Taxing Exits

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Introduction: Expatriates and Flag Burners

Renouncing U.S. citizenship to save taxes is like flag burning; it offends people.[1] It offends people so much that tax-motivated expatriation[2] has become a *cause celebre* that has spawned both

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I thank my friend and colleague, Rick Greenstein, for his many insightful comments on the subjects of punishment and expatriation as well as on drafts of two other pieces that preceded but are related to this one. His ability to see connections in my work continues to inspire me. I also want to thank my colleagues, Mark Anderson, Nancy Knauer, and Jim Strazzella, for helpful suggestions, and John Necci of the Temple Law Library for his prompt and dedicated research assistance. Finally, I am grateful for the care with which Larry Lokken and Peter Faber read a prior draft and for the depth and extent of their comments. Of course, all errors are mine.

[1] I am indebted to Professor Bill Piatt for the analogy between flag burning and expatriation, which he made in a letter to me dated June 14, 1995. In an editorial published nearly one month later, *The Philadelphia Inquirer* made the same analogy. *Deserting Principle,* THE PHILADELPHIA INQUIRER, July 11, 1995, at A6.

[2] I use the term "expatriation" because that is the term generally used to describe the renunciation of citizenship in the context of the current debate. The dictionary definition of the term is actually much broader, referring generally to an individual's leaving one country for another and not necessarily implicating the renunciation of citizenship. *See* 1 THE NEW SHORTER OXFORD ENGLISH DICTIONARY 884 (Lesley Brown ed., 1993); WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 799 (Philip B. Gove ed., 1993). Because this Article addresses the issue in the context of the current debate, I will continue to use the term as it has been used in that debate. For a description of the debate and an explanation of the tax benefits that flow from the renunciation of U.S. citizenship, see *infra* part I.B.

Individuals can expatriate, as I will use that term in this Article, in two ways. They can do so directly, by affirmatively renouncing their U.S. citizenship before a diplomatic or consular officer in a foreign country. 8 U.S.C. § 1481(a)(5) (1994). They can also expatriate indirectly, by participating in specific actions, such as voluntarily becoming a citizen of a foreign country, serving in a foreign army, or committing an act of treason. *Id.* § 1481(a)(1)-(4), (6)-(7). *See generally* 4 CHARLES GORDON & STANLEY MAILMAN, IMMIGRATION LAW AND PROCEDURE § 100.03 (1992). In addition, a naturalized citizen can lose that citizenship through the process of denaturalization, which has the effect of vacating the act of naturalization and can be invoked upon allegations of fraud or illegality in the naturalization process. *See* 4 *id.* (discussing denaturalization of naturalized citizens). (I want to thank Professor Steve Legomsky for his correspondence instructing me on many of these points.) The expatriations which have served as the focus of the current debate are of the affirmative renunciation type, and, unless otherwise stated, that is the type of expatriation

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unrelenting media coverage and an attempted Congressional response.[3] The Congressional response has been to propose

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to which my comments will generally be addressed.

[3] In November 1994, *Forbes* ran a cover article on wealthy Americans who had apparently expatriated to avoid U.S. taxes. Robert Lenzner & Philippe Mao, *The New Refugees*, FORBES, Nov. 21, 1994, at 131. The article tantalizingly proclaimed that Michael Dingman, the chairman of Abex, might be able to pay for his new 15,000 square-foot home in the Bahamas with money he saved in taxes by giving up his American citizenship. *Id.* at 131-32. It went on to wax eloquent on the ease of expatriation, providing numerous examples and detailing conversations with lawyers whose practice involves counseling wealthy individuals on the benefits to be reaped from expatriating. *Id.* at 131-34. A week later, Michael Kinsley's acerbic essay in *Time* referred to the wealthy individuals featured in the *Forbes* article as "financial draft evaders" and contrasted their motives with those of traditional immigrants. Michael Kinsley, *Love It or Leave It*, TIME, Nov. 28, 1994, at 96. On February 22, 1995 the television news magazine *Prime Time Live* aired an episode on expatriation. The episode featured two attorneys who claimed to have counseled wealthy individuals with regard to expatriation. STAFF OF JOINT COMM. ON TAXATION, 104TH CONG., 1ST SESS., ISSUES PRESENTED BY PROPOSALS TO MODIFY THE TAX TREATMENT OF EXPATRIATION 65 n.118 (Comm. Print 1995) [hereinafter JCT REPORT].

The *Forbes* article came to the attention of President Clinton, whose outrage provided the impetus for his Administration's proposal to treat expatriation as a realization event. *Clinton Administration Proposes Antiabuse Provisions for Foreign Trusts, Expatriation*, 95 TAX NOTES TODAY 25-4 (1995); Nancy Loube, *Expatriate Games: Politics Obscures Technical Issues*, 67 TAX NOTES 158, 158 (1995). The Administration's proposal was transmitted to Congress as part of the 1996 Budget Proposal on February 6, 1995, and was introduced as H.R. 981 and S. 453 on February 16, 1995. H.R. 981, 104th Cong., 1st Sess. (1995); S. 453, 104th Cong., 1st Sess. (1995). The Senate also introduced an amendment to the Self-Employed Persons Health Care Deduction Extension Act of 1995, H.R. 831, 104th Cong., 1st Sess. (1995), which was a revised version of the Administration's proposal. Nevertheless, the expatriate provision did not make it out of Conference. 141 CONG. REC. H1951 (daily ed. Feb. 21, 1995). Instead, the final version of the Self-Employed Health Insurance Act, Pub. L. No. 104-7, § 6, 109 Stat. 96 (1995), required the Joint Committee to study the expatriate tax issue. The *JCT Report* was issued in compliance with that mandate. JCT REPORT, *supra*, at III, 1. The Joint Committee's estimate of the tax provisions in the President's budget contains a succinct history and description of the various bills. *See JCT Estimates Tax Provisions in President's Budget*, 95 TAX NOTES TODAY 34-56 (1995).

In May 1995, following enactment of H.R. 831, Rep. Gephardt offered his own expatriation proposal (H.R. 1215) as did Sen. Moynihan (S. 700) and Rep. Gibbons (H.R. 1535). H.R. 1215, 104th Cong., 1st Sess. (1995); S. 700, 104th Cong., 1st Sess. (1995); H.R. 1535, 104th Cong., 1st Sess. (1995). Subsequently, House Ways and Means Committee Chairman Bill Archer introduced H.R. 1812, which would strengthen the current anti-expatriation provisions of the Internal Revenue Code (the Code). H.R. 1812, 104th Cong., 1st Sess. (1995). In addition, Rep. Frank Cremeans introduced H.R. 2012, which would amend income, estate, and gift tax provisions dealing with expatriation. H.R. 2012, 104th Cong., 1st Sess. (1995). For insightful commentary on H.R. 1812 as well as on the other proposals, see Barbara Kirchheimer, *Archer's Expatriate Proposal Clears Ways and Means*, 67 TAX NOTES 1565 (1995), C. Jones Perry Jr. & Gerald Rokoff, *Expatriation Tax Act Is Reasonable but Raises Concerns*, 68 TAX NOTES 1134 (1995) (letter to the editor), and Lee A. Sheppard, *Defining the Expatriate Tax Debate*, 67 TAX NOTES 1566 (1995). *See also* Alice G. Abreu, *The Difference*

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amendments to the Internal Revenue Code (Code) so that expatriation is no longer attractive.[4] Like Congressional efforts to punish flag burning,[5] Congressional efforts to change the taxa-

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Between Expatriates and Mrs. Gregory: Citizenship Can Matter, 67 TAX NOTES 692 (1995) (explaining that expatriation debate has overlooked consequences of renouncing U.S. citizenship going beyond payment of U.S. taxes); *Clinton Administration Proposes Antiabuse Provisions for Foreign Trusts, Expatriation*, *supra*, at 25-4 (describing budget proposals that would revise taxation of foreign trust income and increase taxation of expatriates).

In the months that followed the initial flurry of anti-expatriate proposals spawned by the *Forbes* article, others in Congress weighed in with proposals of their own. A bill containing a variation on H.R. 1812 was actually approved by Congress in 1995, but it failed to become law when it was vetoed by President Clinton. The Health Care Affordability and Portability Act of 1996, H.R. 3101, approved by the House on March 28, 1996, contained a provision like H.R. 1812. *See House Expected to Pass Health Insurance Bill*, 96 TAX NOTES TODAY 63-3 (1996). On March 21, 1996, Sen. Harkin introduced S. 1637, the Expatriation Tax Reform Act of 1996. *See Harkin Bill, S. 1367, Would Revise Expatriate Tax Rules*, 96 TAX NOTES TODAY 68-50 (1996). S. 1637 is practically identical to the proposal contained in Title IX of the Revenue Reconciliation Act of 1996, President Clinton's latest (1997) budget plan. *See White House Statutory Language; Title IX, Revenue Reconciliation Act of 1996*, 96 TAX NOTES TODAY 56-1 (1996). Like S. 700, S. 1637 would treat expatriation as a realization event. Notably, S. 1637, like the President's most recent proposal, would amend § 102 of the Code so as to make gifts and inheritances from "covered expatriates" includable in the recipient's income. In addition, a provision that would deny reentry to former U.S. citizens who have expatriated to save taxes was included as part of the Immigration in the National Interest Act of 1995, which was approved by the House of Representatives on March 21, 1996. *See Expatriation Tax Provision Survives In House Action on Immigration Bill*, Daily Tax Rep. (BNA) No. 57, at G-4 (Mar. 25, 1996) [hereinafter *Expatriation Tax Provisions Survives*]. The Clinton Administration has opposed the no-reentry provision of the immigration bill and has argued that the problem of tax-motivated expatriation should be addressed by the Code. *See id.*; *see also Administration Wants Tax Code to Deal with Expatriates Avoiding U.S. Taxes*, Daily Tax Rep. (BNA) No. 52, at G-3 (Mar. 18, 1996) [hereinafter *Administration Wants Tax Code to Deal with Expatriates*].

[4] *See supra* note 3. For a description of the benefits attendant to expatriation, see *infra* part I.B.

[5] Burning of the American flag was criminalized in Texas, and the resulting constitutional challenge was the subject of the Supreme Court's decision in Texas v. Johnson, 491 U.S. 397 (1989). In *Johnson*, the Court held that burning the American flag was speech protected under the First Amendment. *Id.* at 406. The Court's decision in that case, and the constitutional issues raised by the criminalization of the act of flag burning, have been the subject of substantial scholarly commentary. *See, e.g.*, Akhil R. Amar, *The Case of the Missing Amendments:* R.A.V. v. City of St. Paul, 106 HARV. L. REV. 124 (1992); Robert J. Goldstein, *The Great 1989-1990 Flag Flap: An Historical, Political, and Legal Analysis*, 45 U. MIAMI L. REV. 19 (1990); Eric A. Isaacson, *The Flag Burning Issue: A Legal Analysis and Comment*, 23 LOY. L.A. L. REV. 535 (1990); Frank Michelman, *Saving Old Glory: On Constitutional Iconography*, 42 STAN. L. REV. 1337 (1990); Daniel H. Pollitt, *The Flag Burning Controversy: A Chronology*, 70 N.C. L. REV. 553 (1992); Geoffrey R. Stone, *Flag Burning and the Constitution*, 75 IOWA L. REV. 111 (1989). *See also* Paul F. Campos, *Advocacy and Scholarship*, 81 CALIF. L. REV. 817 (1993) (criticizing Professor Amar's article and *Johnson* decision).

Congress criminalized flag burning in the Flag Protection Act of 1989, Pub. L. No.

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tion of expatriation have been fraught with an abundance of rhetoric but constrained by a paucity of deliberate analysis.[6] The issue can benefit from thoughtful examination of the principles at stake and the consequences of legislative action.[7]

The push to enact legislation that would either make the act of expatriation a taxable event[8] or extend the taxing jurisdiction of the United States to expatriates,[9] has proceeded from a sense of outrage that began with President Clinton and spread to Congress.[10] That outrage followed the publication of stories that detailed how wealthy Americans had renounced their U.S. citizenship and moved abroad, thereby saving millions in federal taxes.[11] The outrage that followed those reports seems to have

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101-131, 103 Stat. 777 (1989), which was held unconstitutional in United States v. Eichman, 496 U.S. 310, 312 (1990). Following the Court's decision in *Eichman*, Congress attempted to pass a constitutional amendment to permit the criminalization of flag burning. Although the proposed amendment failed to win the necessary two-thirds vote in both houses of Congress, it did garner majorities in both. *See* 136 CONG. REC. S8736-37 (daily ed. June 26, 1990); 136 CONG. REC. H4087-88 (daily ed. June 21, 1990). Congress is now trying again. Rep. Gerald Solomon has sponsored a joint resolution proposing that the Constitution be amended to give Congress and the States "the power to prohibit the physical desecration of the flag of the United States." H.R.J. Res. 79, 104th Cong., 1st Sess. (1995). That resolution passed the House on June 28, 1995 by a vote of 312 to 120 and is now before the Senate. 141 CONG. REC. H6446 (daily ed. June 28, 1995).

[6] *See supra* note 3. The political leanings of those who have chosen to champion each of these issues provide an illuminating contrast. Flag burning seems to be the Republicans' issue, while expatriation seems to be the Democrats'. *See Kennedy Blasts Archer's Expatriate Proposal*, 95 TAX NOTES TODAY 134-2 (1995) (describing Sen. Kennedy's reaction to H.R. 1812); Robert D. Hershey, Jr., *Closing a Tax Loophole and Opening Another*, N.Y. TIMES, July 10, 1995 (with correction published on July 15, 1995), at A2. It is also interesting to note that those who burn the flag are generally not rich, while those who expatriate in order to reduce their U.S. tax liability are generally very rich.

[7] Flag burning has been the subject of much thoughtful scholarly commentary. *See supra* note 5. Expatriation, however, has not. Exceptions include Bernard Wolfman et al., *Professorial Views of the Expatriate Tax Proposals*, 68 TAX NOTES 359 (1995) (reprinting letter from authors to Leslie B. Samuels, Assistant Treasury Secretary for Tax Policy), Perry & Rokoff, *supra* note 3, and, I hope, my own Abreu, *supra* note 3.

[8] *See infra* note 22 and accompanying text.

[9] *See infra* note 23 and accompanying text.

[10] *See supra* note 3 (discussing history of tax proposals). Technically, it is fair to say that the outrage began with Robert Lenzner and Philippe Mao and the editors of *Forbes*, because it was their article that brought the issue to the President's attention and thus made the topic a politically controversial one. *See* Loube, *supra* note 3, at 158 (noting that Clinton asked Treasury for solution to expatriation issue after reading *Forbes* article).

[11] *See supra* note 3. For a glimpse of the depth of feeling the issue seems to have aroused, see *Unofficial Transcript of July 11 Finance Committee Hearings on Expatriates*, 95 TAX NOTES TODAY 141-57 (1995) [hereinafter *Hearings*]. During the Finance Committee hear-

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two distinctly different components. One component is indignation. It offends people to think that some individuals think so little of their U.S. citizenship that they renounce it for mere pecuniary gain.[12] That sense of indignation, or offense, leads quite naturally to a desire to exact retribution from those who inflict it and to deter the offensive behavior.

The desire for retribution and deterrence complicates the analysis of proposals to change the taxation of expatriation because retribution and deterrence are traditional aims of punishment, not of taxation.[13] One important question that any analysis of proposals to change the taxation of expatriates must therefore address is the extent to which the proposal amounts to punishment for expatriation, and, if so, the extent to which such punishment is a permissible objective of taxation.[14]

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ings, Sen. Baucus referred to those who expatriate to avoid taxes as "freeloaders. . . [and] greedy, unpatriotic people that FDR called malefactors of great wealth. . . [who] are skipping town, evading taxes, and making us cut Medicare and student loans to make up the difference." *Id.* Sen. Mosely-Braun drew an analogy between tax expatriates and an individual who expatriated to avoid having to serve in the armed forces during the Vietnam War, whose case she tried as a young Assistant U.S. Attorney. *Id.*

See also 141 CONG. REC. H3845-52 (daily ed. Mar. 28, 1995). The Representatives who spoke on Rep. Gibbons's motion to require House conferees to agree to inclusion of an expatriate tax provision in H.R. 831, the Self-Employed Health Insurance Act, were equally passionate. *See House Considers Conference For Self-Employed Health Deduction Bill*, 95 TAX NOTES TODAY 70-20 (1995). The House version of the bill did not contain such a provision, but the Senate version of the bill, passed after that body had held hearings on the subject, did. The provision was dropped in Conference, a result that Gibbons's motion was designed to prevent. (Adapted from Abreu, *supra* note 3, at 693 n.2).

[12] I include myself within this group. *See* Abreu, *supra* note 3, at 694.

[13] *See generally* SANFORD H. KADISH & STEPHEN J. SCHULHOFER, CRIMINAL LAW AND ITS PROCESSES 136-53 (5th ed. 1989); NIGEL WALKER, WHY PUNISH? (1991); Joel Feinberg, *The Classic Debate*, *in* PHILOSOPHY OF LAW 646 (Joel Feinberg & Hyman Gross eds., 4th ed. 1991). Deterrence is generally associated with utilitarian philosophers such as Jeremy Bentham. WALKER, *supra*, at 13-20; *see also* 1 JEREMY BENTHAM, THE WORKS OF JEREMY BENTHAM 396-97 (John Bowring ed. 1962). Retribution is generally associated with deontologists and contractarians such as Emmanuel Kant and Robert Nozick, respectively. WALKER, *supra*, at 67-118. Other legal philosophers are more eclectic. For example, Professor Hart generally sees the function of punishment in utilitarian terms. H.L.A. HART, PUNISHMENT AND RESPONSIBILITY 6 (1968). However, he believes that the innocent should never be punished, thus suggesting the value that underlies retribution. *Id.* at 11-13. *See also* WALKER, *supra*, at 67.

[14] That making expatriation a taxable event would be tantamount to punishing expatriation was not lost on several members of Congress, who worried that any such proposal would violate significant international conventions. *See, e.g.*, 141 CONG. REC., *supra* note 11, at H3848 (statement of Rep. Johnson). It was also not lost on the Joint Committee on Taxation. *See infra* text accompanying note 157. For an excellent exploration of the tax

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The other component of the outrage spawned by reports of the tax benefits of expatriation is regret over foregone revenue. If expatriation has tax advantages, the argument goes, the federal government can raise revenue simply by eliminating those advantages.[15] Desires for revenue, retribution and deterrence can be powerful forces and they explain why this issue has not simply gone away.[16]

Notwithstanding the attractiveness of expatriation as a tax planning technique, the tax advantages that can attend expatriation are not the result of a deliberate policy decision to favor expatriation. Rather, those advantages are a by-product of the adoption of policies that now serve to attract foreign capital.[17]

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policy implications of enacting tax provisions that seek to deter specific behavior, see Eric M. Zolt, *Deterrence Via Taxation: A Critical Analysis of Tax Penalty Provisions*, 37 UCLA L. REV. 343 (1989).

[15] The Treasury estimates of the amount of revenue to be raised by the bills principally discussed here range from $10 million for H.R. 1812 without a treaty override, to $1.68 billion for S. 700, both over the next five years. *Hearings*, *supra* note 11 (testimony of Leslie B. Samuels, Assistant Secretary Treasury for Tax Policy). The Treasury and JCT disagree over the specific amount of revenue each proposal is expected to generate, with the Treasury being generally more optimistic about the revenue-raising potential of S. 700, and the JCT being more optimistic about H.R. 1812. *See id.* Debate over the accuracy of the Treasury and JCT estimates, and the reasons why they differed, is featured prominently in the *Finance Committee Hearings*. *See id.* (testimony of Samuels and Kies).

[16] Although the *Forbes* article that seems to have brought this issue to the attention of the public was published in November 1994, the issue was still making the front pages of major metropolitan area newspapers in July 1995. *See, e.g.*, Jennifer Lin, *Campbell Soup Heir Escapes Taxes in Ireland*, BUFFALO NEWS, July 16, 1995, at A8; *see also* Jeff Brown, *Making Money, Wrecking Lives*, PHILADELPHIA INQUIRER, July 11, 1995, at C1; *Hanging Together: Tax Expatriates Chisel Away At Our National Ideals*, DALLAS MORNING NEWS, July 19, 1995, at 10A; Hershey, *supra* note 6; *Deserting Principle*, PHILADELPHIA INQUIRER, July 11, 1995, at A6.

In October 1995, the *New York Times* reported that one particularly notorious expatriate, Kenneth B. Dart, is attempting to have the best of all tax worlds—avoiding U.S. taxes and living in the United States—by returning to the United States as a diplomat from Belize, the country of which he is now a citizen. Karen DeWitt, *Exile's Effort to Return Puts Focus on Tax Loophole*, N.Y. TIMES, Oct. 1, 1995, § 1, at 14. Technically, such a ploy could succeed because diplomats are exempt from the provisions that can confer residency status for tax purposes upon those who are physically present in the United States for a prescribed period of time. I.R.C. § 7701(b)(5)(A)(i) (1994). Dart's attempt ultimately failed, however. The State Department, aware of precisely what Dart was trying to do, denied Belize's request to establish a consulate in Sarasota, Florida, where Dart's wife and children live, and to appoint Dart consul. DeWitt, *supra*.

[17] *See infra* notes 72-74 and accompanying text. Although the current system may not have been the result of a deliberate policy decision to design a system that would attract foreign capital, it is apparent that a desire to attract foreign capital accounts for its current retention. Proposals to change the system have met vociferous opposition on the ground

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Expatriation can be an effective tax reduction technique because the United States taxes capital owned by foreigners in ways that are very different from, and more favorable than, the way it taxes capital owned by U.S. citizens and residents.[18] When U.S. citizens expatriate,[19] they become foreign and their capital becomes foreign capital subject to the more favorable regime that applies to foreign capital.[20] Because the metamorphosis of capital from domestic to foreign accounts for the tax advantages that attend expatriation, it is hardly surprising that attempts to curb tax-driven expatriation operate to prevent that metamorphosis.

The specific question of how expatriation should be treated is but one variant of the question of how exits from the tax system should be treated. In Part I, I analyze the reasons for taxing exits generally and expatriating exits in particular. I isolate the reason for taxing exits and describe the benefits of expatriation under current law. Next, I examine the extent to which proposed changes to the tax treatment of expatriation are likely to bring neutrality to the tax treatment of expatriation, punish expatriation, enhance the progressivity of the system, or make a symbolic statement. After identifying the problems posed by each of those four objectives, I consider the use of the system that now taxes the physical exit of individuals from the tax system—the transfer tax system—as a mechanism for taxing expatriating exits in Part II. That consideration leads me to observe that while the estate tax system avoids some of the problems that inhere in using the income tax system to tax an individual's

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that they would discourage foreign investment in the United States alone. *See infra* note 74.

[18] *See infra* notes 51-54 and accompanying text. For purposes of this discussion I will use the term "domestic capital" to refer to capital owned by U.S. citizens or residents or by domestic corporations.

[19] U.S. citizens and residents are generally taxed in the same way, and a number of the expatriate tax proposals also address the relinquishment of residency status. *See* I.R.C. §§ 1, 2(d), 7701(a)(30)(A) (1994); *see also infra* note 157. Nevertheless, I will generally confine my remarks to the treatment of expatriation by U.S. citizens. Not only is such expatriation what is driving the current debate, but the treatment of the relinquishment of residency status raises some issues that differ from those involving the relinquishment of citizenship and that are generally beyond the scope of this Article.

[20] *See infra* text accompanying notes 51-71. For purposes of this discussion, I will use the term "foreign capital" to refer to capital owned by individuals or entities other than U.S. citizens and residents or U.S. corporations.

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exit from the system, it is not sufficiently superior to warrant strong support. I conclude that the benefits of taxing expatriating exits using either the income or the transfer tax systems do not outweigh the serious systemic problems such taxation poses and that expatriation, like flag burning, is better left alone.

I. TAXING EXPATRIATING EXITS THROUGH THE INCOME TAX SYSTEM

Proposals designed to curb tax-driven expatriation rely on the income tax system and generally use one of two approaches.[21] One approach treats the act of expatriation as a realization event that subjects all previously unrealized gain to U.S. taxation at a time when the owner of the capital is still subject to the domestic rules.[22] The other approach is to retain taxing jurisdiction for the United States by treating the expatriate's capital as domestic and thus as subject to the rules generally applicable to domestic capital (at least to the extent that the income from the capital would be treated as U.S. source income under the Code).[23] I will refer to the proposal that uses the first approach as the realization proposal, and I will refer to the proposal that uses the second approach as the jurisdictional proposal. While

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[21] These proposals generally tax both expatriation and emigration, that is, the renunciation of permanent resident status. *See, e.g.*, S. 700, *supra* note 3, § 1(e)(1)(B) (defining "expatriate" to include U.S. long-term residents who cease to be lawful permanent U.S. residents). Nevertheless, I will confine my discussion to their treatment of expatriation, because the corresponding arguments I make apply at least equally, and perhaps even more forcefully, to proposed changes in the taxation of emigration. Although permanent residency status must be deliberately acquired—one is not simply born with it, as one is born with citizenship—it does not carry with it the benefits of citizenship, such as entitlement to an American passport. (Travel with a U.S. Re-Entry Permit is markedly different from travel with a U.S. passport.) Whatever additional obligations might be thought to arise from the deliberate request for residency status are at least cancelled out by the reduced benefits, as compared with citizenship, that are received in return. Indeed, from a tax perspective, permanent residency status is the worst of all worlds: it carries with it the tax obligations of citizenship but has few of the benefits. The arguments in favor of being able to relinquish one's status without incurring an additional tax burden are thus more compelling in the case of residents than in the case of citizens.

[22] *See, e.g.*, H.R. 981, *supra* note 3; S. 453, *supra* note 3: H.R. 1215, *supra* note 3; S. 700, *supra* note 3; S. 1637, *supra* note 3.

[23] *See, e.g.*, I.R.C § 877 (1994); H.R. 1812, *supra* note 3; H.R. 3103, *supra* note 3; *see also* STAFF OF JOINT COMM. ON TAXATION, 104TH CONG., 1ST SESS., EXPLANATION OF H.R. 1812 ("EXPATRIATION TAX ACT OF 1995") (Comm. Print 1995).

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numerous expatriation proposals have been introduced since the subject gained popular and political notoriety in November 1995, the proposals follow one of these two basic approaches, and I will discuss them generically rather than attempting to dissect minute differences between them.[24]

A report issued by the staff of the Joint Committee on Taxation (JCT staff) on June 1, 1995 (*JCT Report*), pursuant to a Congressional directive, contains the most comprehensive analysis of the issues presented by attempts to change the taxation of expatriation.[25] The JCT staff fulfilled its mandate quite nicely, and the *JCT Report* is very good.[26] In it, the JCT staff attempts to provide a dispassionate account of the issues raised by proposals to tax the act of expatriating. In addition to a thorough analysis of the tax, human rights, and treaty issues raised by the realization proposal, the JCT staff showed persistence and ingenuity in attempting to answer the empirical question regarding the magnitude of the problem.[27] Although the JCT staff concluded that few wealthy Americans have renounced their U.S. citizenship,[28] its revelation of the magnitude of the wealth of

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[24] The only exception is a provision of the Immigration in the National Interest Act of 1995, which was approved by the House on March 21, 1996. *See supra* note 3. This provision would deny reentry to former citizens who have expatriated for tax reasons. It has been criticized vehemently by both the Clinton Administration and members of the bar. *See Administration Wants Tax Code to Deal with Expatriates*, *supra* note 3. For a discussion of some of the other proposals, see *supra* note 3.

[25] JCT REPORT, *supra* note 3. Congress is to be commended for deciding to study the issue before enacting legislation to address it.

[26] I confess to being an admirer of the JCT's staff's work, which I think is generally very good. For an example of some of its best work, see JOINT COMM. ON TAXATION, METHODOLOGY AND ISSUES IN MEASURING CHANGES IN THE DISTRIBUTION OF TAX BURDENS (1993).

[27] To answer that question, the JCT staff engaged in an astute bit of sleuthing, joining information garnered from *Forbes* with State Department records to ascertain the number of wealthy Americans who renounce their citizenship in any given year. JCT REPORT, *supra* note 3, at 65-66. The JCT's empirical work, like all such work, suffers from the limitations inherent in the data used. Nevertheless, it represents an excellent first step and certainly a more deliberate attempt at ascertaining the magnitude of the problem than the hyperbolic claims that preceded it. *See id.* at 65 & n.119 (contending that Vice President Gore's statement that 24 billionaires would expatriate if no legislative action is taken is unsupported).

[28] For many, this conclusion is hardly surprising and is testimony to what I have said elsewhere, that is, citizenship matters. *See* Abreu, *supra* note 3, at 1613 (noting benefits of U.S. citizenship). Indeed, the JCT numbers suggest that this entire controversy is much ado about very few people, but perhaps that should not be surprising either given the large amount of wealth those few people control. Notwithstanding the small number of people

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some expatriates will probably provide enough fodder to keep the fires of the anti-expatriate movement burning for some time to come.[29]

As good as the *JCT Report* is in analyzing some of the specific problems raised by the realization proposal, it is ultimately unsatisfying because it fails to answer the question central to the entire debate over the taxation of expatriates. That question is: as a matter of tax policy, how should expatriation be treated?[30]

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affected, the issue is worth writing, and reading, about because it provides a useful springboard for the analysis of exits from a tax system and for exploring the consequences of punitive taxation.

[29] The JCT found that of the 801 wealthiest Americans, only "4 of them renounced their U.S. citizenship in the last 10 years—Ted Arison (net worth of $3.65 billion), Robert Dart (net worth of $330 million), John T. Dorrance III (net worth of $1.2 billion), and Anthony Martin Pilaro (net worth of $390 million)." JCT REPORT, *supra* note 3, at 66 (footnotes omitted). The release of the *JCT Report* has not put an end to the debate on the taxation of expatriates, however, and proposals to accomplish that end continue to be seriously debated in Congress. *See, e.g.*, H.R. 1812, *supra* note 3; *Hearings*, *supra* note 11. On June 5, 1995, the Cato Institute sponsored a debate on the expatriate tax and drew such well-known international tax experts as David Rosenbloom of Caplin & Drysdale and politicians such as former Republican Senator Steve Symms. *Tax Policy Collides with Politics on Expatriate Tax Issue*, 95 TAX NOTES TODAY 109-2 (1995).

[30] Reasonable people might differ on whether the *JCT Report* should have attempted to answer that question. The JCT staff evidently decided not to answer it, perhaps because their mandate did not explicitly include the making of recommendations. In the absence of a specific request, any attempt at making recommendations might have been viewed as partisan. Nevertheless, § 6(a) of Pub. L. No. 104-7 directed:

> The staff of the Joint Committee on Taxation shall conduct a study of the issues presented by any proposals to affect the taxation of expatriation, including an evaluation of—
>
> (1) the effectiveness and enforceability of current law with respect to the tax treatment of expatriation,
>
> (2) the current level of expatriation for tax avoidance purposes,
>
> (3) any restrictions imposed by any constitutional requirement that the federal income tax apply only to realized gains,
>
> (4) the application of international human rights principles to taxation of expatriation,
>
> (5) the possible effects of any such proposals on the free flow of capital into the United States,
>
> (6) the impact of any such proposals on existing tax treaties and future treaty negotiations.
>
> (7) the operation of any such proposals in the case of interests in trusts,
>
> (8) the problems of potential double taxation in any such proposals,
>
> (9) the impact of any such proposals on the trade policy

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By analyzing the arguments in favor of changing the tax consequences of expatriation both specifically and systemically, this Article provides one answer to that question.[31]

The first step in analyzing the desirability of taxing exits from the tax system is determining why exits pose any problem worthy of attention. That determination is relatively easy to make. Exits pose a problem because exits can allow taxpayers to escape the imposition of tax on economic income that the tax system fails to take into account.[32] The realization requirement is at

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> objectives of the United States,
>
> (10) the administrability of such proposals, and
>
> (11) possible problems associated with existing law, including estate and gift tax provisions.

Pub. L. No. 104-7, *supra* note 3, § 6(a).

The *JCT Report* fulfills its mandate precisely. It examines problems and explains the law. It meticulously avoids drawing any conclusions regarding the merits of the enterprise itself. Indeed, in some respects the *JCT Report* is almost too tentative. For an example, see *infra* note 158 and accompanying text.

That the JCT staff's decision to so limit the scope of its inquiry might represent an exercise of sound judgment on the staff's part does not remove my sense of disappointment at the absence of recommendations. The JCT staff is composed of very bright, highly qualified people, and I would have been interested in reading their views. Subsequent to the publication of the *JCT Report*, the Chief of Staff made his views known in testimony before the Senate Finance Committee. Specifically, he opposed the realization proposal and endorsed the jurisdictional proposal, even referring to the latter as "our bill." John Godfrey, *Packwood: Finance Will Sharpen Ways and Means' Aim on Expatriates*, 68 TAX NOTES 242 (1995).

[31] Although I refer to the two proposals that have received the most serious attention, and to a third of my own, I do not attempt to address the specifics of any of the proposals. I have deliberately limited myself to analyzing the conceptual basis of the proposals rather than the details of their effectuation. Indeed, one of the problems posed by the tenor and content of the current legislative debate is that it has moved to a discussion over details, while the theoretical underpinnings of the taxation of expatriates remains largely unexplored. *See infra* note 209.

[32] The most widely accepted definition of economic income is that of Henry Simons: "Personal Income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question." HENRY C. SIMONS, PERSONAL INCOME TAXATION 50 (1938). This definition is considered to be a refinement of Robert Haig's definition of income as "the money value of the net accretion to one's economic power between two points of time." Robert M. Haig, *The Concept of Income—Economic and Legal Aspects*, *in* THE FEDERAL INCOME TAX 1,7 (Robert M. Haig ed., 1921) (emphasis omitted). Thus, Simon's definition has come to be known as the "Haig-Simons definition of income." MICHAEL J. GRAETZ & DEBORAH H. SCHENK, FEDERAL INCOME TAXATION, PRINCIPLES AND POLICIES 107 (3d ed. 1995). The Haig-Simons definition of income, which uses market values to define the term, has no place for the concept of realization. Under that definition, an individual has income when the value of her house goes up, regardless of

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the root of that failure, for the realization requirement prevents the taxation of gains until the moment of realization. If a taxpayer leaves the system before realizing accrued gains, those gains will escape the grasp of the system, unless some other tax system steps in,[33] or unless the income tax system itself either creates realization where none has arguably occurred,[34] or pretends that the exit did not take place.[35]

A. *The Problem of Realization*

The concept of realization has long been at the core of the federal income tax system.[36] Indeed, one of the seminal cases on defining income puts the concept of realization at the center of that definition.[37] Although scholars no longer view realiza-

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whether she chooses to realize that income.

The income tax system generally requires realization as part of the definition of income. *See* I.R.C. § 1001(a) (defining gain in terms of amount realized); Commissioner v. Glenshaw Glass Co., 348 U.S. 426 (1955) (defining income as "undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion"). Therefore, the income tax system departs most fundamentally from the economist's definition of income. Reasons for this departure include the difficulty of valuing assets absent a sale, the possibility that some taxpayers might be forced to dispose of assets in order to pay the tax, and a distrust of "paper gains." BORIS I. BITTKER & MARTIN J. MCMAHON, JR., FEDERAL INCOME TAXATION OF INDIVIDUALS ¶ 3-7 (1988).

[33] In the case of an exit occasioned by the death of an individual taxpayer, that other system is the wealth transfer tax system of Subtitle B (Chapters 11-14) of the Code. *See* I.R.C. §§ 2001-2622.

[34] In the case of a corporate death (occasioned generally by liquidation), § 336 of the Code creates realization by treating a liquidating distribution as a sale. I.R.C. § 336(a) (1994). Sections 338 and 475 provide other examples of statutorily created realization. Both impose taxation as if property had been sold, and gain (or loss) had been realized. I.R.C. §§ 338(a), 475(a) (1994). Deeming a sale to have occurred is preferable to simply taxing the event because deeming a sale allows the entire tax system to operate in pre-set, familiar patterns that avoid the need for drafting a myriad of special rules. Thus, the existence of a deemed sale allows the entire gain recognition mechanism of the Code, complete with timing and other rules, to kick in. In short, deeming a sale is technically neat. By taking basis into account, it also prevents under- or over-taxation.

[35] Section 877 creates such a system in the case of someone whose principal purpose for expatriation was the avoidance of U.S. income or estate taxes. *See* I.R.C. § 877 (1994). Proposals like Rep. Archer's, which would tax American expatriates like citizens for a period of 10 years following expatriation, would also result in such a system. *See supra* note 3 (discussing Archer's introduction of H.R. 1812). Section 691, which taxes income in respect of a decedent, has a similar objective. *See* I.R.C. § 691 (1994).

[36] "Realization" refers to the concept that an identifiable event, most often one that separates the income from the capital, such as a sale, has occurred. *See* Eisner v. Macomber, 252 U.S. 189, 207 (1920); *see also* sources cited *infra* note 37.

[37] *Eisner*, 252 U.S. at 207. Because of its importance to the definition of income, and

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tion as integral to the constitutional definition of income,[38] it is still fair to say that realization is integral to a finding of income under the Code.[39] Absent the impediment of realization, gains could be taxed as accrued, and there would be no need to tax them upon a taxpayer's exit from the system.[40] The continuing importance of realization and the systemic difficulties of imposing taxation without realization,[41] explain why the system needs a mechanism for taxing exits.

Exits from the system are of two primary types. There are dissolutionary exits, where the subject of taxation ceases to exist, and there are relocationary exits, where assets or persons are

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because of its arguable constitutionalization of the realization concept, Boris Bittker once expressed the view that *Macomber* is one of the most extensively discussed cases in the tax law. 1 BORIS I. BITTKER, FEDERAL TAXATION OF INCOME, ESTATES, AND GIFTS 1-23 n.38 (1981). It still appears to be. *See, e.g.*, Marjorie E. Kornhauser, *The Constitutional Meaning of Income and the Income Taxation of Gifts*, 25 CONN. L. REV. 1, 5-10 (1992); Henry Ordower, *Revisiting Realization: Accretion Taxation, the Constitution,* Macomber, *and Mark to Market*, 13 VA. TAX REV. 1 (1993); Patricia D. White, *Realization, Recognition, Reconciliation, Rationality and the Structure of the Federal Income Tax System*, 88 MICH. L. REV. 2034, 2045-46 (1990). *See generally* Daniel N. Shaviro, *An Efficiency Analysis of Realization and Recognition Rules Under the Federal Income Tax*, 48 TAX L. REV. 1 (1992).

[38] In their treatise, Boris Bittker and Marty McMahon have observed that the realization requirement has been "badly eroded as a constitutional principle, if not wholly undermined," although "realization as a rule of administrative convenience (or legislative generosity) remains largely intact." BITTKER & MCMAHON, *supra* note 32, ¶ 3.2. For a good compendium of the scholarship on this issue and a discussion that comes to the same conclusion, see JCT REPORT, *supra* note 3, at 69-77 & n.139. *See also* David J. Shakow, *Taxation Without Realization: A Proposal for Accrual Taxation*, 134 U. PA. L. REV. 1111, 1113-14 n.9 (1986) (advocating for accrual taxation in lieu of realization taxation).

[39] The trend toward mark-to-market and similar provisions that eschew realization as a marker for the recognition of income is growing. *See, e.g.*, I.R.C. §§ 475, 1256, 1272 (1994); BITTKER & MCMAHON, *supra* note 32, ¶14.3, at 14-14 to 14-15; Thomas L. Evans, *The Evolution of Federal Income Tax Accounting—A Growing Trend Towards Mark-to-Market?*, 67 TAXES 824 (1989); Mark L. Louie, Note, *Realizing Appreciation Without Sale: Accrual Taxation of Capital Gains on Marketable Securities*, 34 STAN. L. REV. 857 (1982). Nevertheless, recognition upon realization continues to be the rule, not the exception. *See* I.R.C. § 1001(d) (1994). The need for non-recognition rules, and the increasing numbers of such rules, are a testament to that. *See, e.g.*, *id.* §§ 351, 354-355, 1031-1043; *see also* William Vickrey, *Tax Simplification through Cumulative Averaging*, 34 LAW & CONTEMP. PROBS. 736, 742-44 (1969); Carl Shoup, *The White Paper: Accrual Accounting for Capital Gains and Losses*, 18 CAN. TAX J. 96, 97 (1970) (providing lists of provisions that could be eliminated by move to accrual system of taxation). For an illustration of the reduction in tax disputes that would flow from a move to an accrual system, see Shakow, *supra* note 38, 1117-18.

[40] For a provocative description of a tax system without realization, see Shakow, *supra* note 38.

[41] These difficulties involve chiefly valuation and liquidity problems. *Id.* at 1113.

physically removed from the taxing jurisdiction. Physical death provides an example of a dissolutionary exit. The liquidation of a corporation (jural death) provides another. Both of these exits are subject to tax under the Code, although each is subject to a different type of tax. Physical death triggers liability under the transfer tax system,[42] and a corporate liquidation triggers liability under the income tax system.[43]

Some relocationary exits trigger tax liability as well. Section 367(a) has, in various ways over the years, attempted to ensure that accrued gain is either taxed before property is transferred outside the taxing jurisdiction of the United States or that the possibility of taxing it is maintained.[44] Section 1491 imposes a thirty-five percent excise tax on certain transfers of property by U.S. persons to foreign corporations or partnerships.[45] Subpart

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[42] Although the gift tax is part of the transfer tax system and does not, by its terms, require death, I include it here because without the need to protect the estate tax base, there would probably be no gift tax. The gift tax backstops both the estate and income taxes. *See* RICHARD B. STEPHENS ET AL., FEDERAL ESTATE AND GIFT TAXATION ¶ 9.01-2 (6th ed. 1991). It was enacted, however, principally to protect the estate tax. *See* 75 CONG. REC. 5691, 5788 (1932); *see also* Hesslein v. Hoey, 91 F.2d 954, 956 (2d Cir. 1937) (holding that gift and estate taxes serve same purpose and must be construed in pari materia); JOHN E. HUGHES, THE FEDERAL DEATH TAX § 231 (1938) (asserting that gift tax was enacted to prevent avoidance of estate tax and that Supreme Court has said that they are in pari materia).

The integration (albeit incomplete) of the estate and gift tax systems in 1976 is further evidence of the link between the systems. For a good analysis of the process of integration and the steps that remain before full integration is achieved, see Theodore S. Sims, *Timing Under a Unified Wealth Transfer Tax*, 51 U. CHI. L. REV. 34 (1984). *See also* George T. Altman, *Integration of the Estate and Gift Taxes*, 7 LAW & CONTEMP. PROBS. 331, 331-32 (1940); Paul L. Caron, *Taxing Opportunity*, 14 VA. TAX REV. 347, 354-55, 423 (1994); C. Lowell Harriss, *Legislative History of Federal Gift Taxation*, 18 TAXES 531, 536 (1940).

[43] I.R.C. § 336 (1994). *See generally* BORIS I. BITTKER & JAMES S. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ¶ 10.05[1]-[2] (6th ed. 1994) (explaining § 336 and calculation of corporate gain upon liquidation).

[44] I.R.C. § 367 (1994). For a good synopsis of the history and evolution of § 367, see MICHAEL J. MCINTYRE, THE INTERNATIONAL INCOME TAX RULES OF THE UNITED STATES § 7/A1a (1995). For an excellent explanation of the reason for the existence of § 367 and a detailed description of its operation, see BORIS I. BITTKER & LAWRENCE LOKKEN, FUNDAMENTALS OF INTERNATIONAL TAXATION ¶¶ 68.6-.7 (1991). For a comprehensive description of the history, policy basis, and operation of § 367, see 2 JOSEPH ISENBERGH, INTERNATIONAL TAXATION ¶¶ 32.1-.52 (1990). *See generally* 1 JOEL D. KUNTZ & ROBERT J. PERONI, U.S. INTERNATIONAL TAXATION ¶¶ B2.03-.04 (1991).

[45] I.R.C. § 1491 (1994). Section 1491 generally applies to transfers that are not caught by § 367, most notably, certain transfers to partnerships and gifts made through foreign trusts. BITTKER & LOKKEN, *supra* note 44, ¶ 68.6.7. *See generally* 2 ISENBERGH, *supra* note 44, ¶¶ 32.48-.50; 1 KUNTZ & PERONI, *supra* note 44, ¶¶ B2.03-.04; 2 MCINTYRE, *supra* note 44,

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F,[46] the foreign personal holding company rules,[47] the foreign investment company provisions,[48] and the passive foreign investment company provisions[49] all attempt to tax income realized outside the taxing jurisdiction of the United States as if it had been realized within the taxing jurisdiction of the United States. These provisions can all be seen as ways of recouping for the federal income tax system at least some of the benefits taxpayers can derive from relocationary exits.[50]

B. *The Benefits of Expatriation*

Expatriation is a relocationary exit. The primary tax benefits of expatriation are the ability of non-resident aliens to avoid any U.S. tax liability on capital gains, other than capital gains derived from the sale or exchange of U.S. real property interests,[51] and the ability of non-resident aliens to avoid U.S. estate

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§7/A2.

[46] I.R.C. §§ 951-954 (1994).

[47] *Id.* §§ 551-558.

[48] *Id.* § 1246.

[49] *Id.* § 1297.

[50] The chief benefit of a relocationary exit under current law is the deferral of U.S. tax on the foreign source income generated by the exiting capital. *See* MCINTYRE, *supra* note 44, § 6/A; U.S. TREASURY DEP'T, INTERNATIONAL TAX REFORM: AN INTERIM REPORT (1993), *reprinted in* SAMUEL C. THOMPSON, JR., U.S. TAXATION OF INTERNATIONAL TRANSACTIONS § 12.14 (1995). For a very readable and comprehensive analysis of the operation of all of these provisions, see 2 ISENBERGH, *supra* note 44, ¶¶ 24.1-32.52.

[51] I.R.C. § 897 (1994). Section 897 was added to the Code by the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA), as a subtitle of the Omnibus Reconciliation Act of 1980. Pub. L. No. 96-499, §§ 1121-1125, 94 Stat. 2599, 2682-91, and amended by the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 831, 95 Stat. 172, 352, and, to a lesser extent, by subsequent enactments. *See* 1 ISENBERGH, *supra* note 44, ¶ 11.2. Its enactment was prompted by reports that large numbers of foreigners were acquiring vast amounts of farmland in the midwest and that their doing so was driving up the price of American farmland, to the detriment of Americans. Arthur A. Feder & Lee S. Parker, *The Foreign Investment in Real Property Tax Act of 1980*, 34 TAX LAW. 545, 548 & n.20, 549 (1981); *see also* Richard L. Kaplan, *Creeping Xenophobia and the Taxation of Foreign-Owned Real Estate*, 71 GEO. L.J. 1091 (1983) (analyzing pre-FIRPTA tax system and FIRPTA's modification of that system). Rather than prohibit such purchases outright, Congress decided to make them less attractive by subjecting any gain realized on a subsequent sale of the property to full U.S. income taxation. The resulting legislation applied to all sales of U.S. real estate or interests in U.S. real property and thus had a reach much broader than the concern that initially prompted its enactment. For a good history of FIRPTA and description of its operation, see Feder & Parker, *supra*. *See also* Fred Feingold & Herbert H. Alpert, *Observations on the Foreign Investment in Real Property Tax Act of 1980*, 1 VA. TAX REV. 105 (1981).

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tax liability with respect to property other than U.S. property.[52] Because non-resident aliens who are present in the United States for less than thirty-one days and who do not elect to be taxed as residents will pay no U.S. income tax on U.S. source non-real estate capital gains,[53] a U.S. citizen who holds appreciated stock in a domestic corporation can avoid U.S. income tax liability for all of the accrued but unrealized gain by expatriating, spending no more than thirty-one days in the United States, and selling the stock.[54] All of the gain will escape U.S. taxation, and as long as it is reinvested outside the United States, none of it will

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In 1984, Congress added a withholding requirement that placed on the U.S. seller of U.S. real property interests the burden of collecting and withholding the tax due. I.R.C. § 1445 (1994). *See also* 2 KUNTZ & PERONI, *supra* note 44, ¶ C2.04. The Senate's version of the Tax Reform Act of 1986 would have repealed FIRPTA, but the repealer was dropped in Conference. 1 *Isenbergh*, *supra* note 44, ¶ 11.21.

[52] In the case of nonresident aliens, the gross estate for federal estate tax purposes includes only property which, at the time of the decedent's death, is situated within the United States. I.R.C. § 2103 (1994). For this purpose, stock in domestic corporations is considered situated within the United States. *Id.* § 2104(a). *See also* Estate of Nienhuys, 17 T.C. 1149, 1163 (1952); 2 KUNTZ & PERONI, *supra* note 44, ¶ C3.02, at C3-11 to C3-12.

[53] *See* 1 ISENBERGH, *supra* note 44, ¶¶ 3.6-.8.1. The determination of an individual's status for tax purposes is made by § 7701(b) of the Code. I.R.C. § 7701(b) (1994). Section 7701(b) treats as residents individuals who are "lawful permanent resident[s] of the United States at any time during" the taxable year (the "green card" test), individuals who have been physically present in the United States for more than a specific number of days during the taxable year (the "substantial presence" test), and individuals who make a special election. *Id.*

Under the substantial presence test, which is actually rather involved, an individual will be treated as a resident if she has been present in the United States on at least 31 days during the calendar year and the individual was present for a total of 183 days during the current and the two preceding years, determined by using a fractional multiplier for the preceding years. *Id.* § 7701(b)(1)(A)(ii). Thus, an individual could be present in the United States for more than 31 days and still avoid classification as a U.S. resident depending on the number of days she was present in the United States during the current and two preceding years. *Id.* § 7701(b)(3)(A). I have used the 31 day figure nonetheless because if an individual is not present in the United States for at least 31 days during a given year, she cannot be treated as a U.S. resident during that year.

[54] The gain on such a sale would be capital gain unless one of the anti-abuse provisions of Subchapter C of the Code applied. The same benefit could be reaped by simply liquidating a corporation, although that benefit is significantly smaller than it used to be before the repeal of *General Utilities*. (Under the *General Utilities* doctrine, corporations did not recognize gain upon a distribution of appreciated property to shareholders. BITTKER & EUSTICE, *supra* note 43, ¶ 8.20[3]. Now, corporate level appreciation will still be subject to tax, courtesy of § 336, and only the shareholder level tax can be avoided by expatriating. Indeed, one of the two litigated cases involving American expatriates involved a liquidation that took place in the halcyon days before the repeal of *General Utilities*. *See infra* note 62 (discussing Max Kronenberg's renunciation of U.S. citizenship).

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be subject to federal estate tax. If the property is not sold, income from it might be taxed at a flat thirty percent rate under section 871 or at a reduced rate under a bilateral income tax treaty,[55] and no foreign source income will be subject to the taxing jurisdiction of the United States.

The anti-expatriation mechanisms currently in the Code are inadequate to ensure that the United States recoups all that it may lose as a result of taxpayer expatriation.[56] Section 877 provides that taxpayers whose principal purpose for renouncing citizenship is tax avoidance will continue to be taxed under the rules applicable to U.S. citizens on their U.S. source income for a period of ten years from the date of expatriation.[57] However, section 877 does not remove the benefits of expatriation with respect to income from sources without the United States.[58] Tax-motivated expatriation therefore remains attractive for those willing to wait ten years to liquidate their holdings of U.S. non-real estate capital assets as well as for those with substantial

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[55] Section 871 provides for a flat rate of 30% on U.S. source income subject to tax, and many bilateral treaties reduce that rate, at least on dividends and interest, to 15%, or sometimes even to 5%. *See, e.g.*, Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes, Aug. 21, 1991, U.S.-F.R.G., art. 10(2), ¶ 3249.21. The flat 30% rate provided by § 871 will sometimes be higher, and sometimes lower, than the graduated rate that might have applied under § 1.

[56] The *JCT Report* notes that the Treasury Department views § 877 as ineffective and unenforceable. JCT REPORT, *supra* note 3, at 61. Section 2107 contains a rule similar to that of § 877 for federal estate tax purposes. *See* I.R.C. § 2107 (1994). Section 7701(b)(10) provides that resident aliens who become nonresidents and then become residents again within three years, will be taxed under the rules of § 877 for the three year interim period. *Id.* § 7701(b)(10). If § 877 is ineffective and unenforceable, it is difficult to imagine how §§ 2107 and 7701(b) could be otherwise. Because the former addresses dead people and the latter people who were not citizens in the first place, it is difficult to see how they would be easier to enforce than § 877. Nevertheless, the need for transfers of title through executors in the case of the dead and the requirement of a sailing permit in the case of aliens generally might make them somewhat easier to enforce. *See id.* § 6861(d)(1) (1994) (requiring aliens other than vacationers, business travelers, and diplomats to obtain certificate of compliance with federal income tax laws before leaving country); *see also* George Guttman, *The Sailing Permit: Tax Compliance and Departing Aliens*, 63 TAX NOTES 24 (1994). Nevertheless, no litigated cases exist under either § 2107 or § 7701(b)(10).

[57] I.R.C. § 877. For a good description of the operation, and limitations, of § 877 and related rules, see JCT REPORT, *supra* note 3.

[58] The terminology is the Code's, not mine. Section 862, entitled "Income From Sources Without the United States," was apparently designed to contrast with § 861, entitled "Income From Sources Within the United States." Tax professionals typically refer to these categories as U.S. source and non-U.S. source income. I will do likewise.

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foreign holdings.[59]

Moreover, section 877 is very difficult to enforce. First, it is difficult for the Service to uncover cases in which the provision might apply. Second, proving the existence of tax avoidance as the principal purpose for renunciation of citizenship requires proof with respect to state of mind, something inherently difficult to prove.[60] The two cases in which the application of section 877 has been litigated provide graphic examples of the benefits of expatriating and of the difficulties of enforcing section 877.

The first of these cases involved Max Kronenberg, a Swiss national who had become a naturalized U.S. citizen but had retained his Swiss citizenship as well.[61] For many years Mr. Kronenberg was the president and majority shareholder of a U.S. corporation. Mr. Kronenberg renounced his U.S. citizenship just prior to liquidating the corporation and took the position that all of the capital gain realized upon liquidation escaped U.S. tax.[62] Unfortunately for Kronenberg, the Tax Court found

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[59] *See supra* notes 44-45 and accompanying text.

[60] *See supra* note 56 and accompanying text. The Service will have to take the lead in enforcing § 877 if it ever wants compliance with it. The *JCT Report* did note that at least a few individuals paid tax in accordance with the commands of § 877. JCT REPORT, *supra* note 3, at E-2. Even the JCT staff, though, seemed shocked at the existence of any voluntary compliance at all. *See id.* After all, the people to whom § 877 applies, are no longer citizens and may have few ties to the United States.

[61] Kronenberg v. Commissioner, 64 T.C. 428 (1975). Professor Bill Piatt has noted that the tax treatment of naturalized and native-born U.S. citizens might properly differ. Accordingly, he suggests that those who request U.S. citizenship, and thus affirmatively choose it, might be held to a different, and higher, standard when expatriating than native born citizens, who had no choice in the acquisition of U.S. citizenship. Letter from J. Hadley Edgar Piatt, Professor of Law, Texas Tech. University, to Alice G. Abreu, Charles Kein Professor of Law and Government, Temple University (June 14, 1995) (on file with author). Although the Tax Court did not purport to give any weight to Kronenberg's status as a naturalized citizen, it is interesting to consider whether that difference between Kronenberg and Madame Furstenberg, whose case is discussed *infra* in notes 66-71 and accompanying text, might have influenced its decision in the two cases, causing the court to judge Kronenberg more harshly than Furstenberg. It is, of course, also possible that Furstenberg was the beneficiary of the sexist assumption that women do things for love, not for tax savings.

[62] Kronenberg renounced his U.S. citizenship one day before the liquidation. *Kronenberg*, 64 T.C. at 428. This gambit was particularly attractive in Kronenberg's day because pre-1986 §§ 336 and 337 were still in effect to protect most of the corporate level gain from tax. Also, § 331 made the shareholder level gain capital. It would not be subject to U.S. tax if realized by a nonresident alien, which is what Kronenberg was at the time of the liquidation.

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that he had expatriated to avoid U.S. tax and that section 877 applied to subject his capital gain to U.S. tax.[63] If section 877 had not applied, expatriation would have saved Kronenberg close to $100,000 in taxes for the year of expatriation alone.[64] It is impossible to tell how much it would have saved him in subsequent years.[65]

Unlike Kronenberg, Madame Furstenberg,[66] daughter of one of the founders of the company that became the Exxon Corporation,[67] was able to convince the Tax Court that she was not motivated by tax avoidance, and was able to save in excess of $5 million by expatriating. Furstenberg renounced her U.S. citizenship after marrying an Austrian prince.[68] She became an Austrian citizen and, because she was living in Paris, took the position that she was a French resident for purposes of the tax treaty between the United States and France. Under that treaty, U.S. source capital gains would not be taxed, dividends and interest would be taxed at rates of fifteen and ten percent, respectively,

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[63] *Id.* at 435.

[64] The amount of the deficiency in the case was $98,344.76. *Id.* at 428. Although there were other issues in the case, those issues arose only because the Service challenged Kronenberg's filing status. Had the Service been content to treat him as a nonresident alien, neither the issue of the value of the note he had received from the corporation at distribution nor the issue of the deductibility of the expenses for his move to Switzerland would have arisen. It is therefore safe to surmise that the entire amount of the deficiency was attributable to the application of § 877 and that, therefore, no deficiency would have arisen if § 877 had not applied and if Kronenberg could have been taxed as a nonresident alien.

[65] Kronenberg had caused his corporation to invest the amounts collected from receivables in securities that he selected. *Id.* at 430. The gain recognized on the sale or exchange of these securities may have been U.S. source under the source rules then applicable. *See* Internal Revenue Code of 1954, ch. 736, § 861(a)(6), 68A Stat. 276, *amended by* Tax Reform Act of 1986, Pub. L. No. 99-514, § 1211(b)(1)(B), 100 Stat. 2085, 2536. Nevertheless, § 871 would have made it not subject to U.S. income tax as long as Kronenberg was not present in the United States for 183 days or more. *See* I.R.C. § 871(a)(2) (1994). If the gain was U.S. source, however, § 877 would have subjected it to U.S. tax unless Kronenberg waited 10 years to realize it. *Id.* § 877(b)(1). In addition, if he died within that 10 year period, those securities which represented interests in U.S. companies would have been part of his gross estate for federal estate tax purposes and could have subjected him to liability for the federal estate tax as well, depending on their total value. *Id.* § 2107.

[66] Furstenberg v. Commissioner, 83 T.C. 755 (1984).

[67] Furstenberg's father was Robert L. Blaffer. *Id.* at 756-57. *See also* RICHARD L. KAPLAN, FEDERAL TAXATION OF INTERNATIONAL TRANSACTIONS 529 (1988).

[68] *Furstenberg*, 83 T.C. at 759.

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and other income would be taxed at a rate of thirty percent.[69] The difference between taxation as a non-U.S. citizen resident of France and as a U.S. citizen resident of France was more than $5 million, and that is the amount that the Service tried to collect. As in *Kronenberg*, the Service took the position that Furstenberg's expatriation was tax-motivated and that section 877 applied to subject all of her U.S. source income to U.S. taxation.[70] Unlike Kronenberg, however, Furstenberg won the case, proving perhaps that love conquers all, even the IRS.[71]

The advantages that attend expatriation are not the product of a deliberate attempt to encourage or abet expatriation or of an express desire to tax expatriates more favorably than U.S. citizens and residents.[72] They are simply the result of the operation of a tax system that combines the realization requirement with a virtual exemption from tax for appreciation in foreign capital.[73] This system likely proceeded from the difficulty of attempting to tax foreign capital but has served to attract foreign capital as well.[74]

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[69] *Id.* at 769-73.

[70] *Id.*

[71] The court seemed taken with Furstenberg's statement that she had expatriated to show Prince Furstenberg, who was then 71, close to 20 years her senior, that she would be "very proud to marry him, bear his name, his title, and his nationality," and so that she could be "Austrian the way he wished it." *Id.* at 761. Furstenberg seems to have been the beneficiary of the court's willingness to cast her into a very traditional role. *See supra* note 61 (discussing possibility that court assumed Furstenberg had acted for love, not tax savings).

In fairness, though, Furstenberg's case was easier than Kronenberg's because she had not arranged her affairs so as to have expatriation take her from full U.S. taxation to zero U.S. taxation; she had been willing to pay U.S. tax on some of the distributions received from the trust established by her family and she was paying some taxes in France. Nevertheless, I believe her defense to have been successful principally because she was able to convince the court that she was concerned with love and the lifestyle of the rich and famous, not taxes. Given her gender and wealth, the court seemed to have little difficulty believing her. Tradition has it that women do not worry their pretty (and, in this case, probably expensively coifed) little heads about things such as taxes. Pity.

[72] Indeed, § 877 was enacted to discourage tax-motivated expatriation. H. R. REP. NO. 1450, 89th Cong., 2d Sess. (1966).

[73] Only gains from foreign capital invested in U.S. real property interests or realized by non-resident aliens present in the United States 183 days or more is subject to U.S. taxation. *See* I.R.C. §§ 871(a)(2), 897.

[74] *See* S. REP. NO. 1707, 89th Cong., 2d Sess. (1966) (providing background of Foreign Investors Tax Act); H.R. REP. NO. 1450, *supra* note 72 (setting forth Foreign Investors Tax Act); *see also* Alan G. Choate et al., *Federal Tax Policy for Foreign Income and Foreign Taxpayers:*

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Given that the tax advantages of expatriation do not proceed from an attempt to encourage expatriation, the next questions are whether those unintended advantages should be eliminated or curtailed when they are reaped by former U.S. citizens and, if

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History, Analysis and Prospects, 44 TEMP. L.Q. 441 (1971); John M. Neihuss, *Foreign Investment in the United States: A Review of Government Policy*, 16 VA. J. INT'L L. 65 (1975); Jay L. Lenrow, Comment, *Foreign Direct Investment in the United States: Possible Restrictions at Home and a New Climate for American Investment Abroad*, 26 AM. U. L. REV. 109 (1976).

Reaction to attempts to change the favorable treatment of foreign capital appreciation serves to demonstrate the extent to which the current system is thought to attract foreign capital investment. In 1989, 1990, 1992, and again in 1995, bills introduced in Congress would have subjected at least some non-real estate U.S. source capital gains to U.S. taxation. *See* Revenue Reconciliation Act of 1989, H.R. 3150, 101st Cong., 1st Sess.; Foreign Tax Equity Act of 1990, H.R. 4308, 101st Cong., 2d Sess.; Foreign Income Tax Rationalization and Simplification Act of 1992, H.R. 5270, 102d Cong., 2d Sess.; Seven-Year Balanced Budget Reconciliation Act of 1995, H.R. 2491, 104th Cong., 1st Sess.; Balanced Budget Reconciliation Act of 1995, S. 1357, 104th Cong., 1st Sess. This latest attempt, which was introduced by Sen. Kohl as amendment 3016, would have funded a provision that would have permitted rollover of gain from the sale of farms to IRAs. *See House Passes Budget Bill, 227-203*, 69 TAX NOTES 886 (1995). The opposition to the proposed change was swift and strong. On November 7, 1995, William M. Paul of Covington & Burling wrote to the Deputy International Tax Counsel on behalf of a client that managed two investment partnerships which provided equity capital to U.S. growth companies and argued forcefully that enactment of the proposal would discourage U.S. capital formation, provoke retaliation by our trading partners and generally "work to the detriment of the United States." *Proposal to Tax Foreign Shareholder's Gain on Disposition of U.S. Firm Stock Is Criticized*, 95 TAX NOTES TODAY 248-38 (1995). Similarly, the Tax Section of the New York State Bar Association wrote to members of Congress and to various government officials arguing strenuously against the adoption of the proposed measure on similar grounds. *NYSBA Urges Taxwriters to Scrap Proposed Foreign Shareholder Tax*, 95 TAX NOTES TODAY 227-61 (1995) [hereinafter *NYSBA*]. Commentators were also critical. *See* David Benson & William F. Leary, *Senate Measure Would Tax Foreigners' Stock Sales and Limit Treaty Benefits*, 69 TAX NOTES 925 (1995).

The prior attempts at enacting similar changes also met with deadly opposition from various quarters. In reaction to the 1989 attempt, foreign investors themselves stated that U.S. taxation of foreign capital appreciation would significantly reduce the attractiveness of the United States to foreign investors. *See Withholding on Gains by Foreign Investors Opposed*, 89 TAX NOTES TODAY 232-16 (1989) (reprinting letter from Alan J. Patricof); *see also* Kathleen Matthews, *Capital Gains Tax on Foreigners Would Be Major Change in International Tax Policy*, 44 TAX NOTES 954 (1989). Members of the American Bar Association Tax Section's Committee on U.S. Activities of Foreigners and Tax Treaties also submitted comments urging Congress not to enact the proposed changes because of the wide-reaching and adverse economic consequences they could have. *See ABA Members Oppose Enactment of Proposed Section 899*, 89 TAX NOTES INT'L 44-42 (1989). The 1992 attempt received even more serious attention, prompting hearings at which Fred Goldberg, then Assistant Treasury Secretary for Tax Policy, testified in opposition to the proposal on the ground that it would increase the cost of capital for U.S. businesses, decrease foreign investment, be complex to administer, and be difficult to enforce. *See* Benson & Leary, *supra*, at 926.

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so, whether such elimination or curtailment would undermine economic or tax policy. Answering the first question requires a determination of the objectives that might be served by such elimination or curtailment. Answering the second question requires speculation regarding the likely effect of the change. Section C, which immediately follows, provides an answer to the first question. Section D below attempts to answer the second.

C. *Reasons for Taxing Expatriating Exits*

There are at least four separate reasons for imposing some tax consequences on exits from a tax system. First, the system could try to deny any unintended benefits that might flow from the exit, thus making the act of exiting tax-neutral. Second, the system could seek to punish those who exit. Although punishment should not be the only objective of taxation, it is sometimes one of its objectives.[75] Third, the system could seek to increase its progressivity by using the exit as the occasion for taxing amounts that have gone untaxed before, when circumstances suggest an ability to pay more.[76] Fourth, the system

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[75] *See* Zolt, *supra* note 14; *see also infra* notes 145-47 and accompanying text.

[76] Professor Michael Graetz has argued persuasively that the wealth transfer tax system, which taxes the dissolutionary exit of human taxpayers, serves chiefly to add progressivity to the income tax. Michael J. Graetz, *To Praise the Estate Tax, Not to Bury It*, 93 YALE L.J. 259 (1983). His argument, however, has stirred up some debate. *See* Charles O. Galvin, *To Bury the Estate Tax, Not To Praise It*, 52 TAX NOTES 1413 (1991) [hereinafter Galvin, *To Bury the Estate Tax*] (arguing that estate tax no longer serves any purpose except raising revenue, which could better be raised by other means); Robert B. Smith, *Burying the Estate Tax Without Resurrecting Its Problems*, 55 TAX NOTES 1799 (1992) (responding that Professor Galvin's proposals have same problems as existing system and proposing alternatives to wealth transfer tax system); Charles O. Galvin, *Burying the Estate Tax: Keeping the Ghouls Out of the Cemetery: A Reply to Professor Smith*, 56 TAX NOTES 951 (1992) (agreeing that wealth transfer tax system should be replaced). If government economists are right in their conclusion, used at least for purposes of formulating tax policy on Capitol Hill, that owners of capital bear the economic burden of the corporate income tax, a similar argument to Professor Graetz's could be made in favor of the corporate income tax. *See* JOINT COMM. ON TAXATION, *supra* note 26; *see also* Emil M. Sunley, *Corporate Integration: An Economic Perspective*, 47 TAX L. REV. 621, 636-38 (1992) (discussing incidence of corporate income tax). For a good synopsis and analysis of the difficulties in determining the incidence of the corporate income tax, including a discussion of the difficulty in defining the concept of incidence itself, see William A. Klein, *The Incidence of the Corporation Income Tax: A Lawyer's View of a Problem in Economics*, 1965 WISC. L. REV. 576, 602 nn.104-07. *See generally* MARIAN KRZYZANIAK & RICHARD A. MUSGRAVE, THE SHIFTING OF THE CORPORATION INCOME TAX (1963) (discussing incidence of corporate income tax and estimating rate of return); JOSEPH A. PECHMAN, FEDERAL TAX POLICY 141-46 (5th ed. 1987) (explaining shifting and

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could seek to make a symbolic statement. A statement symbolic of disapproval invites examination of the difference between negative symbolism and punishment, especially if it is likely that at least some people might actually have to pay the symbolic tax.

1. Taxing Expatriating Exits as a Neutralizer

Although changes to the tax treatment of expatriation are likely to raise some revenue,[77] raising revenue is not the primary objective of the proposals that would change the taxation of expatriation. Instead, the proposals seek to deny a benefit that current law provides.[78] The benefit provided by current law proceeds from the application of general principles of U.S. taxation, such as the realization requirement and the jurisdictional limitation of full taxation to citizens and residents, not from deliberately granted incentives.[79] The proposals would change

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incidence of tax); John G. Cragg et al., *Empirical Evidence on the Incidence of the Corporation Income Tax*, 75 J. POL. ECON. 811 (1967) (providing framework for analyzing effects of corporate income tax and drawing inferences as to probable incidence of it); Jane G. Gravelle, *The Corporate Income Tax: Economic Issues and Policy Options*, 48 NAT'L TAX J. 267 (1995) (discussing arguments for retaining separate corporate tax); Arnold C. Harberger, *The Incidence of the Corporation Income Tax*, 70 J. POL. ECON. 215 (1962) (analyzing Krzyzaniak-Musgrave approach to extracting empirical evidence on incidence of corporate income tax); Laurence J. Kotlikoff & Lawrence H. Summers, *Tax Incidence* (describing "static general equilibrium models of tax incidence"), *in* 2 HANDBOOK OF PUBLIC ECONOMICS 1043, 1050-65 (Alan J. Auerbach & Martin Feldstein eds., 1987); George Mundstock, *Taxation of Intercorporate Dividends Under an Unintegrated Regime*, 44 TAX L. REV. 1, 18-39 (1989) (evaluating current regime for taxation of intercorporate dividends); Peter B. Sorensen, *Changing Views of the Corporate Income Tax*, 48 NAT'L TAX J. 279 (1995) (explaining different viewpoints on nature and impact of corporate income tax). Thus, the corporate income tax and the federal wealth transfer tax arguably serve the same master: progressivity.

[77] *See* JCT REPORT, *supra* note 3, at E1-E7. The *JCT Report* did not estimate the revenue effects of the jurisdictional proposal. It is difficult to imagine, however, that the proposal, if enacted, would not raise *some* revenue given the JCT's conclusions regarding the current virtual non-enforcement and non-enforceability of § 877. *See id.* at 61-64. Subsequent to publication of the *JCT Report*, Kenneth Kies, Chief of Staff of the JCT, provided some estimates of the revenue likely to be raised by the jurisdictional proposal. *See infra* note 204. That the proposals purport to raise revenue makes enactment of one of them a virtual certainty in these days of budgetary deficits.

[78] *See supra* text accompanying notes 10-12 (stating that desire for retribution and deterrence are behind proposals to change taxation of expatriation).

[79] *See supra* notes 72-74 and accompanying text. Those who argued against the adoption of proposals that would have made some capital gains realized by nonresident aliens

those general principles in the case of expatriates. Thus, the realization proposal would distinguish between U.S. citizens who expatriate and those who do not and would cause realization of accrued gains and losses for the former but not for the latter.[80] Under this proposal, all but $600,000 of accrued gain would be subject to taxation at the time of expatriation unless the individual elected to remain subject to U.S. taxation with respect to specific property,[81] posted adequate security, or was not sufficiently wealthy to be covered by the provision.[82] The jurisdictional proposal would distinguish between aliens who were U.S. citizens in the past and aliens who were not.[83] It would extend the taxing jurisdiction of the United States to former citizens for a period of ten years following expatriation.[84] The proposal would cover U.S. source income, broadly defined,[85] and it would apply to individuals who have an average net income tax liability of more than $100,000 during the five year period preceding expatriation or a net worth of $500,000 or more as of the time of expatriation. As originally crafted the proposal would

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and foreign corporations subject to tax repeatedly argued that taxation of capital gains by the country of residence rather than the country of source was a longstanding principle of international taxation which would be abrogated by adoption of the proposed changes. *See* the two bar association reports cited *supra* note 76.

[80] S. 700 is the realization proposal most seriously considered by Congress until 1996. *See supra* note 3 (discussing Congressional response to tax-motivated expatriation). H.R. 831 was the realization proposal that was approved by the Senate during the 103d Congress. S. 700 would add § 877A to the Code to make the act of expatriation a realization event. S. 700, *supra* note 3. Proposed § 877A provides a $600,000 exemption amount and contains detailed provisions that address the problems raised by the possession of interests in trusts. *Id.* S. 1367 is the realization proposal most recently introduced. *See supra* note 3. While it differs from S. 700 in some respects, it shares the general approach reflected by S. 700.

[81] *See supra* note 80 (discussing current realization proposal, S. 700).

[82] S. 1367 would apply to expatriates whose average net income tax for a period prior to expatriating was more than $100,000 or whose net worth at the time of expatriation is $500,000 or more. *See Harkin Bill, S. 1637, Would Revise Expatriate Tax Rules*, *supra* note 3 (setting out text of S. 1367, including proposed § 877A(c)(1)).

[83] H.R. 1812 is the jurisdictional proposal originally introduced in Congress. *See supra* note 3 (describing Congress's reaction to tax driven expatriation). It would amend § 877 to make the existence of a tax avoidance motive presumptive in many cases. H.R. 1812, *supra* note 3, § 2(a). *See also infra* note 174 and accompanying text (providing additional details of and commentary on this proposal). Section 421 of H.R. 3103 is the version currently under consideration. *See supra* note 3. It retains many of the distinctions made by H.R. 1812.

[84] H.R. 1812, *supra* note 3, § 2(a).

[85] H.R. 1812 would provide special, broader, source rules for purposes of computing the tax due under § 877(b). *See id.* § 2(c).

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provide exceptions from its coverage for certain naturalized citizens and for certain other citizens with familial ties to a foreign country.[86]

The new distinctions that each proposal creates might encourage expatriation, discourage it, or make the tax consequences of it neutral. Because both proposals increase the cost of expatriation, they can hardly encourage it. Therefore, their only possible aims are discouragement or neutralization. Further analysis reveals that to classify the proposed changes as neutralizing is to engage in fantasy or wishful thinking.

That adoption of either proposal would make expatriation tax-neutral is perhaps the most compelling argument on their behalf. Indeed, the argument that the proposals would make expatriation tax-neutral is the linchpin of the conclusion that the proposals do not violate the international human right to expatriate.[87] The neutralization argument proceeds from the following syllogism:

> *Major premise:* The current system encourages expatriation;
> *Minor premise:* The proposals remove that encouragement;
> *Conclusion:* The proposals therefore make expatriation tax-neutral.[88]

Such syllogistic reasoning is flawed because it assumes that an advantage can be removed without imposing a disadvantage. The argument is based on the view that the proposals are instruments of removal, not instruments of infliction. Yet instruments of infliction is what they are.

Perhaps a mathematical analogy will help to explain why the syllogistic reasoning above is flawed. The major premise of the neutralization argument is that current law gives expatriation an advantage of, say, plus five when compared to non-expatriation. The minor premise is that the proposals remove that plus five by injecting a minus five, that is, by attaching negative tax con-

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[86] *See infra* note 174.

[87] *See* JCT REPORT, *supra* note 3, at 99 (determining that proposals do not arbitrarily infringe right to expatriate given that they attempt to neutralize tax consequences of expatriation).

[88] *Id.*

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sequences to the act of expatriation. Because every school child knows that five minus five equals zero, the conclusion that the proposals neutralize the tax consequences of expatriation appears to follow inexorably from the minor premise. But the minor premise is flawed.

The minor premise is flawed because five minus five equals zero only as long as the act of subtracting the five does no more than subtract five. Yet the act of subtracting a benefit does much more than subtract that benefit, at least when the act of subtracting takes the form of the current proposals. Neither the realization nor jurisdictional proposal merely removes the benefit of expatriation. Instead, while purporting to remove a benefit they impose an affirmative burden on the act of expatriation, and the imposition of that affirmative burden makes neutrality impossible.

The realization proposal adds to the act of expatriation a burden that would not attend retention of citizenship. That burden is the deemed realization of accrued gains even though no actual realization event has occurred. The jurisdictional proposal also adds a burden to the act of expatriation. That burden is the need to continue to pay U.S. tax at domestic rates on U.S. source income even though the individual is no longer a U.S. citizen and can receive none of the substantive benefits of citizenship. Because each proposal adds a burden to the act of expatriation each fails to make that act tax-neutral. Closer examination reveals how.

Although the realization proposal has been touted as a simple equalization device that is designed to atone for the inability of the United States to collect a tax on accrued gain following expatriation,[89] closer analysis reveals that the proposal goes much further than that. Suppose Richie Rich owns a large and very valuable portion of the stock of Souptime, Inc. The stock has a basis of $100 and a fair market value of $1,000; it also pays dividends of $10 per year. If Richie remains a U.S. citizen, he will pay U.S. income tax at ordinary income rates (up to 39.6% under current law)[90] on the dividends, and he will pay

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[89] *See id.* (claiming that proposals aim to neutralize tax consequences flowing from decision to expatriate).

[90] I.R.C. § 1 (1994).

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U.S. income tax at capital gains rates (a maximum of 28% under current law)[91] on the $900 of accrued gain if he decides to sell the stock. If he retains the stock, neither Richie nor his heirs will be subject to income tax on the appreciation at Richie's death.[92] However, the income derived from the dividends will be part of his gross estate if not consumed, as will the full value of the stock at that time.[93]

If, instead, Richie renounces his citizenship, moves to Ireland and becomes an Irish citizen, the dividends he receives will be subject to tax at the reduced rate of fifteen percent under the U.S-Ireland tax treaty.[94] In addition, only U.S. property would be subject to the federal estate tax.[95] If he retains his stock in Souptime, Inc., that stock will be considered U.S. property, subject to the federal estate tax.[96] If Richie sells that stock and reinvests the proceeds in the stock of a foreign corporation, however, he would pay no U.S. income tax on the sale[97] and no federal estate tax would be due at his death.[98] Alternatively, Richie might be able to retain the stock and place it in trust or

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[91] *Id.* § 1(h).

[92] Richie's heirs will have a fair market value basis in the stock. *Id.* § 1014.

[93] Alternatively, the stock can be valued as of the date six months after Richie's death. *Id.* § 2032(a)(2).

[94] Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Sept. 13, 1949, U.S.-Ir., art. VI, 2 U.S.T. 2303, 2310. The treaty provides for rates reduced to as little as 5%. *Id.* The rates of less than 15%, however, might not apply to someone in Richie's position. Regardless, the difference between 15% and 39.6%, or more, is substantial.

[95] I.R.C. §§ 2101, 2104 (1994).

[96] *Id.* § 2104.

[97] *Id.* § 871(d). This is assuming that he would not be present in the United States for 183 days or more. *See id.* § 871(a)(2).

[98] Section 2103 only includes in the gross estate of a nonresident alien not a citizen the value of property situated in the United States. *Id.* § 2103. Section 2104 deems stock of domestic corporations U.S. property. *Id.* § 2104. By implication, this confirms that stock issued by foreign corporations will not constitute U.S. property for purposes of § 2103. *See* 26 C.F.R. 20.2105-1(f) (1995) (making this implication explicit). *Cf.* Fillman v. United States, 355 F.2d 632 (Cl. Ct. 1966) (finding that stock in domestic corporation held in name of foreign corporations was includable in gross estate of non-resident alien decedent because foreign corporations were only custodians for alien).

The hypothetical in the text assumes that § 2107 will not apply. The absence of any litigated cases under § 2107 suggests that its enforcement is even more sparse than that of § 877. *See supra* note 56 (discussing § 2107's improbable enforceability). Indeed, the general paucity of cases on §§ 2103-2106 suggests that enforcement of § 2103 itself is sparse, particularly of late.

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in a foreign holding company in a way that would allow him to retain a significant amount of control over it but would not result in inclusion of his interest in the trust or foreign holding company in his gross estate for federal estate tax purposes.[99] In either event, none of his foreign property would be subject to the federal estate tax. By expatriating, Richie would save both federal income taxes and federal estate taxes. That is what offends so many people.[100]

The realization proposal seeks to eliminate those savings by treating expatriation as a realization event. Under that proposal, Richie would not save income taxes because the $900 appreciation in his stock would be subject to tax at the time of expatriation. By taxing that gain, the realization proposal purports to make the act of expatriation tax-neutral, but any such neutrality is illusory for two reasons.

First, even after realization, expatriation remains advantageous. True, in present value terms, an expatriating Richie will pay

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[99] Of course, the corporation could not be a mere conduit. *See Fillman*, 355 F.2d at 634-35 (holding that foreign corporations were only custodians for decedent nonresident alien; thus, value of stock held by corporations is includable in decedent's gross estate). In addition, to be absolutely safe, Richie would have to use traditional U.S. planning techniques to avoid the tentacles of §§ 2035-2038, as the Service takes the position that § 2103 is coextensive not only with § 2031 itself, but with § 2031 as augmented by §§ 2031-2045. *See* 26 C.F.R. § 20.2103-1 (1995) (defining "entire gross estate" of nonresidents); § 20.2104-1(b) (providing that property included in gross estate of nonresident alien decedent through application of §§ 2035-2038 is deemed situated in United States if it was so situated either at time of transfer or at time of decedent's death). The courts seem to have agreed with this expansive reading of § 2103. *See* Estate of Swan, 247 F.2d 144 (2d Cir. 1957), Commissioner v. Nevius, 76 F.2d 109 (2d Cir. 1935), *cert. denied*, 296 U.S. 591 (1936). A more textualist court, however, might be willing to disagree. A strong argument could be made that §§ 2035-2038 exist because without them, the property which they claw back into the gross estate would escape inclusion. Thus, if Congress had wanted to make § 2103 coextensive with § 2031 *and* with §§ 2035-2038, the argument would run, it should have said so. In addition, the difficulties of enforcing any tax levy with respect to property that is included in a nonresident alien decedent's gross estate only because the nonresident alien decedent transferred it to a foreign entity but retained a life estate are monumental. Therefore, compliance with the obligation imposed by any such construction is a matter of charity toward the U.S. government. Foreign trusts pose persistent and serious problems for the U.S. tax system and have been the subject of substantial proposed legislation, sometimes even in tandem with anti-expatriation legislation. *See* S. 1367, *supra* note 3; *NYSBA*, *supra* note 74.

[100] The outrage tax-motivated expatriation produces is manifest not only in the tone of press reports describing the benefits of expatriation, but in the Congressional commentary during hearings on the issue. *See Hearings*, *supra* note 11.

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more in federal income tax than a non-expatriating Richie, not only because he will pay it now but also because he will definitely pay it, whereas the non-expatriate may never pay it at all.[101] Nevertheless, even after enactment of the realization proposal, the expatriating Richie may be better off expatriating than not expatriating, because expatriation can fix and cap his federal income tax liability and can eliminate federal estate tax liability.

If Richie were to realize the gain subject to tax under the proposal and then reinvest the proceeds in equally productive foreign property,[102] he would have accomplished a result almost as attractive as the preferred stock freezes so popular before 1986.[103] Although such an expatriating freeze would be less attractive than the old preferred stock freezes because the analog to the old recapitalization could not be effectuated free of current tax,[104] the expatriating freeze would be substantially

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[101] This will obtain as long as § 1014 continues to step up the basis of property transferred at death. The existence of the federal estate tax does not compensate for this because much escapes the estate tax. *See* George Cooper, *A Voluntary Tax? New Perspectives of Sophisticated Estate Tax Avoidance*, 77 COL. L. REV. 161, 164 (1977) (asserting that estate planners can exploit loopholes which exist in estate tax); Joel C. Dobris, *A Brief For the Abolition of All Transfer Taxes*, 35 SYRACUSE L. REV. 1215, 1217 (1984) (stating that estate tax has lost much of its impact); Galvin, *To Bury the Estate Tax*, *supra* note 76, at 1413 (claiming that estate tax has run its course); Edward J. McCaffery, *Rethinking the Estate Tax*, 67 TAX NOTES 1678 (1995) [hereinafter McCaffery, *Rethinking the Estate Tax*] (arguing that current estate tax may be losing money and should be repealed); *see also* Edward J. McCaffery, *The Uneasy Case for Wealth Transfer Taxation*, 104 YALE L.J. 283 (1995) [hereinafter McCaffery, *The Uneasy Case*] (noting that estate tax does not appear to be working and analyzing case against taxation of wealth transfer).

[102] It would have to be foreign property in order to escape the federal estate tax. I.R.C. § 2107.

[103] In a typical preferred stock freeze the stock of a corporation whose stock was owned by an older generation would be recapitalized into common and preferred. The older generation would then make gifts of the lower value common stock to the younger generation while retaining the fixed value preferred, with the objective of owning only the preferred at their death and thus shifting any further increases in the value of the corporation into the common. Because the amount included in the older generation's estate would be only the value of the preferred at the time of the recapitalization, this technique effectively froze the older generation's estate at that time.

The combination of the repeal of the *General Utilities* doctrine in 1986, which increased the use of S corporations (and, in turn, precluded the issuance of preferred stock) together with the enactment of Chapter 14 ended the glory days of freezes. (I recall a friend and practitioner who described the substance of his work during November and December 1986 as "reversing every freeze transaction ever done" so as to put corporations in a position to elect S status. I also recall being very glad I had moved to academia by then).

[104] Indeed, proposed § 877A is the precise antithesis of the regime effectuated by

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more attractive in another way: Richie would not need to divest himself of control over his property to effect the freeze. Thus, expatriation would remain attractive as a tax reduction technique in many cases even following enactment of the realization proposal.[105]

Nevertheless, enactment of the realization proposal would hurt Richie. Not only would Richie be worse off after enactment of the proposal than he would be if he expatriated under current law,[106] but he would also be worse off than someone like his equally wealthy sister Leona Rich, who did not choose to expatriate. Although Leona would have to continue to pay federal income tax at ordinary income rates on any dividends she received on her Souptime stock, Leona would not need to include any other amount in income until she sold her stock. If she held the stock until her death, it would be included in her gross estate.[107] Nevertheless, the stock would not be subject to tax if she left it to her husband.[108] In addition, although the stock might be subject to tax at her husband's death, it would not be subject to transfer taxes at all if either she or her husband, or both, made systematic inter vivos gifts of it to their descendants in a way that made the gifts subject to the annual exclusion.[109] In any event, Leona and her attorney could devise an estate plan that could take maximum advantage of the gift

§§ 368(a)(2)(E), 354, and 361.

[105] This assumes that Richie would move to a country with income and transfer tax rates substantially lower than our own. The wealthy expatriates whose stories have been told in the press have uniformly done just that. *See Forbes, supra* note 3.

[106] This assumes that § 877, as currently in effect, would not affect Richie, either because he could show the existence of a non-tax motive for expatriating or because the Service decided not to pursue the issue, either on economic or risk of litigation grounds.

[107] *See* I.R.C. § 2031 (1994).

[108] This results from the operation of the estate tax marital deduction. *See id.* § 2056.

[109] I.R.C. § 2503(b) allows individuals each year to exclude the first $10,000 of gifts of present interests made to each donee. *See id.* § 2503(b). Married individuals can therefore exclude $20,000 of gifts, per donee, per year. *See id.* § 2513. A planned program of annual giving can therefore result in the tax-free transfer of a substantial amount of wealth, particularly if begun early in life. The transfers can be made to trusts, allowing the retention of a significant amount of control by the donor. The donor can determine the use of the trust principal through provisions in the terms of the trust, as long as the trust contains certain provisions (generally known as "Crummey powers" by estate planners) designed to make the beneficiaries' interest present. The gifts would thus qualify for the § 2503(b) annual exclusion, with just enough control withheld from the donor so as to prevent inclusion of the trust principal in the donor's gross estate.

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tax annual exclusion,[110] the estate tax unified credit,[111] and the generation skipping transfer tax (GSTT) exemption of $1 million.[112] Thus, even if Leona's husband predeceased her, Leona could probably pass $1.2 million free of any income or transfer taxes and could ensure that at least $1 million of that total would not be subject to transfer taxes upon transfer by the next generation.[113] Because the realization proposal allows only a $600,000 exemption, the effect of the $1 million GSTT exemption and relatively straightforward estate planning is to give Leona an advantage over an expatriating Richie, especially if Richie is single and dies shortly after expatriating.[114] That advantage consists of: (a) the ability to transfer $1.2 million of property free from federal income or transfer taxes; (b) the present value of the federal income tax that would not be due at all; and (c) the present value of the federal estate tax that would not be due until Leona's death; reduced by (d) the need to pay federal income tax on the dividends at ordinary income rates.

It is, of course, impossible to quantify the advantages that citizen Leonas would have over expatriate Richies, or even to conclude that there would be an advantage to either expatriating or staying in all cases, but the foregoing analysis shows that expatriation is not likely to be *neutral*. As long as the federal tax system treats non-resident aliens and citizens differently, and as long as the United States cannot extend its taxing jurisdiction to the foreign source income received by non-resident aliens,[115]

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[110] *Id.* § 2503(b). *See also supra* note 109 (discussing application of § 2503(b)).

[111] I.R.C. § 2010 (1994).

[112] *Id.* § 2631(a).

[113] *See id.* §§ 2001, 2010, 2631(a). The full amount of the unified credit would be available to both Leona and her husband with some rudimentary estate planning.

[114] The realization proposal, as currently drafted, applies to "expatriates," which it defines as "any United States citizen who relinquishes his citizenship." S. 700, *supra* note 3. This language suggests that each individual who is part of a married couple would receive one $600,000 exclusion, and that would make sense given that the transfer tax unified credit equivalent is computed on a per person basis. The trend in the income tax, however, is to give two married individuals the same exclusion as one. *See, e.g.*, I.R.C. §§ 68(b), 151(d)(3)(B), 469(i)(5). The $600,000 exemption of proposed § 877A may very well become a part of that trend, particularly because following that trend would increase the revenue-raising potential of the proposal.

[115] The United States does not have jurisdiction now to tax nonresident aliens' foreign source income, and even if it did, it would be an exercise in futility. *See infra* note 117.

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expatriation will necessarily result in some difference in taxation attributable to the act of expatriation. The difference might make the expatriate better off in some cases and worse off in others, but it will not leave the individual's tax picture untouched.

Under a system that distinguishes between citizens and nonresident aliens, then, expatriation cannot be neutral. If the realization proposal is adopted, expatriation could inflict higher lifetime tax liability on those who expatriate than on those who do not. Yet, even after adoption of the proposal, expatriation could allow individuals to reduce their lifetime tax liability by expatriating earlier in life, before substantial gain has accrued, or shortly after receiving inherited property, which under current law has a basis equal to its fair market value and thus carries with it no unrealized gain.[116]

Although the jurisdictional proposal comes closer to achieving neutrality than the realization proposal, it also fails to achieve that goal. The jurisdictional proposal is more neutral than the realization proposal because it attempts to abolish the distinction between citizens and non-citizens by taxing both alike for a period of time. Nevertheless, U.S. taxation of aliens can never be exactly like U.S. taxation of citizens for the simple reason that even if the United States were somehow to assert worldwide taxing jurisdiction over non-resident aliens, enforcement of such a regime would be impossible.[117]

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[116] *See* I.R.C. § 1014.

[117] The difficulties in enforcing any provision that attempts to impose U.S. tax liability on persons over whom the United States does not have personal jurisdiction are a recurrent theme for critics of the jurisdictional proposal, as well as of the current law. *See Hearings*, *supra* note 11 (discussing methods by which foreign citizens evade U.S. taxation). It is interesting to note that the Code, by its terms, does not limit its applicability to U.S. citizens and residents. Section 1, which imposes the tax, applies to "individuals", a term not defined in the statute. Although § 2(d) provides that nonresident aliens will be taxed to the extent provided by §§ 871 and 877, nothing in the Code says that it applies to only U.S. citizens and residents. Indeed, as Professor Joseph Isenbergh has wryly noted, "section 1 could be read to reach nonterrestrial 'individuals,' if creatures worthy of that term reside on other planets or even in other galaxies." 1 ISENBERGH, *supra* note 44, ¶ 1.5.3. Nevertheless, as Professor Isenbergh has also observed: "Common sense suggests that there must be some limiting principle, and there is. The American tax system does not attempt the vain act of taxing billions of persons beyond the reach of effective enforcement." 1 *id.*

Lord Mansfield's Rule, laid down in Holman v. Johnson, 98 Eng. Rep. 1120, 1121 (K.B. 1775), provides that "no country ever takes notice of the revenue laws of another."

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Current versions of the jurisdictional proposal, like the statutory provision that it amends, recognize that limitation by restricting their reach to taxation of the U.S. source income of expatriates. Such a proposal, like current law, fails to eradicate the tax advantage of expatriation because expatriation will continue to be more desirable than retention of citizenship for individuals with substantial foreign holdings and will always be more desirable than retention of citizenship for those who are willing to hold U.S. property for ten years after expatriating.[118] Therefore, while the jurisdictional proposal reduces the advantages of expatriation, it hardly removes them. It certainly does not make expatriation tax-neutral.

Moreover, the assumption that either treating expatriation as a realization event or extending the taxing jurisdiction of the United States for some period of time will treat expatriates like those who choose to stay is based on a highly questionable premise. That premise is that if expatriates remain citizens, they will eventually pay some tax, either income or transfer, on all appreciation. I dare say that many tax advisors would attribute such a premise to wishful thinking on the part of the government. Some might even find it laughable. Sophisticated estate planning, together with the realization requirement and the income-tax-free step up in basis provided by section 1014, will ensure that even those who remain citizens will pay much less than the government hopes. Indeed, it may be that a large chunk of the money tax expatriates are saving is not tax dollars, but estate planning fees. It may also be that a large component of the benefit they are getting is not a reduced tax bill, but an equivalent bill devoid of the need to relinquish any control over property.

Given that neither the realization proposal nor the jurisdictional proposal achieves neutrality and that both make expatriation less desirable than it is under current law, we must deter-

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Under the aegis of this rule, the courts of a foreign country will not, in the absence of treaty provisions to the contrary, enforce U.S. revenue laws. *See, e.g.*, United States v. Harden, 1963 S.C.R. 366 (Can.) (upholding British Columbia Court of Appeals decision dismissing suit for enforcement of U.S. federal district court tax judgment).

[118] The latter advantage could be removed simply by making the provision applicable until the individual's death. That, however, would become an even greater administrative nightmare than enforcement of the provision for only 10 years after expatriation.

mine whether either of the proposals amounts to punishment for the act of expatriation. If so, we must also determine whether the advantages of using the tax system to punish expatriates outweigh the disadvantages.

2. Taxing Expatriating Exits as Punishment

Punishment can have one or more objectives. While those objectives are generally thought to include retribution, deterrence, reform, and incapacitation,[119] some moral philosophers add a fifth objective: the expression of societal disapproval.[120] I will refer to this last objective as symbolism. In the case of punishments delivered through the tax system,[121] reform and incapacitation are unlikely objectives, but retribution, deterrence and

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[119] *See generally* KADISH & SCHULHOFER, *supra* note 13, at 113-65 (describing justification of punishment).

[120] JOEL FEINBERG, *The Expressive Function of Punishment* (asserting that punishment is device for expression of resentment disapproval, and indignation), *in* DOING AND DESERVING 95 (1970), *reprinted in* PHILOSOPHY OF LAW, *supra* note 13, at 636. *See also* PATRICK DEVLIN, THE ENFORCEMENT OF MORALS (1965), *reprinted in* KADISH & SCHULHOFER, *supra* note 13, at 175-78.

[121] The tax system can deliver something that very closely resembles traditional punishments because some taxes possess six of what Nigel Walker has identified as the seven features of punishment. *See* WALKER, *supra* note 13, at 1-3. First, like punishment, the imposition of a tax "involves the infliction of something which is assumed to be unwelcome to the recipient." *Id.* at 1. Second, like punishment, the imposition of a tax "is intentional and done for a reason." *Id.* Third, as in the case of punishment, "[t]hose who order it are regarded—by the members of the society, organization, or family—as having the right to do so." *Id.* at 2. Fourth, like punishment, "[t]he occasion for the [imposition] is an action or omission which infringes a law, rule or custom." *Id.* Taxes that result from the denial of a deduction pertaining to a disfavored activity possess this feature of punishment. A tax on expatriation could do likewise because even though the act of expatriation would not violate any laws, it could be seen as violative of a custom. Indeed, that is probably what has caused tax-motivated expatriation to strike a responsive chord in so many people. *See infra* notes 126-29 and accompanying text. Fifth, as with one being punished, one being taxed "has played a voluntary part in the infringement, or at least [those who tax him] believe or pretend to believe that he has done so." WALKER, *supra* note 13, at 2. Sixth, as with punishment, the taxer's "reason for [taxing] is such as to offer a justification for doing so." *Id.*

It is the seventh feature that arguably distinguishes taxes from punishments because taxes are not enacted to punish. Walker posits that "[i]t is the belief or intention of the person who orders something to be done, and not the belief or intention of the person to whom it is done, that settles the question whether it is punishment." *Id.* at 3. However, a strong argument could be made that an exaction which has the first six features of punishment and which was enacted with the same objectives as traditional punishment, for example, deterrence of specific behavior, is punishment. Professor Eric Zolt refers to such tax provisions as tax penalties. *See* Zolt, *supra* note 14.

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symbolism are pertinent.[122] The tax system can impose retribution for particular behavior by taxing its consequences more heavily than the consequences of other behavior. By denying a deduction for the costs involved in selling illegal drugs, for example, the tax system can make drug dealing more costly. In this way, the tax system can get back at a drug dealer for carrying on a trade or business that the legal system disapproves of,[123] and it can also deter the behavior in question.[124] In addition, the imposition of a higher cost on running a drug dealing business conveys disapproval of the business and thus serves a symbolic function as well. By making the cost of running a drug dealing business not deductible, the Code simultaneously exacts retribution, deters, and conveys disapproval. In doing so, the Code fulfills the objectives of traditional punishment. Like the monetary fines that are often a part of traditional punishment, tax penalty provisions are motivated by the objectives of punishment and they benefit from analysis as such.

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[122] Some moral philosophers, such as Professor H.L.A. Hart, would not regard the imposition of a tax burden on expatriation as punishment because they define punishment as requiring that it be inflicted "for an offence against legal rules." HART, *supra* note 13, at 5. Because individuals have an internationally recognized right to expatriate, doing so cannot offend legal rules, however much it might offend some people's sense of patriotism. Nevertheless, the desires for retribution and deterrence, traditional aims of punishment even for Professor Hart, are such strong components of the current push to tax expatriation that an analysis of it as punishment is worthwhile even if the congressional action in question does not satisfy every moral philosopher's definition of punishment. *See supra* note 121.

[123] *See* I.R.C. § 280E (1994). This provision was added to the Code by the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 640. Even illegal income is gross income for federal income tax purposes. James v. United States, 366 U.S. 213 (1961); Collins v. Commissioner, 3 F.3d 625 (2d Cir. 1993). Thus, denial of a deduction for the ordinary and necessary costs of carrying on that business will reduce the drug dealer's profits, thereby exacting retribution from him. For an excellent discussion of the differences between retributive and deterrent theories of punishment which classifies retributive theories as backward-looking and deterrent theories as utilitarian and forward-looking, see Feinberg, *supra* note 13.

[124] For example, the inability to deduct the costs of running a drug-dealing business makes the after-tax cost of drug dealing higher than the after-tax cost of engaging in other businesses and could theoretically deter drug dealers. Even if drug dealers never report the income from their drug-dealing activities, the existence of the provision is significant when a drug dealer is apprehended because it allows the Service to reconstruct his income and obtain a larger amount of tax revenue than it could obtain if the costs of running the business were deductible. *See* Browning v. Commissioner, 61 T.C.M. (CCH) 2053 (1991); Bratulich v. Commissioner, 60 T.C.M. (CCH) 1308 (1990).

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a. Penal Objectives of the Proposals

Both the realization and jurisdictional proposals are tax penalty provisions. Neither simply imposes a tax. Although the possibility of raising revenue has not been ignored by proponents of either proposal,[125] the need for revenue is not the engine pulling the anti-expatriate train. Anger is. Anger probably motivated Representative Schroeder, for example, to remark in a speech on the floor of the House: "[E]very time you buy a jar of soup, think of that can of soup and the guy living in Ireland, thumbing his nose at American taxpayers. That is what this is about."[126] Representative Schroeder was undoubtedly referring to John T. Dorrance, III, one of the owners of a large amount of Campbell Soup Company stock, who emigrated to Ireland and renounced his U.S. citizenship, thereby saving millions of dollars in U.S. taxes.[127] Anger probably led the Assistant Treasury Secretary for Tax Policy, Leslie Samuels, to refer to people like Dorrance as "economic Benedict Arnolds."[128] Anger probably also led Representative Abercrombie to go even further. Speaking on the floor of the House, Representative Abercrombie showed the derision in which he held those who expatriated to save taxes when he explained his support for the realization proposal by asking:

> Why should I give two hoots about somebody that wants to give up their U.S. citizenship and shift their assets to another country . . . ?

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[125] *See, e.g.*, 141 CONG. REC., *supra* note 11, at H3845 (statement of Rep. Gibbons). The grave concern that exists over the budget deficit has led to an inability to pass revenue-losing provisions without correlative revenue raisers. Thus, mention of the revenue-raising possibilities of a proposal is hardly indicative of the driving force behind the provisions. The *JCT Report* estimated that the realization proposal would raise much less revenue than had previously been thought. JCT REPORT, *supra* note 3, at E4-E7. *See also infra* note 204.

[126] 141 CONG. REC. H3989 (daily ed. Mar. 30, 1995) (statement of Rep. Schroeder).

[127] The Dorrance expatriation took place so recently that it is likely that the Service has not yet had an opportunity to test the application of § 877 to him. It is interesting to note that the expatriate debate has proceeded on the assumption that § 877 will not apply. Given the publicity that has surrounded the Dorrance expatriation, it is impossible to suppose that the Service will not be taking a look. Nevertheless, as discussed *supra*, expatriation may well benefit Dorrance even if § 877 applies and even if he voluntarily files returns under the assumption that it will apply.

[128] *See* Lin, *supra* note 16. The "Benedict Arnold" tag has stuck. Introducing H.R. 1637, the Expatriation Tax Reform Act of 1996, Sen. Harkin decried the existence of the "Benedict Arnold loophole." *Harkin Bill, S. 1637, Would Revise Expatriate Tax Rules*, *supra* note 3.

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> It has been brought up about double taxation. I say, "You can triple or quadruple tax them as far as I'm concerned, run it up to a hundred percent if they want to give up their citizenship because they don't want to pay their taxes."
>
> . . . .
>
> . . . How can you say that we should all do our share in America, including making all the kids, and the elderly people, and everybody else, have to contribute to the deficit, to bring it down, and at the same time allow these sleazy bums, who don't want to pay their taxes, to leave this country, and renounce their citizenship, and expect me to have one iota of sympathy for them.[129]

Enacting provisions directed at sleazy bums who are economic Benedict Arnolds and who thumb their noses at American taxpayers sounds a lot like trying to punish those people because we do not like what they are doing.[130] It is fair to say that at least some of the members of Congress view punishment—with its attendant goals of retribution, deterrence and symbolism—as one of the objectives of a change in the taxation of expatriation. Even the *JCT Report* predicted that the tax imposed by the realization proposal would be "high enough to delay or deter some expatriation."[131] The significant question is whether the evi-

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[129] 141 CONG. REC. *supra* note 11, at H3850 (statement of Rep. Abercrombie). Rep. Abercrombie was actually speaking to passage of an instruction that would have required the House Conferees on H.R. 831 to retain the Senate's version of the realization proposal. The instruction failed. *Id.* at H3852.

[130] It is, of course, impossible to ascribe motives to the U.S. Congress as a body based on the statements of a few individuals. *See* Frank H. Easterbrook, *Statutes' Domains*, 50 U. CHI. L. REV. 533 (1983); Max Radin, *Statutory Interpretation*, 43 HARV. L. REV. 863, 869 (1938); Patricia Wald, 68 IOWA L. REV. 195 (1983). *Cf.* Daniel A. Farber & Philip P. Frickey, *Legislative Intent and Public Choice*, 74 VA. L. REV. 423 (1988) (describing and criticizing Justice Scalia's objections to use of legislative history, and discussing implications of public choice theory for statutory interpretation); Oliver Wendall Holmes, *The Theory of Legal Interpretation*, 12 HARV. L. REV. 417, 419 (1899) (advocating inquiry into meaning of statute rather than intent of legislators); Peter C. Schanck, *An Essay on the Role of Legislative Histories in Statutory Interpretation*, 80 LAW LIB. J. 391 (1988) (questioning value of legislative history in statutory interpretation, but acknowledging usefulness of legislative history generally); Kenneth Starr, *Observations About the Use of Legislative History*, 1987 DUKE L.J. 371 (criticizing use of legislative history in statutory interpretation). Whatever the limitations on drawing inferences from such statements, the statements should at a minimum support the inference that they reflect the feelings and thoughts of those who made them. That at least some of the individuals who are in a position to affect the enactment of legislation on the taxation of expatriates have publicly espoused the views represented by the statements quoted in the text suggests that motives other than simple neutralization of tax benefits account for the current wave of expatriate taxation proposals.

[131] JCT REPORT, *supra* note 3, at E-5. Leslie Samuels, Assistant Treasury Secretary for

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dence that retribution, deterrence, and symbolism are at least three of the objectives of the proposals, combined with the probability that either proposal will raise comparatively little revenue,[132] will suffice to convert any exaction imposed pursuant to those proposals from a tax into something else.[133]

b. The Difference Between Taxes and Punishments

Nearly seventy years ago Justice Holmes, in a strongly felt and widely quoted dissenting opinion, commented on the difference between taxes and financial punishments, or penalties.[134] Although he acknowledged the similarity between taxes and penalties, observing that "every exaction of money for an act is a discouragement to the extent of the payment required,"[135] he

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Tax Policy, agrees. *See Hearings, supra* note 11. Indeed, Samuels based both the revenue estimates of the realization proposal and his support of it over H.R. 1812 on its likely deterrent effect. *Id.*

[132] *See infra* note 204 and accompanying text.

[133] Both the realization and the jurisdictional proposals are atypical, and thus possible candidates for classification as punishments, for a third reason that I discuss in more detail below in the section on progressivity. Both proposals burden wealthy taxpayers more heavily than poorer taxpayers, not only in the classically progressive fashion, which would be unremarkable, but in another, quite remarkable way: by denying wealthy taxpayers any significant opportunity for the exercise of choice. As I have suggested elsewhere, our tax system rewards material wealth by providing those who hold it with ample opportunities for the exercise of choice, both with respect to the payment of taxes and with respect to the determination of the identity of the bearer of their economic burden. *See* Alice G. Abreu, *Taxes, Power, and Personal Autonomy*, 33 SAN DIEGO L. REV. (forthcoming 1996). The two expatriation proposals are atypical because they distribute both their burdens and their denial of choice progressively. Rather than rewarding the holding of wealth with the opportunity to exercise choice, it is as if Congress was, in this instance, punishing it by denying its holders the opportunity to exercise choice.

[134] *See* Compañía General de Tabacos de Filipinas v. Collector of Internal Revenue, 275 U.S. 87, 100 (1927) (Holmes, J., dissenting). For a good discussion of Justice Holmes's views on this question, see 2 MARK D. HOWE, JUSTICE OLIVER WENDELL HOLMES, THE PROVING YEARS 74-80 (1963). *See also* H.L.A. HART, THE CONCEPT OF LAW 39 (1961) (distinguishing between punishment for crime and tax on course of conduct). The textual discussion that follows is adapted from Abreu, *supra* note 133.

[135] *Compañía General*, 275 U.S. at 100 (Holmes, J., dissenting). Robert Nozick goes significantly further than Justice Holmes and categorizes taxes, like other enforced exactions, as theft. ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA 172 (1974). I do not agree with Nozick. The payment of tax may not be voluntary in the sense that would cause people to do it absent some form of governmental coercion, but I do not believe that the mere existence of coercion makes the act theft. The coercive element of a tax system is a part of its being law. Further discussion of the fascinating question of the difference between taxation and theft is quite beyond the scope of this Article. Indeed, a discussion of the difference

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concluded that taxes differ from penalties because taxes have a positive side: they buy civilization in the form of goods and services provided by the government.[136] By contrast, the purpose of penalties is not the affirmative acquisition of goods or services, but rather, the prevention of certain conduct.[137]

In 1994, the Supreme Court again examined the question of the difference between taxation and punishment. In *Department of Revenue v. Kurth Ranch*,[138] the Court held that a statute imposing a tax on the possession and storage of dangerous drugs imposed a punishment that violated the Fifth Amendment's proscription against double jeopardy when applied to individuals who had already been convicted of possession.[139] To reach that conclusion, the Court pointed out that neither the label attached to the exaction nor the existence of a deterrent purpose for the exaction was determinative of its character, because both taxes and penalties generate revenue, impose fiscal burdens on individuals, and deter certain behavior.[140] Instead, the Court examined a panoply of factors to distinguish between taxes and punishments. These factors included the activity taxed (possession of illegal drugs),[141] the requirements for imposing tax liability (arrest for possession),[142] and the amount of tax imposed (several times the street value of the drug possessed).[143] The Court found that the Montana drug tax was "a concoction of anomalies, too far-removed in crucial respects from a standard

between taxation and theft provides the theme for the course my colleague, Rick Greenstein, teaches on Jurisprudence. I remain indebted to Rick for letting me participate in his Jurisprudence course in Fall 1994.

[136] *Compañía General*, 275 U.S. at 100 (Holmes, J., dissenting). For an examination of other ways in which taxes have positive attributes, see Abreu, *supra* note 133.

[137] *Compañía General*, 275 U.S. at 100 (Holmes, J., dissenting).

[138] 114 S. Ct. 1937 (1994).

[139] *Id.* at 1945-48. The question was a close one and the Court was deeply divided. Justice Stevens wrote the majority opinion, in which Justices Blackmun, Kennedy, Souter, and Ginsburg joined. Justices Rehnquist and O'Connor filed separate dissenting opinions, and Justice Scalia filed a dissenting opinion, in which Justice Thomas joined. The lower courts had been divided as well. A divided Montana Supreme Court had earlier reversed two lower court decisions holding that the tax resulted in a form of double jeopardy. Sorensen v. State Dept. of Revenue, 836 P.2d 29 (Mont. 1992).

[140] *Kurth Ranch*, 114 S. Ct. at 1946-47.

[141] *Id.* at 1947.

[142] *Id.*

[143] *Id.* at 1946 & n.17.

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tax assessment to escape characterization as punishment for the purpose of Double Jeopardy analysis."[144]

The *Kurth Ranch* Court nevertheless acknowledged that taxes could have more than the raising of revenue as their purpose and that one of the additional purposes that taxes could have is the deterrence of undesirable behavior.[145] The Court offered taxes on the purchase of items such as cigarettes as examples of such "mixed-motive" taxes.[146] Although, like punishment, mixed-motive taxes are designed to deter, they retain their status as taxes because the behavior they affect furthers some legitimate governmental goal. In effect, because the behavior they affect has both good and bad aspects, the imposition of a tax reflects a compromise between the abdication of governmental control and the criminalization or prohibition of the behavior. Therefore, according to the Court in *Kurth Ranch,* such exactions are properly regarded as taxes notwithstanding their deterrent component.[147]

In the case of cigarette taxes, the legitimate goals furthered by not criminalizing the use and sale of cigarettes are the raising of revenue and the creation of employment that results from the manufacture and sale of cigarettes.[148] Applying the *Kurth Ranch* analysis to a tax triggered by the act of expatriation reveals that such a tax could properly be characterized as a tax rather than as a punishment. Like taxing cigarettes rather than prohibiting their manufacture, purchase or sale, taxing rather than imposing an outright prohibition on it can serve legitimate governmental goals. Those goals are the maintenance of public confidence in the fairness of the system[149] and the preservation

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[144] *Id.* at 1948.

[145] *Id.* at 1947.

[146] *Id.*

[147] *Id.* The Court distinguished the situation in which the behavior is already forbidden, as in the case of behavior criminalized by the government. It reasoned that in those cases the only motive had to be the infliction of an additional punishment because the government could raise additional revenue by increasing the size of the penalty attendant to the commission of the crime. *Id.*

[148] *Id.* For a different, if callous, perspective on the role of cigarette taxes and the benefits of allowing individuals to smoke, see W. Kip Viscusi, *Cigarette Taxation and the Social Consequences of Smoking,* 9 TAX POL'Y AND ECON. 51, 51 (1995) (arguing that "financial savings from premature mortality in terms of lower nursing home costs and retirement pensions exceed the higher medical care and life insurance costs generated").

[149] *See Hearings, supra* note 11 (testimony of Assistant Treasury Secretary for Tax Policy

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of the right to expatriate.[150] Therefore, a tax on expatriation would simply be a mixed motive tax, designed both to deter tax-motivated expatriation and to raise revenue.

c. *Policy Considerations in the Adoption of a Mixed-Motive Tax*

Concluding that a tax triggered by expatriation[151] should be classified as a tax, and not as a fine, does not answer the question whether enacting such a mixed-motive tax would be consistent with sound tax policy. Answering that question requires determining whether the tax system is the best or even an acceptable mechanism for deterring specific behavior. Professor Eric Zolt has provided a framework for making such a determination.[152] As Professor Zolt has accurately observed:

> [T]ax penalty provisions are blunt instruments that are subject to challenge on both efficiency and equity grounds. . . . The cost of tax penalties often depends on the offender's tax bracket, expenditures incurred in conducting the activity, or general tax rate changes, rather than any estimates of harm

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Leslie Samuels).

[150] The rights to emigrate and expatriate are recognized in international law. HURST HANNUM, THE RIGHT TO LEAVE AND RETURN IN INTERNATIONAL LAW AND PRACTICE 48 (1987). Article 12 of the International Covenant on Civil and Political Rights recognizes the right to emigrate, and "the Universal Declaration of Human Rights . . . , adopted by the United Nations General Assembly on December 10, 1948, recognizes both a right to physically leave" (emigration) and a right to renounce citizenship (expatriation). *See* JCT REPORT, *supra* note 3, at 90. The United States recognizes both of these rights. *Id.* at 90-91. *But see* Detlev F. Vagts, Editorial Comment, *The Proposed Expatriation Tax—A Human Rights Violation?* 89 AM. J. INT'L L. 578 (1995) (asserting that international law does not protect right to expatriate).

The rights to emigrate and expatriate are also reflected in legislation adopted in this country with regard to behavior of other countries. For example, the Jackson-Vanick Amendment to the Trade Act of 1974, 19 U.S.C. § 2432 (1994), limits the United States' ability to grant most favored nation trade status to certain countries that restrict emigration. For a more complete discussion of the effect of the current tax proposals on the rights to emigrate and expatriate, see JCT REPORT, *supra* note 3, at 89-100.

[151] I would classify the tax resulting from operation of the jurisdictional proposal as a tax triggered by the act of expatriation because it is a tax that would not be imposed but for the act of expatriation. I would also classify the tax that would result from electing to remain subject to the taxing jurisdiction of the United States with respect to particular assets under the realization proposal as a tax triggered by expatriation for the same reason.

[152] *See* Zolt, *supra* note 14. During 1989 and 1990, Professor Zolt served as Acting Deputy Tax Legislative Counsel in the Treasury Department's Office of Tax Policy, but the views he expressed and the recommendations he made in the article were his own and not necessarily those of the Treasury Department. *Id.* at 343 n.*.

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caused, probability of enforcement, or gain to or culpability of the offender.[153]

Professor Zolt has concluded that Congress should use tax penalties only when "the advantages of using the tax system outweigh the limitations inherent in tax penalty provisions."[154] He has also recommended that for budgetary purposes, tax penalty provisions be analyzed in the same manner as tax expenditures.[155]

Professor Zolt's analysis can be applied to determine the desirability of enacting any provision that uses expatriation to trigger tax liability. As the discussion above in Part I.C.2.a, has demonstrated, the objective of both the realization and the jurisdictional proposals, like the objective of the provisions Professor Zolt classifies as tax penalties, is chiefly to punish.[156] As Professor Zolt urges with respect to other provisions, the expatriation proposals should be adopted only if the advantages of using the

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[153] *Id.* at 381.

[154] *Id.* at 345.

[155] *Id.* at 346-60.

[156] Thus, both the realization and jurisdictional proposals are motivated chiefly by a dislike for the underlying act. Other provisions in the Code are similarly motivated. For example, under § 901(j)(2)(C), foreign tax credit was denied with respect to amounts paid to the government of South America during Apartheid. Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, § 10231(a), 101 Stat. 1330-418, *repealed by* South African Democratic Transition Support Act of 1993, Pub. L. No. 103-149, § 4(b)(8)(A), 107 Stat. 1503, 1505. Section 901(j)(2)(C) initially singled out South Africa for "dishonorable mention," and then denied the foreign tax credit with respect to taxes paid to South Africa until "the Secretary of State certifies to the Secretary of the Treasury that South Africa meets the requirements of section 311(a) of the Comprehensive Anti-Apartheid Act of 1986." *Id.*

Additionally, deductions are denied for and an excise tax is imposed on greenmail payments. I.R.C. §§ 162(k), 5881 (1994). Golden parachute payments receive similar treatment. *Id.* §§ 2806, 4999. Subsequent to the publication of Professor Zolt's article, Congress again manifested its dislike for what it considered excessive compensation by adding a new § 162(m) to the Code, effective for taxable years beginning on or after January 1, 1994. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13211, 107 Stat. 312, 469-71 (codified at I.R.C. § 162(m) (1994)). New § 162(m) denies publicly held corporations a deduction for employee remuneration that exceeds $1 million. I.R.C. § 162(m). Finally, deductions are denied for the costs of being a drug dealer. *Id.* § 280E. *See also supra* notes 123-24 and accompanying text.

Both the realization proposal and the jurisdictional proposal would produce an extraordinary tax liability because they would produce a tax liability that would not exist under normative principles of taxation, which include actual realization and the exertion of full taxing jurisdiction over citizens and residents only.

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tax system outweigh the limitations inherent in doing so. Perhaps they do.

Direct prohibition of the act of expatriation, even tax-motivated expatriation, would almost certainly violate international law. The JCT staff spent a significant amount of time analyzing the effect that the various expatriation tax proposals might have on the right to expatriate as well as on the related right to emigrate.[157] In the *JCT Report* the staff concluded that although the proposals did not prohibit emigration or expatriation, they nevertheless implicated those rights because they imposed burdens on the exercise of those rights. In spite of that, the JCT staff concluded that the proposals would probably not violate either of those rights.[158] It so concluded because it characterized the proposals "as an attempt to neutralize the tax consequences that flow under U.S. tax laws from the decision to retain or renounce citizenship."[159]

An attempt to neutralize tax consequences, even if misguided, would seem necessarily to require the use of the tax system.[160] Because tax neutralization is the only reed by which the legitimacy of these proposals hangs as a matter of international law (and a flimsy reed it is, as I hope the discussion above in Part I.C.1 demonstrated), Congress seems to have only one option if

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[157] The Clinton Administration's proposal, as well as some of the other expatriation tax proposals introduced in Congress in 1995, implicate the right to emigrate as well as the right to expatriate because they would treat the relinquishment of U.S. permanent residency in a manner similar to that in which they treat expatriation. *See supra* note 19. The similarity of treatment follows from the similar way in which residents and citizens are taxed.

[158] Technically, the JCT staff concluded:

> [V]iewing the objective and design of the 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, even though some techniques remain for those who retain citizenship to effectively exclude some gains from Federal income or estate taxation.

JCT REPORT, *supra* note 3, at 99 (footnotes omitted). Because the rights of emigration and expatriation are not absolute, it is only the arbitrary infringement of the rights that would be troublesome. *See* HANNUM, *supra* note 150, at 46-49 (describing several countries' approaches to limiting emigration); Vagts, *supra* note 150, at 579 (stating that human rights law recognizes certain restrictions on emigration as legitimate).

[159] JCT REPORT, *supra* note 3, at 99. For the full statement of the JCT staff's conclusion, see *supra* note 158.

[160] *See* discussion *supra* part I.C.1.

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it is to address the problem of tax-motivated expatriation while maintaining some claim to legitimacy: it must use the tax system.[161] Directly prohibiting or restricting expatriation are not options in this case.[162]

Directly prohibiting or restricting expatriation would not only fail to make expatriation neutral, but it would shine additional light on the punitive objective which, though barely acknowledged by the *JCT Report*, I believe to be at the root of the proposals.[163] Therefore, although I do not agree with the *JCT Report*'s conclusion, because I do not agree with its premise that the proposals have tax neutralization as their objective, I do believe the case for legitimacy under international law would be almost impossible to make for proposals that operated outside of the tax system.[164] If the problem of tax-motivated expatriation is to be addressed, then, it must be addressed through the tax system.

Indeed, the very features that often make the tax system an undesirable vehicle for meting out punishment—the inequality that can follow from having a punishment whose severity rises with wealth—seem to render the tax system the optimal vehicle for punishing expatriation. The reason for this is that taxing

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[161] The claim of legitimacy comes from the argument that the proposals attempt to make the act of expatriation less favorable and therefore bring neutrality. Although I disagree with that conclusion, I do acknowledge that, to the extent the proposals remove an incentive, they have the potential of making the system more neutral, and perhaps that potential suffices to make the proposals legitimate in the context of international law.

[162] The *JCT Report* cites the work of Professor Hurst Hannum for the proposition that "[d]enial or discouragement of the right to emigrate cannot *itself* be a legitimate justification for a governmental action, as acts whose purpose is to destroy human rights are *per se* prohibited by international law." JCT REPORT, *supra* note 3, at 94 (quoting HANNUM, *supra* note 150, at 39). Reaction to the recent proposal to deny reentry to former citizens who expatriated for tax reasons suggests that any attempted direct prohibition of expatriation or emigration would meet with even stronger opposition. *See Administration Wants Tax Code to Deal with Expatriates*, *supra* note 3; *Expatriation Tax Provision Survives*, *supra* note 3.

[163] *See supra* note 11 and text accompanying notes 122-25.

[164] Although the *JCT Report*'s conclusion is based on the opinions of many noted scholars in international law, I believe their conclusions to be flawed because they are based on flawed assumptions about the operation of the U.S. income and transfer tax systems. That is, the conclusion that the realization proposal achieves tax neutrality is based on the assumption that the U.S. transfer tax system would catch all the transfers of property in excess of $600,000, but that is simply not true. *See supra* text accompanying notes 109-14. The neutrality argument, like tax penalty provisions as a whole, is simply too blunt an instrument to withstand careful scrutiny.

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expatriating exits would make the tax system as a whole more progressive. If, as Professor Zolt has suggested, either the realization or jurisdictional proposal were subjected to the same type of distributional analysis to which other tax provisions are subject, I suspect that such analysis would show that individuals at the higher ends of the income scale would bear a larger share of the burden imposed.[165] Therefore, the proposals might be justified, or derided, on the grounds of their effect on the overall progressivity of the system alone. I will now address the relationship between the proposals and the tax system's progressivity.

3. Taxing Expatriating Exits to Enhance Progressivity

The effect of taxing some exits, as Professor Graetz has pointed out, is to make the tax system more progressive overall.[166] The effect of taxing expatriating exits would also be progressive, particularly under the realization proposal. Indeed, concern over progressivity is at the heart of some of the arguments in favor of the realization proposal, although the rhetoric has not referred to progressivity as such.[167]

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[165] To ameliorate the problems caused by the use of adjusted gross income (AGI) as a starting point, the JCT uses expanded income as a classifier. *See* JOINT COMM. ON TAXATION, *supra* note 26, at 88-96. Expanded income includes tax-exempt interest and other non-taxable amounts which make it a good proxy for wealth. *Id.* at 89. However, it does not use accrued but unrealized capital gains of the sort that would be subject to taxation under either of the proposals. Michael J. Graetz, *Paint-By-Numbers Tax Lawmaking*, 95 COLUM. L. REV. 609, 634 (1995). Because the proposals would tax an amount not taken into account even by expanded income, the application of distributional analysis is likely to be an even more imprecise measure in this situation than in others. *See id.* at 614 (arguing that tax policymaking process would benefit if current practice of contracting distributional tables for consideration while legislation is pending was abandoned). Nevertheless, the use of expanded income as a classifier would substantially ameliorate that effect.

[166] *See* Graetz, *supra* note 76, at 270 (asserting that estate tax provides progressivity in federal tax system).

[167] The impetus for the realization proposal is the feeling that wealthy individuals will avoid the payment of taxes on gains accrued while they were citizens and that such avoidance will create a system that is unfair. *See supra* note 11. Talk of fairness implicates views on the optimum distribution of the tax burden, and those views necessarily include views on the degree of progressivity that is desirable in a tax system. For a thoughtful look at the relationship between values, fairness and progressivity, see Donna M. Byrne, *Progressive Taxation Revisited*, 37 ARIZ. L. REV. 739 (1995); Marjorie E. Kornhauser, *The Rhetoric of the Anti-Progressive Income Tax Movement: A Typical Male Reaction*, 86 MICH. L. REV. 465 (1987); Marc Linder, *I Like Ike: Bringing Back the Eisenhower-Era Progressive Taxation*, 67 TAX NOTES

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The two proposals to change the taxation of expatriating exits would create tax liability where none currently exists and thus would affect the distribution of the tax burden.[168] Because both would apply only to taxpayers who have substantial material wealth, they would only increase the tax liability of those taxpayers.[169] Both proposals would therefore increase the tax burden of wealthy taxpayers more than that of less wealthy taxpayers. Indeed, both would impose their entire burden on holders of substantial wealth, thereby increasing the progressivity of the system as a whole.

For those in favor of increased progressivity in the system, the proposals provide an additional bonus: they provide increased progressivity in burdens without providing a proportional increase in benefits. Many income tax provisions that hinge on the exercise of taxpayer choice provide choices in proportion to the wealth of the taxpayer.[170] This results in a situation in which the positive aspects of the existence of choice with respect to incurring a tax burden can counteract the negative aspects of increasing marginal rates, (the burden itself), and produce a tax system which distributes net burdens less progressively than otherwise appears.

The operation of the realization requirement provides a good illustration of the relationship between choices and burdens. Although individuals with higher realized income face higher income tax burdens, those with large capital holdings have more

833 (1995).

[168] Although the jurisdictional proposal would cover some expatriations theoretically covered by § 877 as now in effect, enforcement of § 877 is currently nonexistent. *See supra* note 56. It is therefore fair to say that the proposal, if enacted, would tax expatriations that are de facto not taxed under current law.

[169] *See supra* note 133.

[170] For example, the realization requirement provides taxpayers with the ability to choose when to pay an income tax, and together with § 1014, even whether to pay one. The wealthier the taxpayer, the less likely it is that she will feel a need to sell an asset to survive and the more choice she will therefore have to realize gains in a way that is tax-efficient.

A tax system that did not base taxation on realization but nevertheless imposed a tax through a progressive structure would be more progressive overall than the current federal income tax system. This is because it would not detract from the progressive distribution of the burden by progressively distributing a benefit, in this case, the ability to choose. For a more thorough discussion of some of the consequences of designing tax systems that provide opportunities for the exercise of taxpayer choice, see Abreu, *supra* note 133.

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choice with respect to the recognition of income, and thus, the payment of taxes, than those whose income must come primarily from the performance of labor.[171] The positive aspects of the choice afforded by a system of taxing income based on realization counteract, to some degree, the negative aspects of the burden imposed by the system. Because the degree of choice regarding realization grows with the holdings of capital, wealthier individuals who are typically the holders of capital, usually have more of a choice than poorer individuals who are typically not large holders of capital. The progressive distribution of both benefits (the choice) and burdens (the tax) combine to create a net distribution that is less progressive overall than the distribution of burdens alone.

In the case of the realization proposal, that relationship between wealth and choice is inverted, at least in part. The realization proposal eliminates the existence of choice with respect to realization. Realization will follow inexorably from expatriation. Thus, as the individual's wealth grows, so too does the potential tax burden of expatriation, without any concomitant increase in the degree of choice that attends its imposition. Of course, any tax triggered by expatriation does provide individuals with a choice. That choice is whether or not to expatriate.[172] Because the amount of tax liability will rise with the wealth of an individual who chooses to expatriate and because the individual will have no further choice once she chooses to expatriate, the tax system will not grant the individual any additional choices. It will only impose additional, progressively distributed, burdens.

The relationship between the existence of choice and the imposition of a tax burden is the most interesting and troubling

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[171] Those whose labor commands a very high price also have more choice than those whose labor commands a low price. The former can convert much of their labor income into capital and then choose to defer recognition of additional labor income until a later, lower tax, day. Thus, highly paid executives often enter into deferred compensation agreements with their employers; they have the capital to afford them and the clout to demand them. Rank and file employees rarely have that choice because they lack the capital that would allow them to forego current realization of all of their wages.

[172] Taxpayers could also be said to have the choice whether or not to divest themselves of assets by making gratuitous transfers prior to expatriation. Because I assume that most taxpayers will not want to become paupers prior to expatriating, and that any who do will become so regardless of whether they expatriate, I regard only the choice to expatriate as worthy of consideration.

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aspect of the realization and jurisdictional proposals. Both proposals are based on the assumption that individuals have a choice with respect to the size of their tax burdens and that to choose a smaller tax burden they only need to choose to expatriate. The proposals seek to remove the choice with respect to the size of the tax burden by eliminating the reduction in tax burden that now accompanies expatriation. The trouble with this approach is that it focuses on only one of the choices taxpayers have.

Taxpayers have not only a choice with respect to the size of their tax burdens, but they also have a choice with respect to their citizenship. The choice of citizenship is not a choice that the tax system provides. It is a choice that exists outside of the tax system, under both national and international law, and that has consequences that are significant outside of the tax law.[173] Nevertheless, the choice of citizenship affects an individual's tax burden. Efforts to remove choice with respect to the size of the tax burden implicate the choice of citizenship and require a careful analysis of the relationship between the two choices. The results of that analysis are both surprising and significant.

Analysis of the choice to expatriate reveals that individuals who want to expatriate for non-tax reasons have no choice with respect to the size of their tax burden under current law and will continue to have no choice following adoption of either proposal. Such individuals will exercise their choice to expatriate and any reduction in tax resulting from the operation of current law, or any increase in tax resulting from the operation of the proposals, will become either a bonus for, or the price of, exercising that choice. Because individuals motivated by non-tax reasons will exercise their non-tax choice of citizenship based on the value of citizenship to them, they will not, in effect, have a choice with respect to their tax liability. Both the realization and jurisdictional proposals will impose upon them a higher tax burden than does current law. Adoption of the proposals will

[173] Abreu, *supra* note 3, at 695. Having urged that the substantive importance of citizenship not be overlooked in the debate over tax-motivated expatriation, I am gratified to note that testimony at the Senate Hearings on the issue included a discussion of the value of American citizenship. *See Hearings, supra* note 11.

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therefore result in a more progressive system with respect to those individuals.

This argument becomes even more compelling when the classes of individuals affected by the two proposals are considered. Both the realization and jurisdictional proposals apply not only to individuals who voluntarily renounce their citizenship, but also to individuals who lose their citizenship by operation of law following participation in certain activities, and to individuals who are denaturalized.[174] The two proposals therefore cast a very wide net that will catch individuals who probably made no affirmative choice with respect to relinquishment of citizenship and certainly made no choice with respect to the resulting tax liability. By trying to catch a few tuna, the proposals may well ensnare a great many dolphin.[175]

For individuals who want to expatriate for tax reasons, as well as for individuals who have a mixture of tax and non-tax reasons for expatriating, the analysis differs markedly because the proposals reserve for them the power to chose. Unlike individuals who lose or relinquish their citizenship for non-tax reasons, tax-motivated individuals *will* be exercising a choice with respect to the size of their tax burden. Because neither proposal eliminates the incentive to expatriate,[176] whether tax-motivated individuals choose to expatriate will depend on the extent to which they choose to reduce the size of their tax burdens. Thus, under

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[174] *See* S. 700, *supra* note 3, § 1(a); *see also supra* note 2 (describing means of indirect expatriation and loss of citizenship through denaturalization). The original version of the jurisdictional proposal created a presumption of tax avoidance purpose as to all wealthy individuals (as defined therein) who lose their U.S. citizenship. *See* H.R. 1812, *supra* note 3, § 2(a); *see also supra* note 83. It permitted rebuttal of that presumption only in the case of certain types of citizens, such as naturalized citizens and those born in another country. For a discussion of the problems presented by the creation of two classes of citizens, see *infra* note 251. Although subsequent versions of the proposal significantly reduce these problems, the fundamental problem created by the existence of distinctions remains. *See* S. 1637, *supra* note 3; H.R. 3103, *supra* note 3.

[175] That the individuals affected by these proposals are, by hypothesis, wealthy does not mean that they are immune from the involuntary loss of citizenship or, perhaps more importantly, that they will not have non-tax reasons for expatriating. As I see it, anyone who expatriates for non-tax reasons is a dolphin. Only the tax-motivated expatriates are tuna. For a thoughtful analysis of the tuna/dolphin controversy, see Jeffrey L. Dunoff, *Reconciling International Trade with Preservation of the Global Commons: Can We Prosper and Protect?*, 49 WASH. & LEE L. REV. 1407, 1409-10 (1992).

[176] *See supra* part I.C.1.

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either proposal, individuals who are willing to expatriate for tax reasons will retain the ability to exercise choice with respect to the size of their tax burdens. Under either proposal, the people who are willing to give up their citizenship to save taxes will retain the power to choose their level of taxation. By attempting to increase the tax burden on tax-motivated individuals, Congress will also be increasing their power to choose.

By contrast, the people for whom citizenship matters,[177] those who will make the decision with respect to citizenship based on non-tax factors, are denied that power. The tax system will become more progressive with respect to them if they decide to leave for non-tax reasons, at the same time that it grants tax-motivated individuals the additional power to avoid that enhanced progressivity. As a result, tax-motivated individuals for whom citizenship does not matter, or does not matter enough, will exercise the choices the system will give them with respect to citizenship and tax liability in such a way as to minimize the size of their tax liability. With respect to tax-motivated individuals, the tax system as a whole will either remain as progressive as it currently is designed to be (in the case of individuals who choose to remain citizens) or will become less progressive than it was designed to be (in the case of individuals for whom expatriation, even after enactment of either proposal, proves advantageous), but in neither case will the system be more progressive than it was designed to be. The system will become more progressive than it is currently designed to be only in the case of individuals who want to expatriate for non-tax reasons.

The effect of the relationship between choices and taxes under the proposals is therefore anomalous and probably precisely the opposite of that which their proponents intended. The proposals will place the burden of taxation on those who care about citizenship and will give the power to choose to those who do not. Thus, not only will the proposals fail to catch the tuna, but they will also give the tuna more choices while denying those choices to the dolphin that become ensnared in the net.

[177] To be important, the citizenship that matters need not be U.S. citizenship. If the right to expatriation is to be accorded the status of an international human right which I think it deserves, all citizenship, even non-U.S. citizenship, should matter equally.

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Provisions which so perversely distribute choices and tax burdens must surely effectuate bad tax policy.[178] By preserving the choice with respect to the size of the tax burden for those who do not value citizenship and by denying it to those who do, such provisions underscore the value of wealth and deny the value of the very thing they are trying to protect: citizenship. Under such provisions those who are wealthy and do not value citizenship will continue to exercise choices that will minimize their tax burdens. Those who are either not wealthy or who value citizenship enough to pay for it will be denied the choice of acting to minimize their tax burdens. The provisions honor wealth and debase citizenship. Given the sentiment that led to their introduction, they operate most curiously indeed.

Close analysis of the choices and values that the proposals promote has revealed that they operate in ways opposite to what their proponents intended. While supporters of progressive taxation can support either proposal on the basis of the likely increase in the general progressivity of the system alone, thoughtful supporters of progressivity will want to know about the distribution of the burden that produces the increased progressivity. They would be surprised to see that the increased burden will be borne by those who should least appropriately bear it: individuals for whom U.S. citizenship matters even if it matters in a way which compels them to renounce it.

The notion that citizenship may matter to some people, while hardly prominent in the current debate, has not been completely absent from it.[179] Perhaps it was acceptance of that notion that led Representative Archer to provide, in his version of the jurisdictional proposal, for exceptions in cases where citizenship might be thought to matter.[180] Thus, H.R. 1812 excepts from its coverage individuals who had dual citizenship at birth and

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[178] If this were environmental law rather than tax law, such a result would be swiftly and universally condemned. Asserting that none of these individuals are likely to be worthy of the sympathy accorded dolphins because they are, by hypothesis, wealthy is tantamount to maintaining that wealthy individuals are less deserving of tax fairness than the rest of the populace. While conceptions of fairness can and do vary, disregard for fairness, however defined, is intolerable.

[179] It is the lack of prominence that the importance of citizenship as a substantive matter was receiving that led me to write *Citizenship Can Matter.* Abreu, *supra* note 3. The importance of it has, happily, surfaced in the more recent Senate hearings. *See supra* note 173.

[180] *See* H.R. 1812, *supra* note 3.

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individuals who renounce U.S. citizenship to assume citizenship in the country in which they, their spouse, or their parents were born.[181] The latest version of the realization proposal also contains some exceptions for individuals who became dual citizens at birth.[182] While the inclusion of such exceptions is perhaps laudable in that it will probably cover some of the cases where citizenship can matter, it is by no means comprehensive and will necessarily be both over- and underinclusive.[183]

It will be underinclusive because it presumes that those who are not naturalized citizens, or dual citizens, or children or spouses of foreign-born citizens, can have no significant non-tax reasons for renouncing their citizenship.[184] It will be overinclusive because it presumes that those with some connection to a foreign country can have non-tax reasons for expatriating.[185] It thus creates two classes of U.S. citizens. This new development has significant substantive and policy consequences outside of the tax law and deserves much additional discussion.[186] It also gives one class of citizens a particular incentive to expatriate.[187]

The *JCT Report* estimates that few U.S. citizens expatriate every year[188] and that even fewer expatriate for tax purposes.[189] If

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[181] *Id.* This provision has been assailed as being unduly favorable for certain apparently well-known Republican donors. *See, e.g.*, Hershey, *supra* note 6.

[182] *See Harkin Bill, S. 1637, Would Revise Expatriate Tax Rules*, *supra* note 3 (setting out text of S. 1637, including proposed.§ 877A(c)(2)).

[183] It is interesting to note that H.R. 1812 would exempt both Mr. Kronenberg, who was born in another country, and Madame Furstenberg, whose spouse was born in another country, from its coverage. *See supra* text accompanying notes 61, 68.

[184] It is interesting to speculate whether this would produce any increase in temporary marriages to foreign born individuals.

[185] By allowing individuals in the prescribed categories to avoid the consequences of § 877, as proposed to be amended, by applying for, not necessarily obtaining, a ruling, H.R. 1812 makes it significantly easier for individuals in those categories to reap the tax benefits of expatriation. Even if the provision required such individuals to obtain a favorable ruling, the advantage would remain because individuals outside those categories are not permitted to show the absence of a tax avoidance motive. *See supra* note 83. Only the failure to distinguish between citizens would avoid the difficulties raised by the creation of different classes of citizens. For a discussion of why the creation of two classes of citizens is objectionable and probably even unconstitutional, see *infra* note 251.

[186] Exploration of those consequences is outside the scope of this Article.

[187] *See Testimony of Leslie B. Samuels Before the Senate Committee on Finance*, 95 TAX NOTES TODAY 135-21 (1995) [hereinafter *Testimony of Leslie B. Samuels*].

[188] The *JCT Report* puts the number of expatriations at 858 for 1994 and 697 for 1993 based on data supplied by the State Department. JCT REPORT, *supra* note 3, at 7. It points

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most of the U.S. citizens who expatriate do so for non-tax reasons, as the JCT staff has found, and if, as a nation, we value the right to expatriate as much as international law says we should, we need to examine closely any proposed law that could potentially burden that right. We should examine most particularly those laws that would create different classes of citizens.[190] Adoption of either of the proposals would result in enactment of precisely such laws.[191]

Because the proposals would make the tax system more progressive on the backs of people who expatriate for non-tax reasons, they raise, for me, precisely the same human rights concerns expressed on the floor of the House during the early stages of the expatriate debate.[192] While those concerns have apparently been put to rest by experts in the fields of immigration, international law and international human rights, and their conclusions have been accepted and endorsed by the Assistant Treasury Secretary for Tax Policy,[193] I remain concerned. My concern arises because the portions of the expert's conclusions that I have seen, that is, those quoted in the *JCT Report,* suggest that those experts reached their conclusions based upon what I consider to be a flawed assumption. That assumption is that the proposals would simply put expatriates in the same position they would have been in had they remained citizens—that is, that the

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out that the State Department data do not distinguish between expatriations by native born U.S. citizens and naturalized citizens, and that in 1994, for example, a significant percentage of the expatriations were naturalized Korean Americans who were returning to Korea. *Id.* at 8.

[189] The *JCT Report* concludes that "there is no significant level of expatriation for tax avoidance purposes." *Id.* at 65. Most U.S. citizens therefore do not expatriate. Indeed, in any given year, the number of U.S. citizens who give up their citizenship (for both tax and non-tax reasons) is, and has always been (at least in the last quarter century), a tiny fraction of the number of persons acquiring citizenship through naturalization.

[190] *See supra* note 185.

[191] On this criterion alone, the realization proposal fares worse than the jurisdictional proposal. Its failure to provide any exemptions for individuals likely to expatriate for non-tax reasons means that it will apply to a greater number of individuals who are expatriating for non-tax reasons than will the jurisdictional proposal.

[192] *See supra* note 14.

[193] *See Testimony of Leslie B. Samuels, supra* note 187.

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proposals are simply neutralizers.[194] I believe that assumption to be flawed because I believe that neutrality is unattainable.[195]

In summary, under either proposal, individuals who want to expatriate for non-tax reasons are not likely to be deterred from expatriating by the enactment of the proposals and are therefore likely to be the ones that bear the full brunt of whatever progressivity the proposals add. If those individuals are deterred from expatriating, their right to expatriate will have been infringed. It is therefore difficult to view increased progressivity as a reason to favor enactment of either proposal. Increased progressivity of burdens that comes at the cost of bestowing the power of choice on those who want to expatriate for tax reasons but effectively denying that power to those who want to expatriate for non-tax reasons, or making them pay for exercising the right to expatriate, is not, in my view, increased progressivity worth having. While it might raise revenue, it will do so at the expense of underscoring the value of material wealth and avarice and undermining the value of citizenship.

The elimination of neutralization, punishment, and increased progressivity as sound reasons for enactment of either proposal leaves but one possible justification to consider: the symbolic value of taxing expatriating exists.

4. Taxing Expatriating Exits as Symbolism

Enactment of either of the proposals would be replete with symbolic value. As the politicians who advocate their enactment eagerly proclaim, enacting either of the proposals will demonstrate that the American people will not allow the wealthy to renounce their citizenship without paying their "fair share" of U.S. taxes.[196] The lure of such rhetoric is hard to resist, as is the power of the image it invokes. The image, of course, is that of an Ippy Dorrance, making money from the Campbell Soup Company his grandfather founded and lollygagging on an Irish estate, while nearly destitute field workers pour their sweat into

[194] *See* JCT REPORT, *supra* note 3, at 89-100.

[195] *See supra* part I.C.1.

[196] *See* Godfrey, *supra* note 30, at 243 (reporting statement of Sen. Baucus at July 11, 1995 hearing before Senate Committee on Finance).

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American soil picking tomatoes and paying federal income and social security taxes on every penny they earn.[197]

The power of the image accounts for the apparent Republican capitulation on the issue. Representative Archer introduced the jurisdictional proposal as the Republican alternative to the realization proposal. The power of the image has resulted in a situation in which enactment of one of the two proposals, or a variation thereof, is a virtual certainty because opposing enactment of either proposal has become tantamount to being against motherhood, apple pie, and even the American flag. Enactment of either proposal would allow politicians to brag about having closed yet another loophole and having stood up for the value of citizenship and the responsibility of paying taxes. It would allow them to claim victory over the greed and disdain for American citizenship that results in tax-motivated expatriation. Good will have triumphed over evil.

However, close examination of the proposals, or of nearly any legislation that Congress would enact, would belie any such claims of victory. As demonstrated above in Part I.C.1., while either of the proposals may make expatriation less attractive than it is now, as long as the United States continues to tax foreign capital more favorably than domestic capital, expatriation will be a tax planning technique worth considering and, for some people, worth effectuating. The issue is therefore one of degree, and the question policymakers should be asking is: are the benefits of enacting such provisions worth the costs?

The United States rarely prohibits foreign ownership of U.S. assets.[198] Thus, whatever economic benefits accrue to citizen-

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[197] The image is, of course, an exaggeration of reality. Ippy Dorrance and others like him are not necessarily lollygagging anywhere, and many field workers may not incur any federal income tax liability at all. Even those who do may not in fact pay any federal income or employment taxes because they may be engaging in some tax planning of their own by simply failing to file. (That would be particularly true of workers illegally employed.) That failing to file is, of course, illegal does not make it nonexistent.

[198] The United States restricts foreign ownership in certain industries such as transportation, nuclear energy, and high technology. *See* Jacqueline J. Ferber, Comment, *The U.S. Foreign Direct Investment Policy: The Quest for Uniformity*, 76 MARQ. L. REV. 805 (1993). Perhaps most controversially, it also restricts foreign ownership in telecommunications. 47 U.S.C. § 310(b) (1988). *See also* James G. Ennis & David N. Roberts, *Foreign Ownership in U.S. Communications Industry: The Impact of Section 310*, 19 INT'L BUS. LAW. 243 (1991); Ian M. Rose, Note, *Barring Foreigners From Our Airwaves: An Anachronistic Pothole on the Global Information Highway*, 95 COLUM. L. REV. 1188 (1995).

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owners of most U.S. assets accrue to non-citizen owners as well. Except in the limited situation in which ownership of an asset is forbidden to non-citizens, U.S. citizenship gives citizen investors no special privileges. Indeed, U.S. citizen investors are arguably at a disadvantage with respect to non-resident alien investors because citizen investors must pay a price—in the form of higher and broader current income taxes—for the ability to invest in the United States.[199] Our economic policy, as manifested through our tax system, entices foreign investors to come and get those benefits by providing them with a higher after-tax return than it provides to citizens.

This suggests that the strongest case for taxing expatriation exists in the case of expatriates who own property that they could not have owned had they not been citizens. Such taxation could easily be accomplished through narrowly targeted provisions which would operate when an individual disposed of such an asset. Ironically, such provisions are probably not necessary. First, the prohibition against foreign ownership would probably require disposition of the asset before expatriation. Disposition would then trigger realization and recognition unless the disposition took the form of a tax-deferred transfer such as a reorganization.[200] Second, the very need to dispose of the asset would probably impose a substantive cost which could offset the tax benefits of expatriation. Nevertheless, unequivocally imposing taxation at the time of expatriation with respect to such assets would make the symbolic statement that those who reap the economic benefits of citizenship must also bear its economic burdens. Perhaps such a symbolic statement would be worth making.[201]

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[199] For example, for federal income tax purposes, U.S. citizens need to include in income any interest paid on deposits with U.S. banks and on loans to domestic corporations. I.R.C. § 61 (1994). Nonresident aliens, however, do not. *Id.* § 871(i), (h).

[200] Even then, § 367 might apply.

[201] But perhaps not. The restrictions on foreign investment in the United States do not proceed from any desire to restrict profits from those industries to U.S. citizens but from a concern about the dangers of foreign ownership of vital and sensitive industries. *See* Rose, *supra* note 198, at 1195 (asserting that legislative history of Radio Act of 1912, which restricts foreign ownership of radio stations, emphasizes national security as basis for restriction). Arguably, then, the rationale for the restrictions does not compel treating the profits derived from those industries any differently than profits derived from industries in which ownership is open to all. I thank Ken Martin, Temple '96, for this insight.

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Neither the realization nor the jurisdictional proposal comes even close to being so narrowly tailored and thus can make no such symbolic statement. On the contrary, both proposals are broadly drafted and reflect the concern of the current debate with the taxation of *all* accrued gain, gain which could have accrued in precisely the same way to a foreign investor, and in the accrual of which the citizenship of the individual played no direct role.[202] Indeed, this is gain that we encourage foreign investors to reap by exempting it from U.S. income tax. Given the benefits that attend foreign investment in the United States, it is little wonder that some Americans who focus exclusively or primarily on the bottom line represented by their personal balance sheets choose to become foreigners. Although that is not what the economic policy may have intended, it is nevertheless where it has led.

In sum, the breadth of the proposals dilutes their symbolic statement. They cannot be symbolic of the duty to pay taxes on gains which citizenship permitted because in nearly all cases, those gains were available to citizens and non-resident aliens alike. They cannot be symbolic of the need to settle tax obligations before changing allegiance because normative principles of federal income taxation require realization, so that no obligation to pay arises by the mere occurrence of a change in status.[203] They should also not be symbolic of the disdain we have for those who would turn their backs on the United States merely to save taxes, for to do so would be tantamount to government sanctioned condemnation, a recognized form of punishment. Infliction of such punishment would almost certainly infringe on the internationally recognized human right to expatriate.

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[202] For example, ownership of stock in the Campbell Soup Company, a company whose founder's heir reportedly expatriated for tax reasons, is open to anyone. *See supra* text accompanying note 197 (discussing expatriation of Ippy Dorrance).

[203] No other change in human status, even the most fundamental change in status, from alive to dead, causes realization. A change in status from married to divorced was held to cause actual realization in United States v. Davis, 370 U.S. 65, 68-71 (1962). Congress stepped in, however, to prevent recognition of the realized gain. *See* I.R.C. § 1041(a)(1994) (providing that no gain shall be recognized on transfer of property incident to divorce). This indicates the unattractiveness of having a change in status result in realization and recognition, however inadvertently. For a discussion of the ways in which the courts and the Service have traditionally viewed changes in citizenship status, see *infra* note 253.

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Even if some of the symbolism of the proposals were positive—even if the proposals could be seen as codifying the importance of discharging present and future tax liabilities before changing allegiances, and even if they raised some revenue[204]—they should not be embraced without an evaluation of their costs. The proposals impose at least three different types of costs, all of which are substantial.

First, the proposals impose distributional costs. These are the costs of distributional injustice, of raising revenue from people who are expatriating for non-tax reasons.[205] Both proposals impose these costs, although the realization proposal is likely to impose them to a greater degree than the jurisdictional proposal.[206] As explained above, many of the people who will expatriate regardless of the increased tax costs will be the people for whom citizenship matters. If the advocates of the proposals are correct, the proposals will discourage tax-motivated expatriation. Therefore, most of the people who will expatriate and who will therefore pay the tax imposed by the proposed provisions, will be those for whom citizenship matters.[207] For them, citizenship will have mattered enough to pay the increased costs of giving it up. Such a result sends a message that is precisely the opposite of that which proponents of the proposals seek to send. The message they will have sent is that if citizenship matters enough

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[204] In testimony before the Senate Finance Committee on July 11, 1995, Kenneth Kies, Chief of Staff, Joint Committee on Taxation, reported that his staff estimated that S. 700, the version of the Administration proposal currently receiving serious consideration, would produce revenue gains of less than $50 million in fiscal years 1995 through 1998, and would produce revenue gains of $0.1 billion in 1999 through 2005. *See Kies' Oral Testimony at Finance Hearing on Taxation of Expatriates*, 95 TAX NOTES TODAY 135-7 (1995). According to Kies's testimony, the JCT staff estimated that H.R. 1812 would produce revenues of less than $50 million in fiscal 1995, $0.1 billion in 1996 through 1998, and then the amount produced would increase until it reached $0.4 billion in 2005. *Id.* These revenue estimates should be taken with a grain of salt. *See* Graetz, *supra* note 165, at 614 (indicating that revenue estimates lack reliability). Also, there are differences between the JCT estimates and the Treasury Department estimates. Nevertheless, it is safe to assume that any revenue actually raised by either proposal is likely to be relatively small.

[205] *See supra* text accompanying notes 176-77.

[206] *See supra* note 191.

[207] This argument is based on the assumption that proponents of these proposals are correct and that the proposals will actually discourage tax-motivated expatriation. As I pointed out *supra* in Part I.C.1, I do not think they are totally correct because under both proposals, expatriation will continue to be an attractive tax planning technique for some people.

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to be relinquished regardless of its costs, people will have to pay. If instead, citizenship matters so little that it will be retained or relinquished depending on the tax costs of either, then there will be a choice with respect to the payment of the additional costs. If policymakers believe that citizenship either does or should matter, they should not enact legislation that is founded on the premise that citizenship does not matter. It is anomalous at best, and tragic at worst, that people for whom citizenship does not matter, or matter enough, have begotten legislation that is likely to hurt primarily those for whom citizenship does matter.[208]

Second, there are the costs of complexity. Neither of these proposals is a paragon of simplicity and both are likely to become more complex before they are enacted.[209] As their proponents strive to craft the proposals to cover only tax-motivated expatriation by wealthy individuals, the proposals will contain more definitions, jurisdictional amounts and other embellishments. In short, the more they strive to be fair, the more complex they will become.[210]

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[208] This anomaly brings to mind one of James Madison's remarks, which I recently read again in a new light. On the floor of the Virginia ratification convention, Madison asked: "'Is there no virtue among us? If there be not, we are in a wretched situation. No theoretical checks — no form of government can render us secure. To suppose that any form of government will secure liberty or happiness without virtue in the people is a chimerical idea.'" RICHARD C. SINOPOLI, THE FOUNDATIONS OF AMERICAN CITIZENSHIP 19 (1992). The limits that Madison ascribed to government generally in the absence of virtue apply equally to tax legislation. Individuals so lacking in virtue as to renounce their citizenship to save taxes are perhaps beyond the scope of government's ability to exact virtuous behavior.

[209] The jurisdictional proposal is particularly complex, as is typical of proposals that tax a fiction. In this case, the fiction is that the individual in question is a U.S. citizen. As is true of such provisions, the statute must provide for what the realities of the situation do not. Thus, the statute must provide special basis adjustment rules, coordinate its provisions with those of the transfer tax system, provide appropriate relief from double taxation, and otherwise craft an entire set of underpinnings for tying the taxation of a foreign national to that of a U.S. citizen. *See* H.R. 1812, *supra* note 3.

Sections 338 and 7872 of the Code provide other examples of the complexity wrought by such attempts at taxing transactions that occur only in the eye of the tax law. *See* I.R.C. § 338 (providing that certain stock purchases are to be treated as asset acquisitions); *id.* § 7872 (dealing with treatment of loans with below-market interest ratios). Section 877, as amended by the jurisdictional proposal, would not suffer by comparison to either of these sections.

[210] The evolution of the proposals from S. 700 and H.R. 1812 to S. 1367 and H.R. 3103 shows that this escalation has already occurred. *See supra* note 3.

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In addition, as long as the proposals fail truly to neutralize the consequences of expatriation, expatriation will remain a tax planning technique worth considering. Tax advisors will tout the availability of potential benefits and charge their clients for determining precisely the extent of those benefits in a specific case. Rendering advice regarding the consequences of expatriation will become more complex. The situation will have changed from one in which a tax advisor could confidently say that for most Americans with substantial holdings of appreciated, non-real estate domestic capital, expatriation will provide significant tax advantages, to one in which in almost every case, a tax advisor will have to spend time (for which she will expect to be duly compensated) ascertaining whether or not a benefit exists, and, if so, the extent of the benefit. Unless the benefits of expatriation are eradicated, as they cannot be under the current tax structure and set of economic priorities, the chief beneficiaries of the proposals are not likely to be the American people generally, but rather the American tax professionals in particular.

Finally, the realization proposal will bring about virtually all of the complexities and administrative difficulties that led to the demise of section 1023, the carryover basis provision enacted in 1976 but repealed retroactively four years later.[211] Just as with section 1023, taxpayers subject to the realization proposal will

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[211] *See* Tax Reform Act of 1976, Pub. L. No. 94-455, § 2005(a)(2), 90 Stat. 1520, 1872-76, *repealed by* Crude Oil Windfall Profit Tax Act of 1980, Pub. L. No. 96-223, § 401(a), 94 Stat. 229, 299. For an excellent discussion of the forces that led to the enactment and repeal of § 1023, see Lawrence Zelenak, *Taxing Gains at Death*, 46 VAND. L. REV. 361 (1993). Professor Zelenak argues forcefully that the complexities which were blamed for the demise of § 1023 are far from insurmountable, and, drawing on considerable research into how other countries, such as Canada and Australia, have implemented such a system, he provides detailed commentary on how the taxation of appreciation at death could be made to work. While I do not necessarily disagree with Professor Zelenak's conclusion and might favor a system of constructive realization at death, I do not feel that the complexities of such a system should be undertaken solely in the case of expatriation. If we are to address those complexities, we should do so consistently for all exits, not just expatriating exits.

For other thoughtful commentary on the consequences of the failure of the current system to tax appreciation at death, see Byrle M. Abbin, *Taxing Appreciation Hits Everything Up Front: Retirement Benefits, Deferred Compensation, and . . .* , 58 TAX NOTES 1659 (1993); Sheldon E. Friedman & Marion M. McRae, *Taxation of Capital Gains at Death*, 38 GEO. WASH. L. REV. 138 (1969); Michael J. Graetz, *Taxation of Unrealized Gains at Death—An Evaluation of the Current Proposals*, 59 VA. L. REV. 830 (1973); Philip E. Heckerling, *The Death of the "Stepped-Up" Basis at Death*, 37 S. CAL. L. REV.247 (1964); Philip Rubin, Comment, *Taxing Appreciated Property at Death; The Case for Reform*, 51 OR. L. REV. 364 (1972).

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have to determine the basis of all of their assets, something they would not have to do if they held those assets until their death.[212]

Third, there are administrative costs. Administration and enforcement of either proposal is likely to be costly. Not only will there be the costs inherent in performing additional complex and necessarily comprehensive audits, but these audits will have to be performed with respect to individuals over whom the United States will no longer have personal jurisdiction. The costs of enforcement and collection in such cases will almost certainly exceed the costs of purely domestic enforcement. It is incongruous for Congress to consider the imposition of substantial additional administrative burdens on the Service while being so parsimonious with respect to the funds necessary to modernize the very computer systems the Service would need for that task.[213]

Symbolism that fails to achieve its objective of expatriational neutrality, burdens those whom should least be burdened, increases complexity, and adds new levels of administrative costs, is not symbolism worth enacting. It is particularly not worth enacting when the action that is symbolically condemned—the accrual of gains while enjoying the benefits of citizenship—should not be condemned. In almost all cases the gains were available to citizens and non-resident aliens alike and did not proceed from the taxpayer's status as a U.S. citizen. Relinquishment of the status, therefore, ought to be irrelevant to taxation of the gains.[214] Of course, I do not have to run for re-election next year. But at a time when so many of those who are running for re-election are doing so on an engine fueled by dissatisfaction

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[212] That taxpayers would be alive to help with the task under the realization proposal, unlike under § 1023, is of scant comfort. However, given that few people expatriate, the number of people affected will be considerably less than the number affected by § 1023.

[213] *See* Ryan Donmoyer, *With Assist From Treasury, IRS Gains Systems Modernization Funds*, 68 TAX NOTES 247 (1995) (stating that Treasury Department's involvement may have saved Service's multibillion-dollar modernization effort from congressional budget axe).

[214] The result of this analysis might differ in the case of a resident alien who ceases to be a resident, if the alien's physical presence in the United States was necessary to the accrual of the gains. Even then, the existence of a system of taxation which, like the present income tax system, tends to tax the product of labor currently and the product of capital when realized suggests that the product of the alien's physical presence will already have been taxed and only the product of her capital investment will have remained untaxed.

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with the complexity and serendipity of the current income tax system, embarking upon a course that significantly increases both the complexity and serendipity of that system seems ill advised.

D. *Economic Consequences of Taxing Expatriating Exits*

Given this country's current desire to attract foreign capital and the possible role of the tax system in attracting such capital, a complete evaluation of the proposals requires determination of their likely impact on our ability to attract foreign capital. That impact is likely to be negligible for two reasons.

First, using the tax system to attract foreign capital requires an assumption that investors can choose whether to invest in the United States. The assumption of choice would result in the development of a tax system designed to cause investors to exercise their choice in favor of investment in the United States. Yet, for all except naturalized citizens, the acquisition of citizenship is not based on choice. Native born citizens do not choose their citizenship, just as individuals generally do not choose the place of their birth or the identity of their parents. U.S. citizenship resulting from birth or parental identity is involuntary[215] and results in full U.S. taxation of worldwide income. The proposals cannot discourage such individuals from investing in the United States because those individuals will be taxed in the same way regardless of where they invest. The only thing the proposals can do is encourage such individuals to expatriate early, before accruing much gain.

Under the realization proposal, once expatriation occurs, the tax system will encourage the expatriate to invest in the United States and reap the benefits of the favorable tax treatment of the growth of her capital. The jurisdictional proposal will have precisely the contrary effect, for that proposal would continue to subject U.S. source gains to full U.S. taxation and thereby encourage the investment of capital in non-U.S. source assets.

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[215] U.S. citizenship can be acquired by being born in the United States or by being born outside of the United States to at least one U.S. citizen parent, in a variety of configurations. 8 U.S.C. § 1401 (1994). It can also be acquired by becoming naturalized. *Id.* § 1421. For a thorough description and analysis of the manners in which citizenship can be acquired, see 4 GORDON & MAILMAN, *supra* note 2, §§ 91.01-98.07.

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Nevertheless, the number of individuals who are likely to be so discouraged is relatively small.[216] That small number is only worth worrying about because of the large amount of wealth they control.[217]

Second, even if either proposal were enacted and even if its enactment made the renunciation of U.S. citizenship more expensive, enactment would adversely affect our ability to attract foreign capital only if it discouraged citizens of other countries from investing in the United States in contemplation of the acquisition of U.S. citizenship. The realization proposal would not discourage such U.S. investment because it would apply to all of a citizen's property, regardless of location. In addition, the proposal would create realization even in the case of long-term residents who relinquish citizenship and its impact could not be avoided by either demurring to naturalization or by investing outside the United States. Again, it is the jurisdictional proposal that might make U.S. investment unattractive by discouraging the investment of capital in the United States by anyone contemplating expatriation. Nevertheless, the numbers at stake are unlikely to make such interference significant, and the type of sizable investment that the individuals involved have made in the United States are largely non-discretionary and therefore could not be discouraged by enactment of the proposal.[218]

That adoption of either proposal is not likely to have a significant adverse effect on the United States' ability to attract foreign capital does not suggest that adoption is desirable. It only suggests that the effect of the proposals on our ability to attract foreign capital is not a reason to oppose them. Whether adoption is desirable should depend on an evaluation of the other costs and benefits of adoption and on a determination

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[216] *See supra* note 28.

[217] *See supra* note 28.

[218] That is certainly true in the case of wealthy individuals who have inherited a business or stock in a family business, such as Ippy Dorrance. *See supra* text accompanying note 197 (describing Dorrance's tax-motivated expatriation). It is also true in the case of individuals whose wealth is represented by stock in corporations which they helped to found or run. An example of such an individual is Michael Dingman, the chairman of Abex who was featured in the *Forbes* article that brought the expatriation issue to the popular and political limelight. *See supra* note 3 (discussing the *Forbes* articles and its fallout). Bill Gates of Microsoft would be another example, although I have no reason to think that he is considering expatriation and do not mean to so imply.

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that no superior proposal exists. A proposal that would tax expatriation as death is precisely such a superior proposal.

II. TAXING EXPATRIATION AS DEATH

The foregoing analysis has centered on the desirability of adopting either the realization or jurisdictional proposals as a mechanism for taxing expatriating exits from the U.S. tax system. Both proposals operate through the income tax system. Perhaps this is because expatriation is a relocationary exit and it is the income tax system that generally addresses those types of exits, or because the income tax is the vehicle most often used for influencing behavior.[219] Nevertheless, the income tax system is not the only system capable of addressing the tax consequences of exits. Another system, the transfer tax system, was designed exclusively for that purpose. Although the transfer tax system currently addresses only dissolutionary exits, it is worthwhile to examine the feasibility of using it to address the consequences of expatriation, a relocationary exit, as well.[220]

Expatriation is a death of sorts. Indeed, expatriation may be viewed as jurisdictional death. With respect to the U.S. income tax system they leave, expatriates may as well be dead, for they no longer exist as taxpayers. Therefore, the reasons for subjecting the dissolutionary exit of an individual to taxation under the transfer tax system may exist as well with respect to the relocationary exit of an individual. In both cases the taxpayer is leaving, and the system must extract now or forever hold its

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[219] As I discuss elsewhere, the reason for this is that the income tax provides maximum opportunities for the exercise of taxpayer choice. It therefore lends itself to the addition of provisions, which, by providing an opportunity for the exercise of choice, can induce taxpayers to make one choice over another. *See* Abreu, *supra* note 133.

[220] I first suggested this in the last footnote in Abreu, *supra* note 3, at 695 n.15. Shortly thereafter Gene Steuerle made a similar proposal, although neither of us knew what the other was up to in advance of publication of our respective pieces. *See* Gene Steuerle, *Alternatives to the Expatriate Tax*, 68 TAX NOTES 567 (1995).

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peace.[221] Indeed, expatriation may be the ideal death because expatriates get to take it with them.[222]

The analogy between expatriation and death has not gone unnoticed by those who designed the realization proposal. Thus, that proposal excludes the first $600,000 of realized gain from income, an amount that corresponds precisely to the amount currently excluded from federal estate taxation through operation of the unified credit.[223] Perhaps the exclusion of that amount also reflects an acknowledgment that the biggest advantage of expatriation might not be the avoidance of federal income tax but the avoidance of federal transfer taxes.[224]

Given the similarities between death and expatriation it is appropriate to consider the possibility of treating expatriation as death for federal transfer tax purposes. The biggest obstacle to doing so is that the transfer tax system would need to create a fictional structure for imposing such taxation. Because no death has physically occurred, no property will actually have been transferred. The tax system would therefore have to create a statutory structure within which it could construct a transfer of property and tax it accordingly.

Because expatriation removes property from the taxing jurisdiction of the United States, it also serves to produce the same

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[221] In 1956, Louis Eisenstein painstakingly traced the history of the estate tax and presented a persuasive argument for the proposition that, whatever the political rhetoric that preceded its enactment, the real, and only significant, purpose of the estate tax was to raise revenue. Louis Eisenstein, *The Rise and Decline of the Estate Tax*, 11 TAX L. REV. 223 (1956). Nearly 30 years later, Professor Graetz made a related argument, defending the estate tax on the ground that it added needed progressivity to the tax system. Graetz, *supra* note 76. Nearly 15 years after that, Professor Edward McCaffery presented testimony before Congress urging the repeal of the estate tax on the ground that it does very little that is constructive and does not even raise much revenue. *See* McCaffery, *Rethinking the Estate Tax*, *supra* note 101 (adapting testimony presented before Senate Finance Committee); *see also* McCaffery, *The Uneasy Case*, *supra* note 101 (advocating against wealth transfer taxation and in favor of progressive consumption-without-estate tax).

[222] I thank my colleague, Nancy Knauer, for this insight.

[223] *See* I.R.C. §§ 2001(c), 2010(a). The unified credit of $192,800 is equal to the amount of federal estate tax that would be due on a taxable estate of $600,000. In testimony before the Senate Finance Committee on the issue of expatriation, Assistant Treasury Secretary for Tax Policy Leslie Samuels stated that the dollar exemption in the realization proposal was included for administrative convenience and that the precise number was based on the unified credit equivalent. *Hearings*, *supra* note at 11.

[224] At a minimum, expatriation avoids the need to engage in complicated and costly estate planning to minimize the transfer tax bite.

estate depleting effect as an inter vivos transfer of property.[225] It might therefore be appropriate to treat expatriates as having made gifts of all of their property to themselves at the time of expatriation. The federal gift tax, whose function it is to backstop the income and estate taxers, could then be pressed into service to do just that. Nevertheless, the absence of an actual transfer will require that the statute create one, just as it would have to create one for the estate tax to apply. The gift analogy, while attractive insofar as it eliminates the need to construct a death, thus fails to eradicate the need to construct a fiction of some sort. In addition, it would be inappropriate simply to construct a transfer of property and then apply all of Chapter Twelve to it because some of its provisions, such as the $10,000 annual per donee present interest exclusion,[226] should not necessarily apply to constructive transfers between an individual and herself. The need to construct a transfer and to adjust Chapter Twelve to account for the peculiar nature of the transfer suggests that treating expatriation as the making of a taxable gift is not necessarily simpler than treating it as death. Because the estate tax is more comprehensive and more fully developed than the gift tax,[227] and because expatriation itself is an exit, I believe that it would be most straightforward to use the system principally designed to address the problems posed by exits from the tax system: the federal estate tax system.

The easiest and most straightforward way to apply the estate tax system to expatriation would be for the statute to construct a transfer from the individual as citizen to herself as a non-citizen on the date of expatriation. The Code constructs corporate transfers in this way for income tax purposes, and an analogous set of rules could be created for the transfer tax system.[228]

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[225] For an excellent discussion of the depleting effects of inter vivos transfers, see Caron, *supra* note 42.

[226] I.R.C. § 2503(b). Sections 2503(c) and (e) also provide exclusions of transfers for the benefit of minors and for the payment of medical or education expenses, respectively.

[227] The estate tax is more comprehensive than the gift tax not only because it has more detailed provisions that have been the subject of greater refinement through judicial and administrative action, but because the estate tax base, unlike the gift tax base, includes the amount of the tax itself. Because it is a tax-inclusive levy imposed at the same rate as the tax-exclusive levy, the estate tax boasts a higher effective rate than the gift tax.

[228] *See, e.g.*, I.R.C. § 338(a) (providing that certain stock purchases are to be treated as asset acquisitions).

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Such a deemed or constructive transfer would have the virtue of corresponding quite nicely to the change in the individual's status from U.S. citizen to non-resident alien. As a conceptual matter, statutorily creating such a transfer and taxing it accordingly is superior both to constructing realization and to extending the taxing jurisdiction of the United States. It would not only correspond to the reality of what has happened, but it would tax that reality under a system designed specifically for addressing the problems posed by an individual's exit from the system. In addition, it would add even greater progressivity to the tax system. The important question is whether the deemed constructive/estate tax approach avoids the pitfalls that attend the other two proposals. Despite its conceptual superiority, it does not.

The constructive transfer/estate tax approach would impose a higher tax burden than either the realization or jurisdictional proposals. The higher burden would result from application of a higher rate (top rate of 55% rather than 39.6%)[229] to a broader base (fair market value of assets, not just appreciation).[230] While the increase in progressivity[231] and the correlative increase in revenue[232] are, for me, desirable objectives, the larger

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[229] The highest marginal estate tax rate is 55%. *Id.* § 2001(c)(1). By contrast, the highest marginal income tax rate is 39.6%. *Id.* § 1. The actual marginal rate can be substantially higher than 39.6% for individuals who lose a substantial portion of their itemized deductions and personal exemptions as a result of the phase-outs effected by §§ 68 and 151(d). *See id.* §§ 68, 151(d). Nevertheless, it probably does not go above 55% even for them. *See* Philip J. Harmelink & Phyllis V. Copeland, *"Hidden Taxes" Through Phaseouts and Floors: Assessment and Policy Implications*, 58 TAX NOTES 77, 83 (1993) (finding effective marginal income tax rate on hypothetical taxpayer with $80,000 in AGI (in 1993) to be just under 52% after factoring in phaseout of IRA deduction, rental loss deduction, itemized deduction, and personal exemptions); Ann Maxey, *West Virginia's Limited Liability Company Act: Problems with the Act*, 96 W. VA. L. REV. 905, 963 n.178 (1994) (estimating top marginal income tax rate, adjusted only for itemized deductions, and personal exemptions to be about 41%). *See generally* Gene Steuerle, *Bubbles, Bangles, and Beads: Fixing Up the Top Rate*, 59 TAX NOTES 425 (1993) (advocating for simplicity and transparency in Code to prevent hiding of top rate).

[230] *Compare* I.R.C. § 2031 (providing that value of decedent's gross estate is value of all property at time of death) *with* I.R.C. § 1001 (stating that gain from disposition of property is amount realized over adjusted basis).

[231] The estate tax, which applies at the time of physical death, adds progressivity to the income tax system. *See* Graetz, *supra* note 76, at 285-86. So should an estate tax, which applies at the time of jural death.

[232] Whether the estate tax proposal would raise more revenue than the jurisdictional proposal is harder to predict because it would depend on the difference between the U.S.

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tax liability would exacerbate, not solve, most of the problems presented by the two income tax-based proposals.

First, the constructive transfer/estate tax approach would not serve to make expatriation tax-neutral. Expatriates would be subject to a tax that would sometimes be higher than that which they would have paid if they had remained citizens and awaited physical death, and would sometimes be lower, but only by the greatest of happenstance would it be the same.[233] So many factors would have to coalesce to make expatriation tax-neutral under such a system that it is difficult to imagine that it could ever be so.[234] The liquidity problems that would attend the imposition of tax under the income tax-based proposals would attend the imposition of tax under the constructive transfer/estate tax proposal as well.

Second, to the extent that the impetus for enactment of any estate tax proposal would proceed from the anti-expatriate rhetoric unleashed by President Clinton, such a proposal could also suffer from classification as a tax penalty. Although that classifi-

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source income likely to be generated by the expatriate over the 10 years following expatriation, the federal income tax rates then in effect, and the fair market value of the assets held at the time of expatriation. Nevertheless, the need to pay the tax now, rather than over a 10 year period, may suffice to make the estate tax proposal more burdensome than the jurisdictional proposal.

[233] The federal transfer tax system taxes transfers differently depending upon the identity of the transferee. Thus, transfers to spouses, like transfers to charities, are not subject to the tax. *See* I.R.C. §§ 2055, 2056 (1994) (regarding transfers to charities and bequests to spouses, respectively). Transfers to children and non-spousal living companions, however, are fully taxable. The distribution of an individual's assets thus determines the amount of estate tax due.

It would be impossible for the tax system to prescribe a distributional pattern that would have any relationship to what a given individual would actually do at death, particularly because such a pattern would be effective at a time before the individual's death and circumstances could change significantly between that time and the time of death. Any distributional assumptions made by the system would necessarily be fictional.

In addition, the need to pay the tax at the time of expatriation rather than later, at the time of death, means that even if the dollars paid are the same in both cases, the economic loss occasioned by the payment will necessarily differ due to the time value of money. These unknowables suggest that the deemed transfer approach should not try to divine or make assumptions about what might happen at the time of physical death, and when such death might take place, but should be grounded in the belief that expatriation is jural death and its taxation need not mimic what might occur at the time of physical death.

[234] Not only would the fair market value of the property have to remain fixed, but the individual would have to dispose of all of her property in a way that does not qualify the disposition for any deductions so as to preserve the size of the tax base.

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cation might be ameliorated somewhat in the case of estate taxation of expatriation because such taxation might be more easily seen as one application of the principle of taxing exits, that amelioration would be slight. It would remain true that dislike of tax-motivated expatriation provided the impetus for enactment.[235]

Third, because the constructive transfer/estate tax proposal adds even more progressivity to the system than either of the other proposals, the proposal exacerbates the collateral effects of progressivity. As with the other proposals, the increased progressivity is likely to affect many of those who expatriate for non-tax reasons.[236] Those who would expatriate primarily to reap the sizable savings that expatriation provides under current law would probably not expatriate if Congress enacted the constructive transfer/estate tax proposal.[237] Thus, the constructive transfer/estate tax proposal would produce even more severely lopsided distributional effects than the other two proposals.

Only its greater symbolism makes the constructive transfer/estate tax proposal superior to the other two.[238] Treating expatriates as having died would have greater symbolic value than either treating them as having sold their assets or extending U.S. taxing jurisdiction over them for ten years. The constructive transfer/estate tax proposal would symbolically say to U.S. citizens that U.S. citizenship is so important that renouncing it is like dying. The proposal thus captures the sense of outrage felt by those who resent wealthy expatriates who can thumb their noses at the U.S. domestic tax system while enjoying the fruits of the U.S. economy by visiting and having other connections with this country.[239]

Symbolism is an important governance tool. It holds society together and allows easy identification of common goals and

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[235] *See supra* part I.C.2.

[236] *See supra* part I.C.3.

[237] That the proposal would deter some, or even most, tax-motivated expatriation does not mean that it neutralizes the tax benefits of expatriation. It only means that it reduces them enough so that the detriments count. Only those for whom expatriation is positive on its own are likely to expatriate in the face of such a regime. Thus, the proposal would raise revenue primarily from those for whom U.S. citizenship matters—even if it matters because they do not want it. *See supra* part I.C.3.

[238] *See supra* part I.C.4.

[239] *See supra* note 16.

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standards.[240] If policy makers want maximum symbolic condemnation of expatriation, then the constructive transfer/estate tax proposal is the one they should adopt.[241] The constructive transfer/estate tax proposal is superior to the realization and jurisdictional proposals because it would treat the taxation of expatriation not as a penalty or some other aberration arguably anathema to the objectives of sound tax policy, but as part of the fabric of a complete system of taxing exits from the tax system. As a result of that treatment, the proposal raises fewer

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[240] *See* FEINBERG, *supra* note 120, at 636 (arguing that punishment has symbolic significance); *see also* DEVLIN, *supra* note 120, at 176 (asserting that many criminal laws only serve to enforce moral principles).

[241] At least two modifications could help to alleviate the untoward effects of the greater tax burden the constructive transfer/estate tax proposal would inflict. To increase the neutralizing effect of the tax imposed under the proposal, the amount paid upon expatriation could be treated as a deposit, to be credited toward an amount determined on the basis of the actual distribution of the individual's property at the time of physical death. Alternatively, the expatriate could be allowed to elect to remain subject to the federal estate tax with respect to assets owned at the time of expatriation. (Proposed § 877A(a)(3) permits just such an election. *See* S. 700, *supra* note 3, § 1(a). However, proposed § 877A(a)(3)(B) limits the amount of transfer tax to the amount of income tax that would have been payable if the property in question had been treated as sold on the date of death. *See id.* The provision is clearly an income, not a transfer, tax provision.)

Although both of these approaches would ameliorate the problems that attend the deemed transfer/estate tax proposal and are therefore worthy of consideration, neither provides a complete solution. First, there is the obvious problem of enforcement. Whatever the Code might say with respect to the tax obligations of a particular individual, the physical removal of the individual from the physical jurisdiction of the United States will make any such provision difficult to enforce. Requiring that the individual waive whatever treaty protections might apply is hardly responsive to that problem. (S. 700 would require such a waiver for those electing to continue to be subject to U.S. tax. *See id.*) Not only does the individual have to be found, but waivers of treaty benefits will be of no use with respect to individuals who expatriate to countries with which the United States has no tax treaties, as is the case with most tax havens. The problem of enforcement can be solved by requiring that the individual post security for payment of the tax due. (S. 700 so provides in proposed § 877A(a)(3)(C)(i). *See id.*) The amount of such security, however, would have to include an interest element and would need to be adjusted upward to reflect increases in the fair market value of the individual's assets between the time of expatriation and the time of death. These features would require that the Service monitor both the whereabouts of electing expatriates and their property holdings, adding to the difficulties of administering the provision.

Second, both the election and deposit approaches would maintain the linkage between the expatriate and the United States and, in effect, prevent full expatriation. While that linkage would proceed from the exercise of individual choice, its existence could be seen as burdening the right to expatriate. This would be particularly true for individuals who expatriate for non-tax reasons and who see making such an election as the only alternative to early penury.

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human rights problems than either of the other proposals. In addition, the constructive transfer/estate tax proposal more accurately symbolizes the derision which many Americans feel towards those who expatriate. If symbolism is one of the reasons to enact any of the proposals, then enacting the one that has the greatest symbolic value and the fewest aberrations and collateral problems appears to be wise.

CONCLUSION

Notwithstanding the conceptual superiority of the transfer/estate tax proposal over both the realization and jurisdictional proposals, I would not favor its enactment. The reason is that I value U.S. citizenship and personal autonomy. For me, the question comes down to a determination of the price, if any, that should be placed on U.S. citizenship. Under current law, that price is full U.S. income taxation of worldwide income and estate taxation of property held worldwide. The law, as currently administered, tells citizens that if they are willing to forego the benefits of citizenship, they can escape the tax burdens that are now tied to it.[242] Indeed, thanks to the realization requirement, former citizens can escape U.S. taxation of gains that accrued while they were U.S. citizens. Those who support the realization proposal or who might support the constructive transfer/estate tax proposal consider that unfair.[243] Those who support the jurisdictional proposal say that disentanglement from the U.S. tax system should not be immediate. All assume either that expatriation carries no price or that the price it carries is not high enough. I believe both that expatriation carries a price and that the price is high enough. That so few people expatriate shows that most Americans agree.[244]

Whether the price of expatriation is high enough depends on the values of each individual. For most Americans, losing their U.S. citizenship is too high a price to pay for any tax savings. For such people, as for Justice Holmes, the tax costs of U.S. citizenship are worth the civilization it buys. For others, the tax

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[242] As described *supra* in note 56, enforcement of § 877 as it currently reads has been nearly non-existent and is likely to remain so.

[243] *See Hearings*, *supra* note 11.

[244] *See supra* note 188 and accompanying text.

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costs of U.S. citizenship are too high. Current law maximizes the personal autonomy of taxpayers by allowing them to decide whether the price of expatriation—loss of citizenship—is too high. By respecting the change in status wrought by expatriation, the tax system allows individuals to decide whether the benefits of U.S. citizenship are worth its costs. Enactment of any of the three proposals would alter that calculus, and in so doing, make the decision with respect to citizenship more difficult. For some, it might even remove the choice with respect to expatriation by making it too costly. In effect, because some individuals think the value of U.S. citizenship is low with respect to its costs, the U.S. government will have raised for everybody the cost of relinquishing it. In its quest for revenue, retribution and deterrence, the government will have transferred some of the power to choose whether to retain or relinquish U.S. citizenship from individuals to itself. The government, not the individual, will have decided whether the price of relinquishing citizenship is high enough.

The debate over the taxation of expatriation therefore implicates values regarding personal autonomy. If individuals should retain maximum ability to determine the value of U.S. citizenship, then the law should not only stay as it is, but section 877 should be repealed. A change in status should be respected for tax purposes and individuals who are willing to give up the substantive benefits of U.S. citizenship should be allowed to shed its tax burdens. Some see this ability as that most popular of political miscreants: a "loophole."[245] I do not.

For me, a loophole is a provision or group of provisions which allows a taxpayer to obtain a favorable tax result at little or no substantive cost. Under that view, the reduction in U.S. taxes that results from expatriation is not a loophole if one believes that the cost of relinquishing U.S. citizenship is significant. I do. For me, the substantive costs of relinquishing U.S. citizenship are high enough to pay for whatever benefits attend the taxation of post-expatriation gain or income. Those substantitive costs eliminate the need either to enact the jurisdictional proposal or to retain section 877 in the Code.[246]

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[245] *See, e.g., Hearings, supra* note 11; Hershey, *supra* note 6; Lin, *supra* note 16.

[246] I recognize the utter impossibility of the repeal of § 877 as a practical matter. Given

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But what of pre-expatriation accrued gain? That gain, the argument for the realization proposal goes, accrued while the individual was a U.S. citizen. That gain, the argument concludes, ought to be subject to U.S. income tax. The problem with this argument is that it makes two assumptions that do not withstand analytical scrutiny. First, the argument assumes that the gain could not have accrued but for the existence of U.S. citizenship. With very few exceptions that argument is simply incorrect.[247] Unless and until the United States restricts foreign ownership of U.S. capital, those gains can accrue to anyone regardless of citizenship.

Second, the argument for taxing accrued gains assumes that if the individual remained a U.S. citizen, the gain would be subject to U.S. income tax. That assumption is also incorrect. Even if the individual remained a U.S. citizen, the gain would be subject to U.S. income tax only if the individual chose to realize it. If the individual exited the system by dying before realizing the gain, the gain would escape U.S. income taxation forever.[248] The gain, along with the entire fair market value of the property in question, would be subject to the transfer tax system, and would be taxed at effective rates that depend on the identity of the decedent's beneficiaries and on the decedent's dispositive scheme.[249] If the reason to tax expatriation is that, like death, it is an exit from the U.S. tax system, then the principle of horizontal equity that requires that equals be taxed equally, requires that expatriation be taxed under the transfer tax system.

If taxing expatriation under the transfer tax system could be accomplished in a way that retains or enhances progressivity by placing burdens on those with maximum ability to pay without also providing them with maximum ability to choose, I would probably support it. But it does not. While it is theoretically

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that the existence of the provision allows for the possibility of enforcement, which would raise revenue, its elimination would be scored as a revenue loser. In the current budgetary climate, the repeal of a revenue raiser is not something that has any realistic possibility of occurring. Knowing that it will not happen does not prevent me from believing that it should happen, however.

[247] *See supra* text accompanying note 198.

[248] *See* I.R.C. § 1014(a) (providing that basis of property acquired from decedent shall be fair market value of property at decedent's death).

[249] *See supra* note 233.

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possible to reduce the likelihood of burdening non-tax motivated expatriation, and thus retaining maximum freedom of choice with respect to expatriation by either providing for categories of exempt individuals, as H.R. 1812 does,[250] or by allowing any individual to convince the Service that tax avoidance is not the primary reason for their expatriation, I find both of these mechanisms unsatisfactory. The first creates two types of American citizens—those who can expatriate without incurring an additional tax burden and those who cannot—and I regard the creation of two classes of citizens as bad, per se.[251] The second places the individual in the position of proving a negative. This is inherently difficult and nearly impossible when the individual would actually save tax dollars by expatriating. Exceptions can possibly be found in cases where the Service, like the *Furstenberg*

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[250] *See supra* text accompanying note 181.

[251] I should probably disclose that I so regard the creation of two classes even though it is likely that I, and naturalized citizens like me, would be the beneficiaries of the separate classification in this case. *See* H.R. 1812, *supra* note 3, § 2(b)(1) (allowing in proposed amended § 877(c) for citizens born in foreign countries and certain other categories of citizens to expatriate as under current law by merely asking for ruling that tax avoidance was not one of principal reasons for expatriation). The slope on which such classifications would place us is not only slippery but probably unconstitutional, as the Supreme Court has repeatedly confirmed that native and foreign born citizens have equal rights. *See, e.g.*, Schneider v. Rusk, 377 U.S. 163, 165 (1964); Knauer v. United States, 328 U.S. 654, 658 (1946). (The only current exception to the principle of equality between naturalized and native born citizens comes from the text of the Constitution itself, in the form of the Article II requirement that only native born citizens can serve as President.)

We have already seen attempts to skirt that slope (though not to traverse it) in the context of the current efforts to reform the welfare system. Two bills now pending, H.R. 4 and S. 269, would deny certain resident aliens access to means-tested social welfare programs by attributing to those aliens the income level of their sponsors. H.R. 4, 104th Cong., 1st Sess. § 421 (1995); S. 269, 104th Cong., 1st Sess. § 202 (1995). This attribution would apply for a stipulated number of years after the aliens entered the United States.

There has in particular been much controversy over a provision in S. 269 which some say would apply the attribution provision for the stipulated time period irrespective of whether or not the alien became a naturalized citizen during that period—a circumstance which would, in the wake of that promotion, mark her (albeit temporarily) as a second-class citizen. *See* Carol Jouzaitis, *Naturalized Citizens Might Lose Benefits; Dozens of Welfare Plans Targeted*, CHI. TRIB., June 15, 1995, at 1 (stating that legislation would require sponsors to support immigrants for at least 10 years, irrespective of whether they become citizens during that period); Letter from Juan A. Figueroa, Puerto Rican Legal Defense and Education Fund, to Senator Robert Packwood (July 12, 1995) (on file with author) (expressing that organization's strong opposition to proposed differentiation among classes of U.S. citizens for purpose of determining entitlement to means-tested welfare benefits). I thank Juan Osuna, Editor of *Interpreter Releases*, for bringing this controversy to my attention.

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court, is willing to believe that expatriation is motivated by love, or by something else, but not by money. Problems of proof found in current law would still plague such a provision and those problems would fall on the taxpayer's shoulders, the very people whose right of expatriation the government should painstakingly preserve.

I therefore conclude that the revenue, retribution, deterrence, and symbolism that adoption of any of the proposals would produce are not worth the complexity and distributional lopsidedness that enactment of any of the three expatriation proposals would bring. Citizenship can matter, and to many people it matters a lot.[252] That it matters little to a few wealthy individuals should not result in the enactment of provisions which will further complicate the law at the expense of people for whom citizenship matters so much that they will exercise their right to renounce it, whatever the tax cost.[253] Although reasonable people can differ on the wisdom of this conclusion, I hope that reasonable people will move toward the analysis undertaken here

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[252] I made this point in Abreu, *supra* note 3, and, interestingly, the editors of *The Philadelphia Inquirer* made it nearly two months later in *Deserting Principle*, *supra* note 1.

[253] The proposed changes deny the importance of citizenship as a status—as something from which tax consequences flow regardless of whether it was acquired knowingly or voluntarily, and regardless of whether it produces any benefits for the individual holding it. In doing so, they run counter to the way in which courts and the Service have traditionally viewed the status of citizenship. Citizenship has traditionally been viewed as a sort of on/off switch that either is on or is not. U.S. citizens who have lost their citizenship under laws later held unconstitutional have been subjected to U.S. taxation during the period of loss on that basis. *See, e.g.*, United States v. Lucienne D'Hotelle de Benitez Rexach, 558 F.2d 37 (1st Cir. 1977) (holding that taxpayer whose expatriation was later declared void is liable for taxes incurred during period she in fact received benefits of citizenship); Rev. Rul. 70-506, 1970-2 C.B. 1 (stating that naturalized citizen deemed to have lost her citizenship under law later declared unconstitutional has been citizen since her naturalization and is taxable as such); Rev. Rul. 75-537, 1975-2 C.B. 5 (determining that U.S. citizen who lost her citizenship under unconstitutional law always has been taxable U.S. citizen). This suggests that it is only the existence of the status, not any individual's state of mind with respect to its possession, that is determinative of taxation. Enacting provisions which proceed from outrage over some individual's willingness to relinquish the benefits of one status to acquire the benefits of another undermines the importance of the status *qua* status. Because I think that the status of citizenship is important, I do not think it should be so undermined.

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and away from the rhetoric and vitriol that has punctuated the debate thus far. Expatriation, like flag burning, seems like a good thing to be against. Perhaps, also like flag burning, it is a difficult and dangerous thing to legislate against.

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