminates the status of the individual as a U.S. citizen for all purposes, including the status of being subject to U.S. tax on worldwide income. Accordingly, the Ways and Means Committee anticipated that the Treasury report, in evaluating whether improved coordination between executive branch agencies could improve compliance with the requirements of the Internal Revenue Code, would review the process through which the State Department determines when citizenship has been lost, and make recommendations regarding changes to such process to recognize the importance of such date for tax purposes. In particular, the Committee anticipated that the Treasury Department would explore ways of working with the State Department to insure that the State Department would not issue a CLN confirming the commission of an expatriating act with the requisite intent necessary to terminate citizenship in the absence of adequate evidence of both the occurrence of the expatriating act (e.g., the joining of a foreign army) and the existence of the requisite intent.

**Effective date**

The expatriation tax provisions as modified by the Ways and Means Committee bill generally would apply to any individual who loses U.S. citizenship on or after February 6, 1995, and any long-term residents whose U.S. residency is terminated on or after June 13, 1995. For citizens, the determination of the date of loss of citizenship would remain the same as under present law (i.e., the date of loss of citizenship would be the date of the expatriating act). However, a special transition rule would apply to individuals who committed an expatriating act within one year prior to February 6, 1995, but had not applied for a CLN as of such date. Such an individual would be subject to the expatriation tax provisions as amended by the bill as of the date of application for the CLN, but would not be retroactively liable for U.S. income taxes on his or her worldwide income. In order to qualify for the exceptions provided for individuals who fall within one of the specified categories, such individual would be required to submit a ruling request within 1 year after the date of enactment of the bill.

The special transition rule is illustrated by the following example. Mr. E joined a foreign army on October 1, 1994 with the intent to relinquish his U.S. citizenship, but Mr. E does not apply for a CLN until October 1, 1995. Under the Ways and Means Committee bill, Mr. E would be subject to the expatriation tax provisions (as amended) for the 10-year period beginning on October 1, 1995. Moreover, if Mr. E falls within one of the specified categories (i.e., Mr. E is age 18 when he joins the foreign army), in order to qualify for the exception provided for such individuals, Mr. E would be required to submit his ruling request within 1 year after the date of enactment of the bill. Mr. E would not, however, be liable for U.S. income taxes on his worldwide income for any period after October 1, 1994.

The information reporting provisions under the Ways and Means Committee bill would apply to U.S. citizens who lose their citizenship and long-term residents whose U.S. residency is terminated after the date of enactment.
V. REVENUE ESTIMATES AND ESTIMATING METHODOLOGY

In general

Estimating the revenue effects of proposed legislation to modify the tax treatment of U.S. citizens and long-term residents who relinquish their citizenship or residence ("expatriates") is inherently difficult, particularly in cases in which the decision to relinquish citizenship or residence is made, at least in part, for tax reasons. Depending upon the proposal, there may be both income and estate tax consequences to the act of relinquishing citizenship or residence. The consequences may be significantly affected by whether the assets of the citizen or resident are U.S. or foreign situs and by whether the assets are held in trust.

Under all of the proposals that have been reported, it is necessary to estimate the number of individuals who will expatriate. Under some proposals, it is necessary to estimate the number of citizens who expatriate for tax avoidance purposes. Under all of the proposals, it is necessary to estimate the behavioral effect that will occur as a result of the proposal. In addition, it is necessary under certain proposals to estimate the unrealized appreciation of assets held by potential expatriates.

The current levels of expatriation are well documented by the State Department. However, the current levels of expatriation for tax avoidance purposes cannot be determined with precision because it is impossible to infer taxpayers' intent in expatriating. Thus, the revenue estimates of the various proposals ultimately are based upon the best judgment of the Joint Committee staff using anecdotal evidence that is available publicly, plus tax return information obtained from the IRS, expatriation data obtained from the State Department, and other data and information available to the Joint Committee staff.

Calculating a baseline

Revenue estimates measure the anticipated changes in Federal receipts that result from proposed legislative changes to the Internal Revenue Code or related statutes. The reference point for a revenue estimate is the revenue baseline, which projects Federal receipts assuming that present law remains unchanged. Thus, in its simplest form, a revenue estimate measures projected Federal receipts under a proposed change in law minus the projected Federal receipts under present law. If this formula yields a negative result, the proposal is a revenue loser. If the formula yields a positive result, the proposal is a revenue raiser.

In order to determine the present-law baseline with respect to proposals to alter the tax treatment of expatriation, the Joint Committee staff received information from the State Department relating to the number of U.S. citizens who relinquish citizenship each year and the number of long-term U.S. residents who change their residence.
More difficult determinations that are relevant for calculating the baseline include the levels of income, unrealized appreciation of assets, location of assets (i.e., U.S. or foreign), the wealth of those who are expatriating under present law, the tax effects of expatriation, and the reasons for expatriation. Individuals may receive any of several tax benefits from expatriation, assuming they relocate to a low-tax environment. First, they remove some or all of their entrepreneurial and investment income from current U.S. taxation. Second, they are able to recognize some or all of their unrealized gains at relatively low cost. Third, they largely insulate themselves from U.S. estate tax liability.

Shortly after release of the Administration's Fiscal Year 1996 Budget, the Joint Committee staff received information from the staff of the Treasury Department concerning U.S. citizens or lawful permanent residents who had relinquished, or appeared to be in the process of relinquishing, citizenship or residence. This information was updated by subsequent information provided by the IRS and the Treasury Department. The subsequent information provided by the Treasury Department contained tax liability information for individuals who had expatriated in 1993 or 1994 according to State Department information and whose names could be matched to the IRS Individual Income Tax Return Master File. Of the 697 individuals who expatriated in 1993, the Treasury Department was able to match 13 names to the Individual Income Tax Return Master File with tax liability information for certain of the years 1989-1992. Of these 13 matches, seven had tax liability in any year less than $10,000. The total tax liability for all years matched was approximately $20 million. The information matched to those who had expatriated in 1994 showed a higher total tax liability for all years matched. However, it is unclear how the information that was matched would relate to information for all individuals who had expatriated during the 1993-1994 period. In addition, the information relating to tax liability provides no information as to an individual's wealth and, to the extent only one or two years of tax liability is shown, may show no information as to what an expatriating individual's tax liability would be if the individual did not expatriate. The Joint Committee staff found the Treasury Department information useful, but not determinative, in analyzing the potential effect of any of the proposals on fiscal year budget receipts.

In addition, the Joint Committee staff asked the State Department to match names appearing on the Forbes 400 list of the wealthiest people in the United States with (1) the names of people who had been publicly reported to have expatriated and (2) State Department data on individuals who had actually relinquished U.S. citizenship during 1994 and 1995. The Forbes 400 list was utilized because it was the only information of which the Joint Committee staff was aware that provided a measure of the net wealth of individuals. In addition, a number of the individuals listed in the Forbes 400 list have been identified publicly as having expatriated or being in the process of expatriating and the Joint Committee staff wanted to verify the extent to which the reported information was accurate.

A present-law baseline was formed by extrapolating available information on expatriation to fiscal years 1995-2005. This extrapolation included judgments about the representativeness of the tax information, the potential numbers of expatriates, and the application of present law.
Expatriation is assumed to be cyclical, affected by numerous factors, and the number of potential expatriates is limited. In addition, potential erosion of U.S. estate tax liabilities was omitted from consideration because of the inherent difficulty in predicting mortality and estate tax consequences.

The published reports of expatriation allegedly for tax avoidance purposes that predated the Administration proposal, the Administration proposal itself, and the reports (and in some cases solicitations) that ensued have altered the individual and institutional (e.g., State Department and IRS) awareness of expatriation, regardless of whether the Administration proposal or something similar is enacted. The Joint Committee staff made the assumption that such publicity has not altered the present-law baseline because it is not clear how the parties involved will react. Some potential expatriates may be wary of the personal and professional stigma that may be attached to expatriation given the greater publicity of the issue in recent months. Others may use the recent publicity as a road map to expatriation. The Joint Committee staff also assumed that the IRS would make no additional efforts to enforce present law with regard to expatriation.

Behavioral effects

One of the most significant elements of the estimates of revenue effects of modifications to the tax treatment of expatriation is the assumed effect of the proposal on taxpayer behavior. For those individuals who it is assumed would expatriate during the budget period under present law, there are two possible reactions to a modification to the tax treatment of expatriation.

First, the individual may decide not to expatriate and, therefore, would remain a U.S. citizen or resident. In this case, the individual would continue to pay U.S. income and estate (if applicable) taxes. In evaluating how many of the individuals who are assumed in the present-law baseline to be likely to expatriate during the budget period but would not do so as a result of the proposal, it was necessary to evaluate the tax consequences of remaining a U.S. citizen or resident relative to the tax consequences of expatriating. For example, because the Administration proposal would impose tax on unrealized gains of assets held upon expatriation, individuals with low-basis assets might be deterred from expatriating. Similarly, the potential double taxation that could occur as a result of the Administration proposal might deter an individual from expatriating.

Second, the individual may decide to expatriate in any event and pay whatever taxes are owed as a result of the expatriation. Individuals who will fall into this category would include those whose expatriation is for nontax purposes in the first place. Also, under the Administration proposal, individuals with high-basis assets might conclude that the cost of expatriation is small relative to the potential exposure to U.S. estate taxes. Some have suggested that the Administration proposal might encourage some individuals who had not previously considered expatriation to do so.
A factor that may also determine whether the decision to expatriate (and the revenue consequences of any proposal) is the age of the individual and the likelihood of death occurring during the period shortly after expatriation. However, as indicated earlier, this element has not been incorporated into the estimates of the present-law baseline or of the effects of any of the proposals because of the inherent difficulty in predicting mortality, wealth, and the estate tax consequences for a particular group of individuals.

**Potential macroeconomic effects**

The estimates of proposals to alter the tax treatment of expatriation do not include any changes in aggregate macroeconomic variables such as domestic investment. This assumption is consistent with the macroeconomic baseline required to be used for estimating purposes by the Joint Committee staff. It also comports with the Joint Committee staff's judgment that a proposal like the Administration's affecting a relatively small number of individuals, regardless of their wealth, would not cause a noticeable change in the overall U.S. economy.

**Estimates of the proposals**

**Administration proposal**

The Joint Committee staff estimates that the Administration proposal would have the following effect on fiscal year budget receipts:

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<tr>
<th>Fiscal Years</th>
<th>[Billions of Dollars]</th>
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<td>Admin-</td>
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<td>istration</td>
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<td>proposal</td>
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This estimate differs from the estimate provided to the Congress during consideration of H.R. 831. In conjunction with its study of expatriation tax issues, the Joint Committee staff acquired additional information on the number and tax status of recent expatriates. In addition, the Joint Committee staff learned more about the decision required of the heterogeneous pool of potential expatriates, under this and other proposals discussed in the study.

The Administration proposal would increase revenue by imposing a tax on appreciation which is effectively absent or delayed under present law. This tax is high enough to delay or deter some expatriation. Potential expatriates with sizable appreciation in self-created assets, such as businesses they started up, would find expatriation more costly under the Administration proposal. As a result, the entrepreneurial and investment income they generate on an ongoing basis would be subject to U.S. income tax. Some potential expatriates may adjust their economic
activities to avoid the tax imposed under the Administration proposal, but this adjustment may be
difficult to make, particularly for individuals who run their own businesses. In the longer term,
four or five years after the proposal is enacted, individuals planning to expatriate at that time
would have had enough of a warning to prepare properly for expatriation, so growth in revenue
attributable to the Administration proposal drops off significantly. As under present law, the
effect of the Administration proposal on estate tax receipts was excluded.

The Administration proposal also may cause some new and accelerated expatriation.
Individuals with high-basis assets but no immediate concern about the U.S. estate tax may
expatriate in response to the Administration's proposal. Some of these individuals would
accelerate expatriation that would have occurred in any event under present law. Others who
would not have expatriated under present law may expatriate because of the Administration
proposal. Individuals falling into this latter group include those who would not expatriate under
present law because with the passage of time they would find it difficult for various reasons to
surrender citizenship or permanent residence, but the Administration proposal stimulates them to
take advantage of a high-basis "window" to expatriate at a time that they are relatively
unencumbered. Individuals in this category include individuals who have recently inherited wealth
or who expect to inherit wealth in the near future and individuals who have recently sold their
businesses in a taxable transactions.

Individuals who would expatriate in the budget window because of the Administration
proposal precipitate two tax effects. These expatriates would be taxed on unrealized capital gain
at the time of expatriation. Secondly, U.S. tax base would be eroded by these expatriating
individuals because: (1) they would be removing subsequent capital gain they would have realized
under present law from the U.S. tax base, (2) they may qualify for reduced U.S. taxation on other
income because of a tax treaty, and (3) they would remove themselves from potential U.S. estate
tax consequences. In the Joint Committee staff's ten-year estimate of the Administration
proposal, these two countervailing effects, the tax on unrealized capital gain and the tax base
erosion, largely cancel each other out. In the longer run, stimulated expatriation will reduce the
revenue raised by the Administration proposal as the tax base erosion factor outweighs the
revenue gain from the tax on capital gain at the time of expatriation.

**Senate amendment to H.R. 831**

The estimate of the revenue effects of the Senate amendment to H.R. 831 is as follows

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<tr>
<th>Fiscal Years</th>
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<tr>
<td>Senate</td>
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* Gain of less than $50 million
The estimated revenue effects of the Senate amendment to H.R. 831 are lower than those for the Administration proposal to reflect the fact that the Senate amendment would not apply to long-term residents of the United States. In addition, the Senate amendment effective date would delay the effective date for payment of the tax to 90 days after the date of enactment. However, this lower revenue gain would be partially offset by the fact that the Senate amendment would, in certain circumstances, deem the loss of citizenship to occur at a date earlier than the Administration proposal, which would apply the tax on expatriation to more individuals and at an earlier date than would the Administration proposal.

S. 700 (Senator Moynihan) and H.R. 1535 (Representative Gibbons)

The estimated effects of the modified bills (S. 700 and H.R. 1535) on Federal fiscal year budget receipts are as follows:

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<th>Fiscal Years [Billions of Dollars]</th>
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<td>S.700 and H.R. 1535</td>
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* Gain of less than $50 million.

Under S. 700 and H.R. 1535, the expatriation tax would apply both to U.S. citizens who expatriate and to long-term U.S. residents who relinquish their residence. Thus, the estimated revenue gain takes into account the potential tax imposed on both groups. Under the bills, an expatriating individual could elect to continue to be taxed as a U.S. citizen, rather than being subject to the tax on expatriation. It is anticipated that individuals would only make this election if the effect would be to reduce the total taxes owed. Thus, the election is assumed to reduce the revenue gain that otherwise might be raised under the bills.

The bills would provide a basis step up with respect to assets held by a nonresident alien individual who becomes a citizen or resident of the United States. Thus, under the bills, the amount of gain on sale of such assets that would be subject to U.S. tax would be the gain during the period the individual was a citizen or resident of the United States. Because this treatment is more favorable to the taxpayer than the treatment accorded under present law (i.e., that all appreciation is subject to tax without regard to whether it accrued during the time of U.S. citizenship or residence), this provision produces a revenue loss relative to present law.
The bills would provide an exception to the expatriation tax with respect to certain individuals who relinquish U.S. citizenship before the age of 18-1/2, which would also be expected to reduce the revenue gain relative to the Administration proposal.

The effective dates of S. 700 and H.R. 1535 are the same as the effective date in the Senate amendment to H.R. 831; therefore, the bills have the potential to subject individuals to the expatriation tax at a time earlier than under the Administration proposal.

**Ways and Means Committee bill (H.R. 1812)**

The estimate of the revenue effects of the Ways and Means Committee bill (H.R. 1812) is as follows:

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<td>Ways and Means Committee bill</td>
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* Gain of less than $50 million.

The Ways and Means Committee bill (H.R. 1812) would subject individuals to U.S. income and estate taxes with regard to U.S.-sourced items for ten years after U.S. citizenship or long-term residence is relinquished. Among other things, the bill includes changes in the provisions covering the transfer or conversion of assets. As described in the following section, the Joint Committee staff estimated that H.R. 1812 would deter some individuals from expatriating while causing others to pay additional U.S. income taxes.

**Variations between Joint Committee on Taxation estimates and Treasury Department estimates**

There are disparities between the revenue estimates of the various expatriation tax proposals provided by the Treasury Department and the estimates provided by the Joint Committee staff. As recently as the markup of H.R. 1812 by the Committee on Ways and Means, the Treasury Department estimated that the Administration proposal would raise Federal budget receipts by $2.2 billion over the fiscal year 1995-2000 period, while the Joint Committee staff estimated an increase of $0.6 billion over the same window. With regard to the Ways and Means Committee bill (H.R. 1812), the Treasury Department estimated an increase of $0.1 billion, while the Joint Committee staff estimated an increase of $0.8 billion. The modified bills (S. 700 and H.R. 1535) have been estimated to raise $1.7 billion by the Treasury Department, while the Joint Committee staff has estimated that these bills would raise $0.2 billion.
One principle guiding the Joint Committee staff revenue estimates with respect to the expatriation proposals is that potential expatriates are heterogeneous. A second principle is that an individual who desires to sever direct economic ties to the United States would be able to circumvent all of the expatriation proposals advanced to this date. The final principle is that there will be no enforcement of present law section 877 in the current budget baseline.

The Joint Committee staff evaluated the income tax effects of all the expatriation proposals in light of these principles. The staff did not account for estate tax effects of any of the proposals because of the lack of reliable data on expatriate wealth, the inaccuracy inherent in applying general mortality tables to a small group of expatriates, and the complexity of forecasting the outcomes of estate settlements (e.g., marital exclusions, philanthropic giving). It is the understanding of the Joint Committee staff that the estimates made by the Treasury Department do incorporate changes in estate and gift tax receipts caused by the expatriation proposals.

Although the Joint Committee staff's revenue estimates do not take into account estate tax effects, it should be noted that the estate tax provisions for expatriates are different under the Administration proposal and the Ways and Means Committee bill. Under the Administration proposal, a former U.S. citizen would be subject to the estate tax provisions for expatriates only if tax avoidance was a principal purpose for the individual's loss of citizenship. Under the Ways and Means Committee bill, former citizens who meet the specified income or net worth threshold generally would be subject to the estate tax provisions for expatriates without regard to their motive for expatriating. Accordingly, a wealthy expatriate who transfers all of his or her assets to a foreign corporation he or she controls and who dies within ten years of expatriation would pay no estate tax under the Administration proposal (unless a tax-avoidance purpose is established) but generally would be subject to the estate tax under the Ways and Means Committee bill.

The "target" expatriate, that is, the individual who the Joint Committee staff believes would be affected by the expatriation proposals, is an individual who wants to maintain a substantial economic presence in the United States after expatriation. This presence might take the form of personal economic activity such as running a business, or might involve a more indirect presence such as substantial holdings of U.S. corporate stock. The target expatriate is assumed to retain at least some U.S. assets, even though this may not result in overall short-term tax minimization. The motive for the target's expatriation could be concern about high income tax rates or possible imposition of estate taxes.

The Administration proposal and the modified bills both impose tax on unrealized gain at the time of expatriation. The Joint Committee staff estimated that the Administration proposal would deter target expatriates with substantial unrealized gains, or would extract significant tax payments in the event expatriation occurs. Taxpayers with low unrealized gains, who under present law would be in no hurry to make an expatriation decision, might find expatriation attractive given their current low-gain status. Expatriates who have low unrealized gains could find it advantageous to expatriate sooner under the Administration proposal, or any other proposal that would impose a toll charge on unrealized gains at time of departure.
The modified bills (S. 700 and H.R. 1535), allow an asset-by-asset election. Under this election, taxpayers would be able to treat high-gain assets throwing off little current income as taxable by the United States following expatriation, while they could treat low-gain assets throwing off substantial income as subject only to the U.S. tax on unrealized gains at the time of expatriation.

The Ways and Means Committee bill imposes a ten-year income and estate tax requirement on expatriates. The Joint Committee staff considers ten years to be a significant obstacle to a potential expatriate who wants to avoid capital gains or estate taxes. The bill does not subject foreign source income to U.S. taxation after expatriation (with some exceptions), but the U.S. tax on foreign source income is contingent on foreign tax credits and accurate reporting. An individual receiving a significant amount of low-tax foreign income would seem to have little incentive to subject himself to U.S. taxation in any event, with or without a change in the tax treatment of expatriates.

With regard to expatriation motivations, the Ways and Means Committee bill also impedes a potential group of expatriates who are not significantly restrained by the other proposals. The ten-year requirement of the Ways and Means Committee bill would reduce the incentive to expatriate when death is pending.
STATEMENT OF
LESLIE B. SAMUELS
ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE COMMITTEE ON FINANCE
UNITED STATES SENATE

Mr. Chairman and members of the Committee, I am pleased today to testify on the taxation of U.S. citizens and certain long-term residents who expatriate by renouncing their U.S. citizenship or abandoning their residency.

In March of this year, the Senate Finance Committee reported out a bill (H.R. 831) similar to the Administration's proposal described below that would have effectively dealt with the problems of tax avoidance through expatriation. The entire Senate then approved that bill. The Administration supports these efforts because we believe that U.S. persons should pay their fair share of U.S. tax. Moreover, we believe that public confidence in our tax system is eroded by the perception that some wealthy individuals are able to escape paying taxes through devices that are not generally available to all taxpayers. Our existing laws generally subject individuals to income tax when assets are sold or subject estates to estate tax when the individual dies. Certain wealthy people have found that they can completely avoid paying U.S. tax on their gains by renouncing their U.S. citizenship. Because of the need to obtain another nationality and other transaction costs, renouncing U.S. citizenship to avoid tax is generally only a viable option for the wealthiest Americans.

Although expatriations by super-rich Americans have been publicized recently, the problem of tax avoidance by renouncing citizenship was first addressed in 1966. Under current rules, a special taxation regime applies to a U.S. citizen who renounces his or her citizenship unless the loss of citizenship did not have as one of its principal purposes the avoidance of tax. This special regime applies for 10 years after expatriation. It subjects certain assets that produce U.S. source income to tax at graduated U.S. rates as if the person were still a U.S. citizen. Thus, taxing U.S. persons who abandon their U.S. citizenship is an accepted part of our law. Unfortunately, existing law has proven to be ineffective.

In February of this year, the Administration offered its own proposal to deal with this issue. Under the Administration proposal, if a U.S. citizen relinquishes U.S. citizenship, property held by that person would be treated as if sold at fair market value immediately before such expatriation. Similar rules would apply to expatriating long-term residents of the United States. However, no tax would be imposed on gains up to $600,000, United States real estate, or interests in certain retirement plans.
Senator Moynihan's version of the expatriation proposal, S. 700, is similar in many respects to the Administration proposal and the Senate-passed version of H.R. 831. One important difference is that it allows expatriates who post adequate security to delay paying U.S. tax on gains from identified assets at expatriation if they elect to continue to be taxed as a U.S. citizen with respect to income or gain generated from those assets.

The House Ways and Means Committee proposal, H.R. 1812, takes a different approach to the taxation of expatriates -- one much closer to the existing law. H.R. 1812 imposes income taxes on certain expatriates on their U.S. source income for a period of ten years and estate taxes on assets in the estates of certain expatriates who die within the ten-year period.

We support S. 700 because it does not interfere with an individual's right to renounce U.S. citizenship and it appropriately ensures that the expatriate will pay tax on all gains earned while subject to U.S. taxing jurisdiction. S. 700 removes many of the tax incentives of current law that entice wealthy individuals to renounce U.S. citizenship. S. 700 is crafted to deal most effectively with the broad range of U.S. and foreign economic interests owned by potential expatriates.

Proposals such as H.R. 1812 which are limited primarily to U.S. assets would be less effective. We oppose H.R. 1812 because:

* H.R. 1812 allows an expatriate who waits for ten years before recognizing gains to avoid U.S. tax.

* H.R. 1812 generally does not tax foreign source income. This exemption of foreign gains rewards investment in foreign assets as well as creates a potential loophole for those who may be able to recharacterize their domestic income as foreign source income.

* H.R. 1812 unnecessarily causes the United States to violate international law by its intended override of most of our tax treaties.

* H.R. 1812 contains many of the same compliance problems as current law and is an ineffective response to the public perception and reality of tax avoidance by wealthy expatriates who have substantial unrealized gains.

I. COMPARISON OF LEGISLATIVE PROPOSALS.

We believe that S. 700 is a more appropriate solution to the problems of tax avoidance by expatriation than H.R. 1812. In our view, S. 700 has five advantages over H.R. 1812: (1) S. 700 does not reward patient expatriates; (2) S. 700 does not exclude income otherwise subject to U.S. tax; (3) S. 700 does not create a special class of U.S. citizens who are subject to different standards upon expatriation; (4) S. 700 is more
administrable; and (5) S. 700 does not violate international law by its intended override of most of our tax treaties.

A. S. 700 DOES NOT REWARD PATIENT EXPATRIATES.

H.R. 1812 retains the loophole in current law that allows individuals to pay no tax on gains accrued while subject to U.S. tax, if they have sufficient resources to wait for ten years to recognize those gains. Consequently, the structural problem of current law which permits a patient expatriate to avoid tax is not corrected by H.R. 1812. Under H.R. 1812, taxpayers may have the beneficial use of their assets during the ten-year period without paying U.S. tax by borrowing against their assets, since H.R. 1812 does not trigger gains if U.S. assets are used as loan collateral.

Under H.R. 1812, unlike S. 700, expatriates who can wait ten years can also achieve permanent exemption of income that has been actually realized prior to expatriation, but the recognition of which is currently subject to deferral under an exception in the Code. Congress created these exceptions, allowing deferral of realized income, based upon the assumption that the income would be taxable by the United States at a later time. Under H.R. 1812, persons who expatriate would after ten years be in a better position than persons who remain citizens, because such expatriates can defeat these Congressional assumptions by permanently avoiding tax on the income.

In contrast, S. 700 does not treat expatriates who can wait for ten years to elapse more favorably than expatriates who must recognize gains during the ten-year period after expatriation or those U.S. citizens who do not expatriate. Under S. 700, all expatriates with more than $600,000 of qualifying gains are required to pay U.S. tax. (S. 700 contains an election allowing expatriates to avoid paying the tax currently by posting adequate security and agreeing to pay U.S. tax on the entire gain when realized. There is no ten-year limitation on the tax imposed under this election.)

B. S. 700 DOES NOT EXCLUDE INCOME OTHERWISE SUBJECT TO U.S. TAX.

Despite our current tax regime which taxes the worldwide gains of U.S. citizens, H.R. 1812 only applies to domestic gains of expatriates. Thus, expatriates with foreign assets are able to avoid tax under H.R. 1812. In addition, expatriates with domestic assets may be able to avoid tax under H.R. 1812 by using tax planning techniques to treat their domestic assets as foreign assets.

1. EXPATRIATES WITH FOREIGN ASSETS.

Under current law, gains from foreign assets that accrued during U.S. citizenship are not subject to U.S. tax after expatriation. H.R. 1812 retains this structural loophole of current law, with relatively minor modifications. Thus, under H.R. 1812, even a
tax-motivated expatriate is not required to pay tax on all gains that accrued during U.S. residence. Consequently, H.R. 1812 does not effectively address published reports of tax abuse involving expatriates who avoided U.S. tax on foreign gains accrued prior to expatriation.

The limited scope of H.R. 1812 is best illustrated by examining the various types of gains it subjects to tax. First, H.R. 1812 would not tax gains from foreign real property. Second, H.R. 1812 would not tax gains from tangible personal property that is not located in the United States at the time that it is sold. Thus, if tangible personal property is moved to a foreign country before it is sold, there will be no tax under H.R. 1812. (As discussed below, the regulatory authority provided in H.R. 1812 to the Treasury regarding tangible personal property will be difficult to administer in many cases.) Finally, stocks and bonds which generate foreign source income are generally not subject to tax under H.R. 1812.

In contrast, as described above, S. 700 follows the framework of our existing tax system which taxes all gains, whether foreign or domestic, of a U.S. citizen.

2. EXPATRIATES WITH DOMESTIC ASSETS.

Under H.R. 1812, taxpayers will continue to be able to use tax planning techniques to avoid U.S. tax on domestic income by resourcing the income as foreign source. We believe that as long as the Code exempts a class of assets from tax upon expatriation, and provides for a waiting period for exemption from U.S. tax, tax advisors will constantly discover new methods to avoid tax. The approach taken in H.R. 1812 lends itself to artful tax dodging. Some holes have already been plugged, but proposals which are similar in concept to existing section 877 can be expected to be circumvented by additional planning techniques. Furthermore, since the "taxpayer" will be overseas, tax avoidance schemes do not have to be as iron-clad because of the difficulties of enforcing U.S. tax law against expatriates. Some of these techniques are described in Appendix A.

We are most concerned about loopholes in H.R. 1812 that we have not identified. Only a bill like S. 700 that does not exempt a broad class of assets or provide a waiting period before exemption can be effective in preventing taxpayers from avoiding tax by expatriation. Otherwise, tax planning techniques will certainly evolve to frustrate the goal of taxing expatriates in an appropriate and fair way.

As a final note on this issue, the JCT Report seems to recognize that aggressive tax planning will be used to circumvent expatriate tax rules. The report indicates "in the longer term, four or five years after the [Administration] proposal is enacted, individuals planning to expatriate at that time would have had enough of a warning to prepare properly for expatriation, so growth in revenue attributable to the Administration
proposal drops off significantly. Although we are unsure of what techniques are contemplated and thus do not agree with this conclusion, it is clear that in comparing H.R. 1812 and S. 700, planning opportunities are very significantly greater under H.R. 1812. We do not understand why the proponents of H.R. 1812 believe that an expatriate would be unable to plan around a provision which only taxes certain income for a limited period of time (such as H.R. 1812), but would be able to plan around the Administration proposal which comprehensively taxes all accrued gains at the time of expatriation.

C. S. 700 DOES NOT CREATE A SPECIAL CLASS OF U.S. CITIZENS.

We agree with H.R. 1812's premise that current law's tax motivation requirement makes current law difficult to administer. For this reason, H.R. 1812 generally does not require the IRS to demonstrate a tax avoidance motive for taxpayers with more than $500,000 of net worth. However, H.R. 1812 provides special exceptions for certain U.S. citizens by exempting them from tax unless tax avoidance can be proven.

H.R. 1812 provides special preferences to U.S. citizens who (1) were born with dual citizenship, (2) have a family member that was born in another country, or (3) have lived outside the United States for ten years. These individuals would be allowed to enjoy the benefits of citizenship, but would not be required to pay tax if they renounce U.S. citizenship unless tax avoidance is proven. We do not believe that it is appropriate to create such classes of U.S. citizens with special tax benefits. U.S. citizens of foreign birth and their children should certainly not be discriminated against nor, as H.R. 1812 would do, be provided with special benefits. This type of rule erodes public confidence in the fairness of our tax system.

H.R. 1812 does not require these exempt expatriates to pay tax to any country in order to avoid the U.S. expatriation tax. These expatriates can retire to a tax haven and still enjoy the exemption provided by H.R. 1812. (H.R. 1812 requires those with family members born in another country to obtain citizenship in that country; but this requirement may not have any real tax effect since almost all countries tax on the basis of residence, not citizenship.)

H.R. 1812 requires that these special taxpayers request a ruling from the IRS to the effect that their expatriation is not tax motivated. Thus, these taxpayers will obtain unique benefits if they merely request a private ruling from the IRS on this issue. Under

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1 Staff of the Joint Committee on Taxation, "Issues Presented by Proposals to Modify the Tax Treatment of Expatriation", June 1, 1995 at E-5. We shall refer to this document hereafter as the "JCT Report".

H.R. 1812, if the IRS does not believe the expatriate’s assertions regarding nontax motivation, the expatriate will effectively avoid the tax because he requested a ruling, unless the IRS successfully challenges the motivation in court. In making such a challenge, the IRS would continue to face the same difficult problems of current law in enforcing a rule based on the taxpayer’s state of mind.

In contrast, S. 700 treats U.S. citizens equally. The only exception is that S. 700 does not apply to an individual who has lived in the United States for less than five years and renounces U.S. citizenship by age 18 1/2. This exception seems appropriate because an individual may automatically be a U.S. citizen if born within the United States, and U.S. nationality laws do not allow such an individual to renounce U.S. citizenship permanently until age 18 1/2.

D. S. 700 IS MORE ADMINISTRABLE.

H.R. 1812 allows expatriates to leave U.S. tax jurisdiction without paying a current tax or posting security. Thus, H.R. 1812 suffers from the same potential compliance problems as current law. Like current law, H.R. 1812’s requirement that the IRS monitor an expatriate’s activities for ten years after departure is very difficult to administer because the taxpayer’s income is not reported to the IRS and the taxpayer is beyond IRS jurisdiction. H.R. 1812 does not ensure that additional information is collected from expatriates for ten years after they depart. H.R. 1812 merely requires the expatriate to file a form at the time of expatriation. No additional information is required which would allow the IRS to monitor taxable events during the ten-year period after expatriation. In addition, H.R. 1812’s penalties for noncompliance are not significant (the greater of 5 percent of the amount due under H.R. 1812 or $1,000).

In contrast, information should be available to enforce the provisions of S. 700 more effectively since the tax is imposed at the time of expatriation and a tax return is due within 90 days of expatriation. Generally, continued monitoring would not be required of post-expatriation activities. However, if an expatriate elects to defer U.S. tax under S. 700, the requirement that the expatriate post security should be sufficient to ensure a continuing flow of adequate information.

There are obviously tax administration issues when a person leaves the United States with unfulfilled tax obligations. S. 700 determines the amount of those obligations as the person departs U.S. jurisdiction and collects the tax shortly after departure (or permits taxpayers to elect continued taxation of specified assets provided adequate security is provided). In contrast, H.R. 1812 requires the IRS to investigate an expatriate’s activities for ten years, with all of the problems incumbent therein.

In addition, the procedure contained in H.R. 1812 which requires certain taxpayers with connections to foreign countries to request an IRS ruling could result in ineffective use of IRS resources. In 1984, Congress recognized that the IRS could not
effectively administer a similar ruling process which required the IRS to determine tax motivation when appreciated property was transferred to certain foreign corporations. Also, if the IRS determines a tax avoidance purpose in the ruling process, the expatriate can reject that determination. The IRS would then be required to litigate the matter. In contrast, S. 700 has no need for such a ruling process.

H.R. 1812 also authorizes regulations that would treat the removal of tangible personal property from the United States as a taxable event. These regulations will be difficult to draft and administer. For example, what would be the tax result if an expatriate visited her U.S. grandchildren for a weekend while wearing appreciated jewelry? Should these regulations impose U.S. tax every time tangible personal property is removed from the United States? What if the tangible property is moved before expatriation?

Finally, H.R. 1812 also provides regulatory authority to apply the bill's antiabuse rules to the five-year period prior to expatriation. It is unclear how these rules would operate. For example, assume an expatriate engages in a transaction that could be subject to the antiabuse rules in year one, and then expatriates in year five. Would the regulatory authority create a taxable event in year one -- now a closed taxable year? In addition, we understand that H.R. 1812 contemplates that Treasury will issue regulations after enactment that will apply to the five-year period prior to enactment. Thus, H.R. 1812 could retroactively create taxable transactions for events that occurred in 1991, 1992, 1993, 1994 and before February 6, 1995.

E. S. 700 BETTER RESPECTS INTERNATIONAL LAW.

There are two ways in which expatriation proposals may affect international law. My testimony first considers their impact on international human rights, and then turns to their impact on U.S. tax treaties.

1. INTERNATIONAL HUMAN RIGHTS.

Some expressed initial concerns about whether the Administration's expatriation proposal would violate international law regarding human rights. It is now clear that those concerns are unfounded. Letters from a multitude of experts indicate that the expatriation proposals that have been introduced do not violate international human rights law. Letters were received from Harvard professor Detlev Vagts, New York University professor Andreas Lowenfeld, and University of Virginia professor Paul Stephan. In addition, Fletcher School of Diplomacy professor Hurst Hannum, who had initially expressed reservations about the Administration proposal, wrote a second letter indicating that the Administration proposal would not violate U.S. obligations under international law. The Department of State has provided an extensive legal opinion that concludes that the Administration proposal is consistent with international law. In response to a Congressional inquiry, the Congressional Research Service has also
concluded that the Administration proposal would not violate international law. More recently, Harvard Professor Ann-Marie Slaughter submitted a letter which concludes that S. 700 does not violate international human rights. She states: "Individuals do not have a right to evade the normal obligations of citizenship, including taxation. To allow citizens to escape these obligations without penalty or compensation would be akin to allowing an unrestricted right for rich portions of a population to secede from their poorer neighbors on the ground that they should not be required to shoulder the burden of providing for the common welfare."

The JCT Report supports these views in concluding: "In sum, viewing the objective and design of the [Administration] proposals as an attempt to neutralize the tax consequences that flow under United States tax laws from the decision to retain or renounce citizenship, it is difficult to conclude that the proposals would be an arbitrary infringement under international law..."

Today, I would like to add the opinions of several others. First, I would like to submit for the record a letter from a prominent international human rights organization, the Minnesota Advocates for Human Rights. The letter states:

While we take no position on the merits of [the Administration expatriation tax] legislation, we are concerned that international human rights law has erroneously been invoked by opponents of the proposal to suggest that it might violate the right to leave and to return to one's country. As organizations devoted to the protection and promotion of international human rights law, we must take issue with the interpretation of international law being espoused by opponents of this legislation... The proposed tax law change would not infringe upon human rights protections... Accordingly, we hope that your Committee will consider the tax proposal on its merits and avoid irrelevant international human rights arguments.

Second, I would like to submit for the record a detailed letter from Anthony D'Amato, the Leighton Professor of Law at Northwestern University School of Law. Mr. D'Amato is the Founder and Chairman of the Human Rights Interest Group of the American Society of International Law. Mr. D'Amato's letter states:

After careful study and research, I believe that the Administration's expatriation tax proposal does not violate, even minimally, the human rights that all persons enjoy under international law. Indeed, a case can be made that the average American taxpayer's rights are infringed under current law if wealthy Americans can expatriate themselves and avoid paying their fair share of capital gains tax.

In summary, the Administration is satisfied that none of the proposals under consideration violate international human rights.

2. TAX TREATIES.

H.R. 1812 will necessarily cause the United States to violate its international obligations because it is intended to override U.S. tax treaties. Although U.S. domestic law allows legislative overrides of tax treaties, these overrides violate U.S. obligations under international law.

Under H.R. 1812, most wealthy U.S. individuals are subject to tax on their U.S. source income for ten years after they expatriate without regard to whether their expatriation was tax motivated. The Committee Report to H.R. 1812 indicates that H.R. 1812 overrides contrary provisions of U.S. tax treaties:4

The Committee is also aware that certain existing U.S. income tax treaties may not permit the United States to assert its taxing jurisdiction on former citizens or long-term residents who are residents of such countries. . . . [T]he new provisions [of H.R. 1812 will] take precedence over the treaties for a period of 10 years.

H.R. 1812 is intended to override at least three categories of U.S. tax treaties. First, by substituting a wealth test for a motivation test, H.R. 1812 overrides 22 tax treaties that allow continued U.S. taxation of former citizens only if their expatriation was tax motivated (income tax treaties: Australia, Barbados, Cyprus, Finland, France, Germany, India, Indonesia, Israel, Italy, Jamaica, Mexico, Netherlands, New Zealand, Norway, Spain, and Tunisia; estate tax treaties: Austria, Canada, Denmark, Germany, and Sweden). As stated in the Committee Report, "the bill subjects certain individuals to the expatriation tax provisions without inquiry as to their motive for losing their U.S. citizenship or residency."5 These treaties only permit U.S. taxation of noncitizens to the extent their expatriation was tax motivated. Moreover, H.R. 1812 would clearly override the 1992 income tax treaty with the Netherlands because that treaty specifically provides that U.S. expatriation tax rules cannot be asserted against any national of the Netherlands, even if the expatriation was tax-motivated.

Second, H.R. 1812 overrides eight estate tax treaties which restrict the ability of the United States to tax transfers by former citizens who are residents of the treaty partner at the time of their death (estate tax treaties: Australia, Finland, France, Greece, Ireland, Italy, the Netherlands, and Norway).

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4 Ways and Means Committee Report at p. 17.

5 Ways and Means Committee Report at p. 17.
Third, the provisions of H.R. 1812 relating to former long-term residents of the United States override most of our income and estate tax treaties. None of these income tax treaties permit the United States to impose tax on certain gains that would be covered by H.R. 1812 on former residents of the United States who become residents of the treaty partner. Similarly, none of the estate tax treaties permit the United States to impose tax on certain transfers of assets that would be covered by H.R. 1812 by former residents of the United States who become residents of the treaty partner.

We also note that the override of tax treaties for a ten-year period ending in the year 2005 (assuming enactment in 1995) is unprecedented. Presumably, any issue which is pressing enough to override a tax treaty should also be pressing enough to override a tax treaty after this ten-year period expires. Also, our treaty partners knowing that the override will sunset after 2005 will attempt to drag out renegotiations so that those treaties would not change their treatment of expatriates after 2005.

Treaty overrides are not an issue that our treaty partners take lightly. The JCT Report indicates that the treatment of former U.S. citizens is an important issue in treaty negotiations. "First, [our treaty partners] may prefer to preserve for their own residents the benefits under the treaty (i.e., not subject to U.S. taxing jurisdiction). Second, they may resist the continuing expansion of taxation by the United States based on citizenship status. Third, they believe that they will lose revenue if they cede to the United States primary jurisdiction over non-U.S. source income." H.R. 1812 allows expatriates to reduce their U.S. tax under H.R. 1812 by any foreign taxes paid on those gains, and thereby cede primary taxing jurisdiction in certain cases to treaty partners. However, this provision does not change the fundamental nature of the treaty override: our treaty partners entered into a bargain with the United States that they did not expect to be broken unilaterally.

If the United States were to renegotiate treaties to take account of an override for expatriation, the JCT Report states that "in order to extract such a concession from our treaty partners during the negotiation process, it probably would be necessary for the United States to forego certain other benefits to obtain a balance of benefits under the treaties." We agree that concessions would be necessary in any renegotiation of our treaties. Therefore, when comparing H.R. 1812 to S. 700, Congress should weigh any tradeoffs in tax treaty negotiations that would be required as a result of H.R. 1812.

We believe that, from the perspective of international law, the approach of H.R. 1812 is fundamentally flawed since it is possible to achieve the tax policy objectives of taxing expatriates without overriding tax treaties. In order to prevent tax avoidance by

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6 JCT Report at p. 120.

7 JCT Report at p. 120.
expatriates in a manner consistent with U.S. obligations under international law, the taxable event should occur while the individual is still a U.S. citizen or resident, and not after his expatriation. S. 700 does not conflict with tax treaties since S. 700 assesses tax while the individual is still a U.S. citizen or resident. The United States would be able to impose this tax consistent with our treaty obligations.

The JCT Report questions whether the provision of S. 700, which establishes a new date on which U.S. citizenship terminates, would violate tax treaties. (This same issue is raised with H.R. 1812.) The JCT Report is concerned that the undefined term "U.S. citizen" in tax treaties would have the meaning it had at the time that the treaty went into effect. This concern is unfounded. The United States interprets this term by reference to the definition that is in effect at the time of interpretation. This U.S. approach is consistent with international norms. The United States interprets undefined treaty terms by reference to the definition in use at the time of interpretation. This approach is consistent with international norms. The 1995 version of the Organization for Economic Cooperation and Development ("OECD") Model income tax treaty will be revised to make this point more explicit, and the commentary will state that this clarification is to conform the OECD Model text more closely to the general and consistent understanding of Member states.

While a legislative override of tax treaties may occasionally be required by compelling circumstances, expatriation tax avoidance is not one of those cases. We strongly urge Congress not to override tax treaties when alternative means of achieving our tax policy objectives can be accomplished without violating international law. In this case, it is clear that S. 700 does not override tax treaties and this fact alone should be the basis for its support over H.R. 1812. We believe that this objection by itself is so serious that H.R. 1812 should be rejected.

F. OTHER ISSUES.

1. INFLUENCE OF PROPOSALS ON THE INCENTIVES FOR EXPATRIATION.

The JCT Report asserted that S. 700 would create incentives for individuals with high basis assets to expatriate. We believe that this concern does not stand up to scrutiny. First, existing law already provides powerful tax incentives for expatriation. Under current law, a taxpayer with high-basis assets (i.e., someone who has recently inherited assets with a step-up in basis) can expatriate, then sell those assets at no or little gain and reinvest in foreign source income producing assets. The sooner the individual expatriates, the sooner he lowers his U.S. income tax liabilities under current law, S. 700, or H.R. 1812. (In this regard, while this tax planning idea for taxpayers with

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8 For the general proposition that the United States interprets undefined treaty terms by reference to the definition in use at the time of interpretation, see Rev. Rul. 80-243, 1980-2 C.B. 413.
high basis assets is theoretically possible, we have not identified very wealthy U.S. citizens who have recently expatriated as being in this category.) Thus, relative to current law, S. 700 is unlikely to provide any additional incentive that would be strong enough to cause acceleration of expatriations.

In addition, H.R. 1812 has similar incentives to those alleged in S. 700. Under H.R. 1812, a recent heir could contribute his high-basis U.S. property to a foreign corporation and incur little or no tax. As a result, the expatriate's U.S. assets would be treated as foreign assets under H.R. 1812 because they are held through a foreign corporation. However, if the recent heir waited until his assets appreciated to expatriate, to the extent he does not plan around the provisions of H.R. 1812, he would trigger a larger amount of U.S. tax when he contributed his then-appreciated U.S. property to the foreign corporation. Thus, to the extent H.R. 1812 is effective, a recent heir has similar incentives to accelerate his expatriation to those he has under S. 700.

H.R. 1812 may provide incentives to accelerate expatriation among a different group of taxpayers. If H.R. 1812 is effective in requiring individuals to pay U.S. tax for ten years after their expatriation, individuals who intend to sell their business when they retire, or give the business to their children, have an incentive to expatriate ten years prior to such transaction. Under current law, they may be able to avoid U.S. tax and delay their expatriation until immediately before the transaction. These same incentives would apply to individuals who intend to expatriate to avoid U.S. estate taxes. S. 700 does not contain this same incentive to accelerated expatriation, because it does not continue to impose U.S. income tax for ten years after expatriation.

On this point, I would like to submit for the record a letter from three law professors at Harvard University: Bernard Wolfman, Reuven Avi-Yonah, and Diane Ring. Their letter indicates that S. 700 is unlikely to increase expatriations, and notes that if it were to cause increased expatriations, H.R. 1812 would be likely to have the same effect. Their letter also makes the point that those with appreciated assets will have substantially more incentives to accelerate their expatriation under H.R. 1812 than under S.700. They conclude: "We believe that a tax imposed on accrued gains at the time of expatriation (such as the Administration proposal) is superior to an approach which attempts to assess tax for ten years following expatriation. The latter proposal seems to provide more incentives to expatriate than the former."

2. TREATMENT OF LAWFUL PERMANENT RESIDENTS.

H.R. 1812 imposes continuing income, gift and estate tax obligations for ten years on any individual who has been a lawful permanent resident of the United States for eight years. Some might view it as unusual to subject these people to continued U.S. taxation for a longer period after they expatriate than the period that they were a U.S. resident.
The JCT Report states: "The Administration proposal would have an unfair effect on U.S. long-term residents who have been in the United States for more than 10 years and who have had no notice that they would be taxed on unrealized gains upon departure from the United States." We do not agree with this analysis. Congress has the right to change the taxation of long-term residents and has done so in the past (e.g., 1984 changes to definition of "resident" of the United States under section 7701(b)). Thus, long-term residents have no right to assume that our tax laws will not change, especially when the change mirrors a provision applicable to U.S. citizens.

Finally, we note that H.R. 1812 is only effective for long-term residents who expatriate after June 13, 1995. We believe that the effective date for any proposal should be consistent with the date used for citizens: February 6, 1995. Also, this effective date for long-term residents was set forth in the Administration's proposal.

II. THE JOINT COMMITTEE ON TAXATION EXPATRIATION REPORT.

In response to the Committee's request to testify at this hearing, the discussion below addresses a few of the points made by the JCT Report.

A. IMPORTANCE OF TAX AVOIDANCE THROUGH EXPATRIATION.

We believe that the available evidence demonstrates that tax avoidance by expatriates is an important problem which needs to be resolved. A group of wealthy individuals are taking advantage of a loophole in existing law which results in a significant revenue loss. Recent media interest as well as the attention devoted by the Congress and its staffs demonstrate a keen interest in this problem and the need to ensure that our tax code is perceived as fair. We have all dealt with reverse situations affecting a few taxpayers and the nominal revenue when the assertion is made that the tax laws were deemed to bite inappropriately. Thus, this issue needs to be resolved as a matter of fairness and public perception, regardless of the exact number of individuals affected or revenue raised.

The JCT Report found that expatriation to avoid tax was not a significant or growing problem. We agree that there are relatively few persons involved, but the revenue involved is not insignificant to either the taxpayer or the Treasury.

The JCT Report states that the Department of State was only able to identify four individuals who had expatriated out of approximately one thousand who were on the

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9 JCT Report at p. 4.

10 JCT Report at 1, 61, 65.
Forbes 400 list over the prior ten years. This does not seem to be compelling evidence of an insignificant problem for several reasons. The Department of State was unable to check a substantial portion of the Forbes 400 list because, due to the limitations of their data, the JCT was not able to provide precise names of individuals who are members of 203 families that were included in the Forbes 400.

There are many wealthy individuals in the United States who are not included in the Forbes 400. Thus, assessing the magnitude of the problem by focusing on this list does not give an accurate measure of the problem. Since the Administration proposal was released in February, Treasury has continued to gather data on the incidence of tax avoidance through expatriation. We are presently able to identify 68 citizens or long-term residents by name who have expatriated in the last five years and are wealthy enough to be affected potentially by H.R. 1812. In attempting to identify these expatriates, we have experienced some of the same frustrations that the JCT has encountered in trying to identify wealthy expatriates by name. We too have found transcription errors and difficulties matching expatriation records with our tax files. Therefore, we believe that we have not identified all wealthy expatriates during this period.

Also, there is a well-known cottage industry of tax advisors who advise on these types of tax planning techniques. Books are published and seminars are regularly presented on these issues. This industry would not exist without a reasonable level of expatriation activity. In addition, based on extensive discussions with practitioners, we believe that recent publicity of the expatriation tax loophole is causing many individuals who had never seriously considered the possibility to begin the process in earnest.

Finally, the JCT revenue estimate, although much lower than the Administration's estimate, confirms the seriousness of the problem. The JCT estimates that the Administration proposal would raise $1.9 billion over ten years. (The revenue estimates are discussed in more detail below.) Even based on the JCT's assessment of the number of individuals involved, a tax loophole that allows these individuals, however many, to save such a significant amount demands attention and action.

B. ENFORCEMENT OF CURRENT LAW.

The JCT Report complains that the IRS has not exerted adequate resources in trying to enforce current law. However, the JCT agrees that current law is so flawed

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12 In addition, the Department of State was unable to verify at least one person on the Forbes 400, Kenneth Dart, because of a transcription error in the data it received.

13 JCT Report at p. 2.
that any such enforcement efforts would have only been effective with respect to those taxpayers who engaged in poor tax planning. The JCT Report concludes: "Because of the limitations in the scope of present law, an individual may be able to achieve significant tax savings through expatriation, even if the person is found to have had a tax avoidance motive, and is thus subject to the special expatriation tax rules."\footnote{JCT Report at p. 69.}

We believe that, given the inadequacies of current law, the IRS over the last 29 years has devoted appropriate resources to tax avoidance by expatriates.

- Information provided to the JCT indicates that the IRS has identified approximately twenty individuals who are wealthy expatriates. The IRS pursued claims against many of these individuals, but existing law has not proven adequate to impose an appropriate amount of U.S. tax.

- For example, one individual expatriated several days before he earned several hundred million dollars of foreign source income. In addition, if that individual had remained a U.S. citizen, the taxpayer would have owed more than one billion dollars in U.S. tax on subsequent transactions. Despite extensive IRS resources devoted to this case, it appears that no U.S. tax will be collected on transactions after the taxpayer’s expatriation.

We conclude that the infirmities of current law are so serious that additional enforcement efforts by the IRS would have been nearly futile.

C. PURPOSE OF EXPATRIATION PROPOSALS.

In evaluating the proposals, we believe that the principal goal should be to move the Internal Revenue Code closer to tax neutrality for preexpatriation gains of an individual that is currently subject to tax as a citizen and facing the choice of whether or not to expatriate. To the extent possible, expatriation should not allow a U.S. citizen or resident to escape tax otherwise due on income or wealth accrued while a citizen or resident. In this regard, proposals should attempt to develop a system where an expatriate is not treated more favorably than a U.S. citizen who does not expatriate.\footnote{H.R. Rep. No. 145, 104th Cong., 1st Sess. 24 (1995). We shall refer to this document hereafter as the "Ways and Means Committee Report".}

Many of the recommendations of the JCT Report are contrary to the goal of moving closer to tax neutrality and achieving fairness. For example, the JCT Report suggests that the United States should not tax gains of expatriates on foreign assets.\footnote{JCT Report at p. 4.}
However, to achieve tax neutrality, the expatriation proposal should apply to foreign source income earned by expatriates because the United States generally taxes U.S. citizens on their worldwide income, exempting the foreign source income of expatriates retains the incentive to expatriate. In contrast, a proposal that taxes worldwide gains unrealized at the time of expatriation would provide much less incentive to expatriate.

In addition, the JCT Report questions whether the expatriation proposal should apply to U.S. citizens who were not born in the United States or who have not lived in the United States for a period of time. However, the United States has taxed its citizens who do not reside in the United States since the enactment of the Internal Revenue Code. The reason the United States taxes nonresidents is that they enjoy substantial benefits of U.S. citizenship. If Congress were to determine that a nonresident citizen does not enjoy enough benefits of U.S. citizenship to justify U.S. taxation of his worldwide income, he should not be subject to any U.S. income taxes. As long as current law provides for taxation of nonresident citizens, the expatriation proposal should also apply to these individuals.

A comprehensive tax at the time of expatriation on accrued worldwide gains, such as S. 700, comes closest to the ideal of tax neutrality. This approach would eliminate a substantial portion of the tax savings that otherwise would result from a decision to expatriate. In this regard, the motive for expatriation should be irrelevant. Further, the expatriation tax provisions should not exempt any accrued gains that would be subject to tax if realized as a citizen. Finally, the comprehensive accrued income approach would not reach beyond the economic income the taxpayer earned while subject to the U.S. tax system. Proposals like H.R. 1812 that tax U.S. source gains accrued after expatriation will encourage citizens to engage in behaviors to avoid U.S. source income after expatriation. This is the experience of current law.

III. REVENUE ESTIMATES.

You have asked for our comments on the revenue estimates of the various expatriation proposals. Treasury estimates that H.R. 1812 would generate approximately $0.10 billion over five years without a treaty override or $0.45 billion over five years with a treaty override, as compared to S. 700 which Treasury estimates would generate approximately $1.68 billion over five years. A summary of Treasury’s revenue estimates for the various expatriation proposals follows.

17 JCT Report at p. 2.
In order to obtain its revenue estimates, Treasury began by examining recent levels of expatriation. To do this, we attempted to locate the tax records from our files of those individuals who had recently expatriated. Our files consist of a sample of about 100,000 individual income tax returns, which includes a high proportion of the very highest income taxpayers. Because of both the incomplete coverage of our files, and the difficulty of matching records based on the name of the taxpayer (rather than the taxpayer's identification number), it is likely that we were not able to locate all of the relevant records. Nevertheless, expatriates whose tax records we were able to locate were used to project a baseline showing the projected future tax consequences of expatriation absent any change in the tax laws. The revenue gains attributable to each of the proposals before you today were then estimated by comparing their resulting tax consequences to this projected baseline.

Revenue estimates of the expatriation provisions are based on the specific financial situations of a relatively small number of taxpayers, and for this reason are subject to more uncertainty than many other revenue estimates. For example, although we have identified data showing at least 68 wealthy expatriates in recent years who apparently would have been subject to H.R. 1812, the revenue estimates of all proposals to tax income of wealthy expatriates are dominated by the potential expatriation of only a few multi-millionaires in any year. Adding or subtracting only one of these multi-millionaires from the sample, especially in the early years of the estimate, will have a relatively large effect on the revenue estimate. Therefore, it would be reasonable to expect that two independent groups, each using their best efforts and judgment, could come to different conclusions about the precise magnitude of the revenues attributable to each bill.

Inferences that can be drawn from the JCT Report suggest that JCT and Treasury may have different views on the best estimate of future levels of tax avoidance through expatriation, on the effect of estate and gift taxes on individuals, and on U.S. taxes that continue to be paid by expatriates. Treasury believes that tax avoidance through
expatriation is a growing problem. Therefore, we believe that the most recent information on expatriations most accurately represents the scope of the problem. In addition, we believe that if expatriation is deterred by a proposal, the United States will collect estate taxes on individuals who would otherwise have expatriated. Finally, we believe that expatriates continue to pay only very modest levels of U.S. tax as nonresident taxpayers under current law. Disparities between Treasury and JCT estimates likely reflect the JCT's somewhat different views on these matters.

Because of the difficulty involved in determining the precise magnitude of the revenue effects, it may be more instructive to focus on the relative magnitude of the estimates for the various proposals. In our view, the Administration proposal should raise the most revenue, S. 700 would rank second, and H.R. 1812 should be expected to raise the smallest amount of revenue.

In order to explain this ranking of the revenue-generating potential of the three proposals, let us compare the effect of each of these proposals on an extremely wealthy U.S. citizen holding a diverse portfolio of appreciated assets who is planning to expatriate solely to avoid income and estate tax under current law. Under the Administration proposal, this individual is faced with a choice: he can expatriate and pay capital gains tax on unrealized gains immediately, or he can remain a U.S. citizen, continue to pay U.S. tax on his worldwide income, and defer tax on capital gains until they are realized or his estate pays estate tax. We believe the Administration's proposal will substantially remove that individual's tax incentives to expatriate. We, therefore, assume that the individual will remain a U.S. citizen, and that the United States will lose no tax revenue from that individual because he will elect to remain a U.S. citizen. (If we had assumed that individuals such as this one would continue with their plans to expatriate, the expatriate would pay a tax on his accrued gains at the time of departure, and the revenue gain in the budget window would have been much larger.)

Generally, we assume that S. 700 will also deter this type of wealthy individual from expatriating. Although S. 700 allows taxpayers to defer the payment of tax on their gains, when the asset is eventually sold, tax is due on the entire gain. Thus, on a present value basis, an expatriate would pay a tax on accrued capital gains under S. 700 that is at least as great as the Administration proposal. However, we believe that certain individuals may choose to expatriate under S. 700 and elect to defer tax until the asset is disposed. Therefore, our revenue estimate for S. 700 is not as great as the estimate for the Administration's proposal. S. 700 would reduce the revenue in a five or ten year period for those individuals who choose to expatriate, because it would allow the taxpayer to defer the tax on assets that have substantial accrued capital gains.

We believe that H.R. 1812 is unlikely to deter many individuals from expatriating. Our hypothetical wealthy individual's tax can be expected to be lower if the taxpayer expatriates. The expatriate will nearly always have a tax incentive to expatriate under H.R. 1812, because only certain types of income will continue to be taxed, whereas he
would be taxed on all income if he remained a U.S. citizen and no tax is due after the ten-year waiting period.

Some of the reasons why expatriation continues to provide tax-saving opportunities under H.R. 1812 are inherent in the design of the bill, while others appear to stem from potential loopholes. The tax incentives to expatriate that remain under H.R. 1812 are four-fold. First, H.R. 1812 imposes tax on the U.S. assets of expatriates for only ten years following expatriation. Thus, expatriates who are patient can forego income from their U.S. assets and can put off realizing the embodied capital gains for ten years. Second, some individuals own foreign assets, whose sale would be exempt from tax after expatriation (as would any income generated by those assets). Third, as described above, there are a number of techniques that seem to allow expatriates to avoid tax on their domestic gains. Finally, H.R. 1812 allows exceptions for certain individuals with ties (by birth, ancestry, or marriage) to foreign countries. Some of the wealthy expatriates we have identified would have benefited from these exceptions.

The foregoing discussion describes the relative tax considerations for a wealthy individual with a wide variety of appreciated assets who was planning to expatriate. Much has been made of the potential effect of the three proposals on the less frequent case of a taxpayer whose assets consist primarily of recently inherited wealth. Because of the step-up in basis for inherited assets, this taxpayer will have a high basis in these assets. The claim has been made that the Administration's proposal encourages these recent heirs to expatriate immediately. We can debate whether this type of taxpayer, who had planned to postpone expatriation to some future date, would in fact immediately expatriate, and the revenue implications of such a decision. However, the Administration's proposal, S. 700 and H.R. 1812 would all lead to similar results for these wealthy heirs. In other words, under all three proposals the taxpayer will be able to expatriate and immediately sell his assets and avoid future U.S. tax consequences, so that this hypothetical should have little or no impact on the relative estimates for the three proposals. In addition, if the Administration proposal speeds up expatriations, those who expatriate are likely to pay some tax on departure, since even recent heirs are likely to also own a number of appreciated assets.

CONCLUSION

In the last few months, extraordinary attention has been focused on tax avoidance through expatriation. We stand firm in our belief that Americans who avoid their tax responsibilities by expatriating should not be rewarded. Instead, they should be asked to pay the same tax on income they accrued while subject to U.S. tax laws that those who remain will pay sooner or later. We believe that Congress should enact an expatriation tax avoidance provision that is based on S. 700.

Mr. Chairman, this concludes my remarks. I would be pleased to answer any questions that the Committee may have.
APPENDIX A

POSSIBLE TAX PLANNING TECHNIQUES FOR EXPATRIATES TO AVOID TAX UNDER H.R. 1812 ON U.S. SOURCE INCOME AND GAINS

1. Under H.R. 1812, taxpayers can effectively dispose of their U.S. assets during the ten-year period through installment sales. If an expatriate sells a U.S. asset to a foreign purchaser for an installment note that will mature in eleven years, it appears that no tax will be imposed on the sale under H.R. 1812. However, during the ten-year period he would be able to receive interest on the installment note without U.S. tax because the interest would be from foreign sources.

2. Property which produces U.S. source income can be transferred to a foreign corporation without recognition of gain. As long as that corporation does not sell the property or make any distribution of income to the expatriate within the ten-year window, there will be no U.S. tax imposed by reason of H.R. 1812 on income from those assets. After the ten-year period, the expatriate can withdraw the income without U.S. tax. Also, an expatriate will always have an incentive to contribute his U.S. assets to a foreign corporation, because any resulting gain is only taxed to the extent of preexpatriation gains. In contrast, if he continued to own the assets directly, he could be subject to tax on all gains.

3. An expatriate may reduce tax under H.R. 1812 by incurring interest expenses which would reduce domestic income. For example, assume that an expatriate will earn $20 million of domestic source dividends each year. The expatriate could borrow $200 million (secured by his U.S. stock) and invest the loan proceeds in foreign instruments. After this transaction, the expatriate will earn $20 million of domestic dividends, pay $20 million of interest expense, and earn $20 million of foreign income. Despite the fact that the expatriate may not have significantly changed his overall economic position, the interest expense may be allocated (in whole or in part) against U.S. income, thereby minimizing his U.S. tax obligations under H.R. 1812.
May 22, 1995

Hon. Leslie B. Samuels
Assistant Secretary (Tax Policy)
Department of the Treasury
Washington, D.C. 20220
Fax: (202) 622-0605

Dear Secretary Samuels:

Your office has asked for my views on the international human rights aspects of the Administration proposal to prevent individuals who choose to renounce their citizenship from avoiding their ordinary tax responsibilities. I teach international law and international litigation and have written in the area of democratic theory and international human rights.

I understand that Senator Moynihan is offering an amendment to the Administration proposal that will allow individuals seeking to renounce their citizenship to choose either to pay capital gains tax on gains in excess of $600,000 or to continue to be treated as a U.S. citizen for tax purposes. I conclude that with the addition of this amendment the Administration’s proposal is consistent with international law and with the U.S. commitment to the protection and promotion of human rights.

As has been ably analyzed by the Office of the Legal Adviser and by various other experts in international law consulted by your office, the proposed tax violates neither the right to emigrate nor the right to expatriate. U.S. citizens remain entirely free to leave the territory of the United States and to live abroad. U.S. citizens also remain free to renounce their citizenship, on the condition that they fulfill the ordinary obligations of citizenship imposed equally and non-arbitrarily on all citizens.

Individuals do not have a right to evade the normal obligations of citizenship, including taxation. To allow citizens to escape these obligations without penalty or compensation would be akin to allowing an unrestricted right for rich portions of a population to secede from their poorer neighbors on the ground that they should not be required to shoulder the burden of
providing for the common welfare. To the extent that expatriation is a means to the end of tax evasion, it is reasonable and legal for a government to qualify or condition the right of expatriation in such a way as to prevent it from being used for such purpose. Indeed, the United States joins the company of nations such as Canada, Germany, Denmark, Sweden, and the Netherlands, nations with a strong record of combining protection of fundamental human rights with recognition of the responsibilities of all members of a polity to contribute their fair share to the commonweal.

To impose the expatriation tax without regard to the motive for expatriation might unfairly burden those who seek emigration for reasons unrelated to tax considerations. However, the amendment offered by Senator Moynihan allowing individuals to elect to continue to be treated as U.S. citizens for tax purposes for a length of time after expatriation alleviates this concern. As amended, the proposed tax is fully consistent with the protection of international human rights.

Sincerely,

Anne-Marie Slaughter
Professor of Law
July 7, 1995

The Honorable Robert Packwood
Chair, Committee on Finance
United States Senate
Washington, D.C. 20510

The Honorable Daniel Patrick Moynihan
Committee on Finance
United States Senate
Washington, D.C. 20510

Leslie B. Samuels
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue N.W.
Washington, D.C. 20220

Dear Sirs:

We understand that the Committee on Finance is considering legislation to subject wealthy U.S. citizens to tax on the capital gains (in excess of $600,000) they have accumulated during the period of their citizenship, even if they try to avoid capital gains or estate taxation by giving up their U.S. citizenship. While we take no position on the merits of this legislation, we are concerned that international human rights law has erroneously been invoked by opponents of the proposal to suggest that it might violate the right to leave and to return to one's country.

As an organization devoted to the protection and promotion of international human rights law, we must take issue with the interpretation of international law being espoused by opponents of this legislation. The Universal Declaration of Human Rights provides in Article 13 that "Everyone has the right to leave any country, including his own, and to return to his country" and in Article 15(2) that "No one shall be arbitrarily deprived of his nationality nor denied the right to change his nationality." Similarly, the International Covenant on Civil on Political Rights, which came into force for the United States on September 8, 1992, states in Article 12(2) that "everyone shall be free to leave any country, including his own."

The proposed tax law change would not infringe upon those human rights protections. U.S. citizens would not be prevented from leaving the U.S.; their right to travel would be undiminished. Neither would U.S. citizens be deprived arbitrarily of their right to change their nationality. Instead, they would be subjected to taxes which they would ordinarily have had to pay upon death or sale of their property and they would not be permitted to avoid taxation by the tactic of renouncing their citizenship.
We understand that opponents of the Administration's tax proposal have even cited the Jackson-Vanik Amendment, Section 402 of the Trade Act of 1974. The Jackson-Vanik Amendment was adopted in response to the very high Soviet tax imposed on Soviet citizens (particularly Jews) who wanted to leave the U.S.S.R., but that tax was imposed on an the basis of an individual's level of education and not their wealth or income. Also, the Soviet tax was imposed on emigration — not on change of citizenship. Hence, the Jackson-Vanik Amendment is not inconsistent with the Clinton Administration's tax proposal.

It is also useful to note that similar tax provisions have been in force in the following countries: Australia, Canada, Denmark, Finland, Germany, Netherlands, Norway, and Sweden. For example, Canada imposes a departure tax upon the termination of Canadian residence, which is somewhat similar to the proposed U.S. tax on expatriation. Indeed, Canada and all the countries mentioned above (unlike the U.S.) have ratified the Optional Protocol to the Civil and Political Covenant or have accepted the individual petition procedure under the European Convention for the Protection of Human Rights and Fundamental Freedoms. Nonetheless, a review of the jurisprudence under the Civil and Political Covenant and the European Convention fails to reveal any support for the idea that human rights law would forbid the proposed tax on expatriation.

Accordingly, we hope that the Committee will consider the tax proposal on its merits and avoid irrelevant international human rights arguments.

Sincerely yours,

Barbara A. Frey
Executive Director

Professor David Weissbrodt
Legal Counsel
Dear Mr. Samuels:

In connection with the hearing that you have scheduled for July 11, 1995, I am sending you the following comments on the international human rights implications of the Administration expatriation tax proposal. I hope these comments may be of assistance to you.

Statement of Qualifications

I am the Leighton Professor of Law at Northwestern University, where I have taught since 1968. I graduated from Cornell in 1958, received a J.D. from Harvard Law School in 1961, and a Ph.D. from Columbia University in 1968. I am the founder in 1985 and still Chair of the Human Rights Interest Group of the American Society of International Law. I have written about twenty books and a hundred articles, specializing on the theory of international law and human rights.

Brief Conclusion

After careful study and research, I believe that the Administration's expatriation tax proposal does not violate, even minimally, the human rights that all persons enjoy under international law. Instead, a case can be made that the average American taxpayer's rights are infringed under current law if wealthy Americans can expatriate themselves and avoid paying their fair share of capital gains tax.

Attendant

I am personally opposed to capital gains taxation; I believe it disadvantages Americans in the world economy. However, as long as capital gains taxation is on the books, there should be no unfair loopholes for anyone who has enjoyed capital appreciation. The Administration's expatriation tax proposal closes a loophole. This can be seen clearly if we consider how Congress might have taxed capital gains and compare that scenario with the way capital gains are presently taxed. From the very beginning of the capital gains tax, Congress might have required each taxpayer at the end of the taxable year to add up all capital appreciation, subtract the amount of capital assets that had devalued during that year, and pay a tax on the net gain if any. Instead, Congress decided to tax capital gains when they were converted or sold. This may have made the capital gains tax more politically acceptable, because a taxpayer who
sold assets would presumably be holding cash, thus easing the tax bite. Yet if we compare what Congress might have done with what Congress actually did, we find that there is no substantial difference as far as measuring the tax is concerned; rather, the only difference is a technical one—that the tax as currently administered is triggered by the sale or conversion of assets, and not simply by bookkeeping at the end of a taxable year. Below the surface, what is really being taxed, in both cases, is the capital appreciation itself. Capital gains taxation is simply a tax on net capital appreciation. When the tax is triggered by a sale or by the taxable year coming to a close—is only of incidental importance.

It seems to me that any American citizen, who has enjoyed the economic and social protections of this country that have enabled him or her to amass capital appreciation, owes a capital gains tax. Congress has provided either that the tax must be paid upon sale or conversion of the capital asset or that the appreciated asset be funneled into the taxpayer’s estate where it incurs estate taxation at higher rates than the capital gains rate. Since everyone who owns a capital asset either sells (or converts) it, or dies holding it, there is in theory no escape from capital gains taxes. When Congress initially enacted the capital gains tax, it was thought that there was no possible escape, and hence the tax was fair because everyone enjoying net capital appreciation would have to pay it sooner or later.

However, it has recently been found that there may have been an unintended expatriate’s loophole. An American taxpayer who has amassed capital appreciation during the term of his or her American citizenship, may decide to avoid the “triggering mechanism” by (a) undergoing expatriation, and (b) selling the appreciated assets after a new citizenship has been acquired in another country. Even under present law, if the IRS can prove that the expatriation was done for a tax-avoidance purpose, the capital gains tax will apply and “follow” the taxpayer to the new country. As I see it, the only reason for the Administration’s current expatriation tax bill is the difficulty of proving a tax-avoidance intent. The expatriating taxpayer can well afford to hire expensive counsel to fight the IRS on the issue of intent, an issue which is inherently difficult to prove.

There should be no reason for the IRS to have to prove intent, because expatriating taxpayers should not be allowed to escape capital gains taxation for the incidental reason having to do with the “triggering mechanism.” For the underlying fact is that capital appreciation was earned during the course of the taxpayer’s American citizenship, and therefore a tax is fairly due on that appreciation at some point in time. If the taxpayer manages to avoid paying the tax because of expatriation, then all the other taxpayers who remain American citizens are proportionally disadvantaged to the extent of the expatriate’s tax avoidance.

International law, a system that dates back over three thousand years, was never intended to confer an advantage on a person who changes national allegiance at the expense of the citizens who remain home. In recent years, international law has affirmatively provided for expatriation, but not at the expense of avoiding one’s legitimate obligations. Thus, in the Universal Declaration of Human Rights, Articles 13 and 15 provide:

Article 13

1. Everyone has the right to freedom of movement and residence within the borders of each state.
2. Everyone has the right to leave any country, including his own, and to return to his country.

Article 15

1. Everyone has the right to a nationality.

2. No one shall be arbitrarily deprived of his nationality nor denied the right to change his nationality.

Those who quote these provisions out of context conveniently forget that the Universal Declaration of Human Rights also contains Article 29:

Article 29

1. Everyone has duties to the community in which alone the free and full development of his personality is possible.

2. In the exercise of his rights and freedoms, everyone shall be subject only to such limitations as are determined by law solely for the purpose of securing due recognition and respect for the rights and freedoms of others and of meeting the just requirements of morality, public order and the general welfare in a democratic society.

3. These rights and freedoms may in no case be exercised contrary to the purposes and principles of the United Nations.

Article 29 paragraph 2 makes it clear that any of the preceding Articles that confer specific rights on persons (such as the right to a nationality and the right of expatriation) are not to come at the expense of the "rights and freedoms of others." Normally, the act of expatriation does not affect the rights of other persons. But if expatriation in fact functions so as to negatively affect the rights of others, then the expatriation can be limited by law so as not to have that negative effect. Thus, the expatriation tax plugs this particular loophole. It ensures that the expatriate does not get away without paying his or her fair share of taxes.

A qualification similar to that of Article 29 is contained in the International Covenant on Civil and Political Rights, ratified by the United States Senate on April 2, 1992, but this time right within the same Article that allows for expatriation. Article 12:

Article 12

1. Everyone lawfully within the territory of a State shall, within that territory, have the right to liberty of movement and freedom to choose his residence.

2. Everyone shall be free to leave any country, including his own.
3. The above-mentioned rights shall not be subject to any restrictions except those which are provided by law, are necessary to protect national security, public order (ordre public), public health or morals or the rights and freedoms of others, and are consistent with the other rights recognized in the present Covenant.

4. No one shall be arbitrarily deprived of the right to enter his own country.

Thus, international law again makes it clear that one person's human rights are not to be at the expense of another person's human rights. It is a fundamental tenet of taxation that persons who are equally situated are subject to equal taxes. American citizens who enjoy capital appreciation and then either sell their assets or include their assets in their estates must pay the capital gains tax (or estate taxes at higher rates). The same holds true for an American citizen who enjoys capital appreciation and then leaves the United States before selling the assets (or, of course, before dying). The capital gains that accrue when during the time that a taxpayer is an American citizen are fairly subject to taxation. Paragraph 3 of Article 12 of the International Covenant on Civil and Political Rights which speaks of the "rights and freedoms of others" ensures application, under international law, of this principle to the expatriating taxpayer.

To be sure, the scale between an individual's human rights and the "rights and freedoms of others" can tip too far in either direction. If an expatriate leaves without paying his fair share of taxes, then, as I have argued, the "rights and freedoms of others" are negatively impacted. But it is also possible to inflate the "rights and freedoms of others" to the point that a person is deterred from expatriating. This is indeed what happened in the Soviet Union in the 1970s, which was rightly subject to the Jackson-Vanick Amendment to the Trade Act of 1974. This Amendment, also known as the "Freedom of Emigration" Amendment, denied most-favored-nation treatment to the Soviet Union so long as it "imposed[d] more than a nominal tax on emigration." (Trade Act of 1974, 19 USC § 2432.) Congress was reacting to the imposition by Moscow of a "diploma tax" on emigrants who had received higher education at the State's expense.

The Soviet Union's "diploma tax," for at least four basic reasons, presented an almost insurmountable barrier to any individual who desired to leave that country. Yet if we look at the "diploma tax" more closely, we can find that it is significantly different from the "exit tax." First, the Soviet Union made the payment of the "diploma tax" a precondition for its citizens to leave the country. This was a physical obstacle to emigration, one that in fact blocked most people from leaving. In contrast, the Administration's expatriation tax imposes no restraint upon anyone's right or freedom to leave the United States and/or give up American citizenship: Second, the "diploma tax" was extremely steep. Although the actual amounts imposed on citizens wishing to leave the Soviet Union varied according to the bureaucrats who administered the tax, my own calculation of the average amount of the "diploma tax" is that it was the equivalent of the amount of money an average Soviet citizen might have been able to save after fifteen to twenty years of labor. As a result, the "diploma tax" was excessively burdensome, and succeeded in reducing the rate of emigration to a trickle. In contrast, the "exit tax" only applies if there are capital gains. And if there are capital gains, the taxpayer is only liable for a tax of 28% (or less) of the cash realized upon sale of the assets. Since the taxpayer will have this cash in hand, paying of a portion of it in taxes, though unpleasant, is hardly a barrier to leaving the country. (In
those cases where it may appear to be a barrier, the bill gives the expatriate reasonable options for deferring payment.) Third, there was no rational basis within the Soviet economy for placing a monetary value on higher education, with the result that the amount of the "diploma tax" was essentially arbitrary. The reason there was no rational basis was that, under the Soviet system, a college graduate received the same monthly salary as a person who did not go to college. The value of higher education was only that you had a wider choice of jobs (e.g., you could be a scientist in military defense if you were a college graduate). Since higher education was free, and since it did not lead to a higher-paying job, a college graduate could not recapture the value of her education in the job market. Hence, raising the money needed for the "diploma tax" within the Soviet economy was unrelated to the fact of having a higher education. Hence the amount of the "diploma tax" was arbitrary. This lack of economic relationship between the diploma and the diploma tax constitutes a major difference from the "exit tax" proposed in the United States, where there is a direct relation between asset appreciation and paying a capital gains tax on that asset appreciation.

Fourth, the Soviet Union imposed the "diploma tax" in order to discriminate against its Jewish citizens who had been emigrating to Israel in large numbers. Although the "diploma tax" applied to everyone who wanted to leave, in fact nearly everyone who wanted to leave in the 1970s was of the Jewish faith. Thus the "diploma tax," quite apart from human-rights provisions regarding nationality and expatriation, may have violated other deep-seated human rights prohibitions against discrimination based upon group membership.

First, allow me to address the contention that even if the Administration's expatriation tax does not violate international law, other countries might perceive it as contrary to the position the United States took regarding the Soviet "diploma tax," and therefore might regard the United States as compromising its moral authority with respect to international human rights. I believe that if other people in other countries take this position, they may be doing it to score political points. For honest reflection should convince them that there is not even the remotest chance that the expatriation tax violates international human rights—indeed, as I have argued, not imposing the tax would violate the rights of all the American taxpayers who do not leave this country. (If they don't want to engage in honest reflection about this point, then there's nothing we can do about it. We shouldn't change our own policies because other people can dishonestly misconstrue them.)

Conclusion

Even though I see no problem whatsoever with the international human rights implications of the Administration's expatriation tax proposal, I am gratified that this issue is being given prominent attention. A few decades ago no one would have cared about human rights. It is a distinct mark of our progress as a civilization that an issue of tax policy is argued in terms of its impact upon international human rights.

Respectfully submitted,

Anthony D'Amato
Leighton Professor of Law
Northwestern University
Leslie B. Samuels  
Assistant Secretary (Tax Policy)  
Department of the Treasury  
1500 Pennsylvania Avenue, N.W.  
Washington, D.C. 20220

Dear Secretary Samuels:

We would like to share with you some of our views regarding one aspect of the expatriation proposals that will be considered by the Senate Committee on Finance on July 11. We understand that it has been suggested that the Administration proposal might create a particular incentive to expatriate for individuals who own unappreciated assets. This suggestion is puzzling. Initially, we wonder how many wealthy individuals have little or no gain in their assets. Even recent heirs often have assets that have appreciated. But assuming the existence of such individuals, current law nearly always provides an incentive to expatriate as soon as possible to avoid U.S. income taxes. The Administration proposal, which would tax accrued gains of expatriating individuals, would seem to add little to the incentives of existing law, especially given the latter’s ineffectiveness. Moreover, the House Ways and Means Committee proposal (H.R. 1812) would have the same purported incentive as the Administration proposal. Under H.R. 1812, an expatriate could “cleanse” U.S. assets by contributing them to a foreign corporation and then recognizing any accrued gains. Thus, under H.R. 1812, a recent heir might have an incentive to expatriate as soon as possible to reduce the amount of appreciation that would be triggered when assets are transferred to the foreign corporation. We conclude, therefore, that individuals with unappreciated assets should be no more likely to expatriate under the Administration proposal than under H.R. 1812.

Furthermore, if H.R. 1812 effectively requires expatriates to pay tax on their U.S. income for ten years following expatriation (a result we doubt), it seems likely that H.R. 1812 would create incentives for wealthy individuals with appreciated assets to expatriate. If an individual planned to sell his or her business and retire at age 65, under current ineffective law that individual could avoid U.S. tax by expatriating immediately before retirement at age 64. If H.R. 1812 were enacted, however, the individual would need to expatriate at age 54 (10 years prior to retirement) in order to avoid U.S. tax. This concern may be more serious because the population of wealthy individuals presumably contains many more people with appreciated assets than those with unappreciated assets. Similarly, an expatriate trying to avoid U.S. estate tax can accomplish that result under current law by
expatriating just before death. If H.R. 1812 were in effect, the individual would be encouraged to expatriate at least ten years before he or she expected to die.

We believe that a tax imposed on accrued gains at the time of expatriation (such as the Administration proposal) is superior, for the above and other reasons, to an approach which attempts to assess tax for ten years following expatriation. The latter proposal seems to provide more incentives to expatriate than the former.

Sincerely,

Bernard Wolfman
Fessenden Professor of Law

Reuven Avi-Yonah
Assistant Professor of Law

Diane Ring
Assistant Professor of Law

The views expressed above are those of the individuals and not necessarily those of the University.
Closing Tax Loophole Opens Another for a G.O.P. Friend

By ROBERT D. HERSHEY Jr.

WASHINGTON, July 9 — Nothing, it seems, gets done easily in Washington, particularly when the issue involves people with a lot of money.

Take the so-called expatriates’ tax, a proposal intended to close a loophole with which a relatively few very wealthy Americans have avoided millions of dollars in income and estate taxes by renouncing their citizenship and moving abroad to countries with lower tax rates or more porous laws.

When President Clinton first proposed the expatriates’ tax in February, to collect $1.5 billion over the next five years, he figured that no lawmaker would dare oppose a measure aimed at making a handful of the super-rich, especially those who have given up their citizenship and therefore can no longer even vote, pay their fair share. “They thought they’d found an easy home run,” one Congressional aide said of White House officials.

But the Republican Congressional majority thought that the President’s approach — taxing assets at the point when the wealthy person acts to expatriate — smacked of unfair, and perhaps unconstitutional, penalizing of successful people by big government. Despite Democratic accusations that they were pandering to the rich, the Republicans managed to kill the idea.

Now the Republicans, who express agreement that the loophole ought to be closed, have come back with a bill of their own, under which former Americans would simply continue to be subject to the regular income tax for 10 years after they expatriate.

Democrats, only in part because they see great practical difficulty in collecting taxes from people who are no longer citizens and no longer live in the United States, call the Republican bill a sham. And they are particularly angered by a provision that would allow one large Republican contributor an exemption.

As designed by Representative Bill Archer, the Texas Republican who heads the House Ways and Means Committee, the majority’s bill, which the committee recently approved, would exempt anyone who takes up citizenship in a country where he, his spouse or at least one parent was born.

This provision was added in committee amid some intense legislative maneuvering undertaken by supporters of Joseph Bogdanovich, the 83-year-old vice chairman of the...
A Tax Loophole Saves Expatriates Millions

Continued From Page A1

Pittsburgh-based H. J. Heinz Company, who moved to Britain last year and recently renounced his American citizenship. Because his father was born in Yugoslavia, Mr. Bogdanovich would be able to escape the expatriates' tax by becoming a citizen of one of Yugoslavia's successor states. Indeed, Democrats maintain that it was largely for him that the provision was written.

One person enlisted on Mr. Bogdanovich's behalf by his lawyers at the Los Angeles firm of Loeb & Loeb was former Representative Guy Vander Jagt of Michigan, who was the second-ranking Republican on the Ways and Means Committee when he was defeated for re-election in 1992. Democrats note that Mr. Vander Jagt is a close friend and former law partner of Kenneth J. Kies, the new chief of staff of the Joint Committee on Taxation, the panel that serves as Congressional tax consultant and referee.

In an interview, Mr. Vander Jagt acknowledged having spoken to two members of Mr. Kies's staff about the Bogdanovich matter but said he had not spoken to Mr. Kies directly. He said he had known his assignment would be delicate, since Mr. Kies is "an exceedingly close family friend."

For his part, Mr. Kies said he had never discussed the matter "with anybody" representing Mr. Bogdanovich. He rejected any suggestion of impropriety and said all the back-and-forth on the expatriates' tax amounted to "just the most ugly political fight" over a small number of taxpayers.

Neither Mr. Bogdanovich nor his lawyers at Loeb & Loeb responded to repeated requests over a two-week period for comment on his citizenship or tax status. Nor did Heinz, although a spokesman for the company did say that Mr. Bogdanovich — whose father founded Star-Kist Foods, the tuna-fish giant bought by Heinz in 1963 — was now in charge of Heinz's fish procurement in Europe.

"In giving up his citizenship, Mr. Bogdanovich joins a small but growing number of Americans. About 1,000 of them did so last year, according to a State Department list whose notables include the New York-born violinist Yehudi Menuhin; Harding—L. Lawrence, chairman of the now-defunct airline Braniff International, and Mr. Lawrence's wife, Mary, a founder of the advertising firm Wells, Rich, Greene.

A G.O.P. proposal could make at least one Republican contributor happy.
Under current law, American citizens, who would otherwise be required to pay Federal taxes on income earned anywhere in the world, can avoid paying them — as well as estate taxes of up to 55 percent — by renouncing their citizenship and leaving the country. (Technically, the Government may continue to impose taxes on the expatriate for up to 10 years if it determines that his departure was tax-motivated, but poor enforcement, as well as sophisticated financial planning by those who leave, frequently makes this provision moot.) Particularly for wealthy people who have not yet realized profits by selling stock or other financial assets that may have been appreciating in value for many years, the tax savings achieved by expatriation can be enormous.

The President's remedy would have been to tax these unrealized gains on all the expatriate's assets at the time of departure, just as if those assets were then being sold.

But the Republicans compared Mr. Clinton's proposal to the oppressive exit taxes once imposed on Jews trying to leave the Soviet Union. They also declared that it was probably an unconstitutional denial of equal protection, since, among all people subject to Federal income taxes, only the expatriates would be taxed on unrealized capital gains.

The Republican solution was to scrap that exit taxation. Instead they proposed levying regular income taxes on expatriates for 10 years after their departure, with no need for the Government to determine the motivation for their leaving.

On its own, either approach — the Democratic or the Republican — would have captured taxes from Mr. Bogdanovich. But then the legislative maneuvering began.

Mr. Bogdanovich had renounced his citizenship last December but had not applied to the State Department for a certificate of loss of nationality until Feb. '94. He and his supporters tried to make the effective date of the bill in the Ways and Means Committee change, but failed.

After that, which some Democrats attribute to the attention the bill had attracted on Capitol Hill, its drafters created the special exempt class of any American expatriate who "becomes a citizen of the country in which the individual, the individual's spouse or one of the individual's parents was born."

Because the Republican bill as it eventually emerged from committee covers expatriation activity as far back as February 1994, Mr. Kies insisted in an interview that it did not let Mr. Bogdanovich — whose 54-year-old son, Robert, also expatriated last year — slip through the tax net. "He is specifically caught," Mr. Kies said.

And what about the escape hatch to the old Yugoslavia? Mr. Kles and other Republicans profess no knowledge of the birthplaces of any members of the Bogdanovich family.

In the meantime, the broader battle over the differing approaches to the expatriates' tax continues. In a long dissent to the Republican bill, the Democratic minority on the Ways and Means Committee contended that it would not stem tax avoidance by expatriates who have the patience simply to defer gains or other income for 10 years and that it would do little to prevent the avoidance of estate and gift taxes.

By the Administration's latest estimate, the Democratic approach would raise about $1.7 billion over the first five years, as against the Republican bill's $100 million. By contrast, the Joint Committee on Taxation, which is of course controlled by Republicans, estimates $800 million for the Republican bill and $200 million for the Democratic substitute.

The stark difference in those assessments reflects what Republicans regard as the Democratic bill's expatriation incentive for people with recently inherited wealth — and thus as yet little unrealized gain to tax. "They clearly say, 'Get out while the going is good,'" Ari Fleischer, the spokesman for the Ways and Means Committee's Republicans, said of the minority.

The Democrats call that characterization absurd. In their Ways and Means dissent, they asked, "How can a bill that results in no taxation in certain limited situations create an incentive for expatriation when the law it replaces results in no tax in virtually all cases?"

The Republican legislation awaits floor action in the House, and the Senate Finance Committee will hold hearings on Tuesday. The outlook is uncertain.