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THE EXIT TAX: A MOVE IN THE RIGHT DIRECTION

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ABSTRACT

Citizenship-based taxation was first enacted during the Civil War, in large part to express congressional disapproval of wealthy individuals who fled abroad to avoid bearing the financial and physical burdens of the war. A century later, motivated by a desire to encourage foreign investment in the United States, Congress passed legislation in 1966 that offered significant tax incentives to nonresident aliens, thereby creating an opportunity for tax abuse. To discourage U.S. citizens from expatriating to avoid U.S. taxation, Congress contemporaneously enacted I.R.C. section 877, which taxes expatriates on certain U.S.-source income for a ten-year period after expatriation. Congress, and the nation, viewed these tax-motivated expatriates as "economic Benedict Arnolds." This Article follows the history and evolution of I.R.C. section 877—the alternative tax regime—as Congress addressed the weaknesses of this provision, and the politics of the replacement by Congress of this provision with I.R.C. section 877A, which imposed a mark-to-market regime (an exit tax) on U.S. citizens and long-term residents expatriating after June 2008. Along with a close examination of the federal income tax consequences of expatriation under both regimes, the gift and estate tax consequences of expatriation are also developed. Additionally, this Article explores the validity of I.R.C. sections 877 and 877A in relation to the U.S. Constitution and existing tax treaties. It then discusses the administrative and enforcement issues arising under the mark-to-market regime, and the administrative and enforcement issues still remaining under the alternative tax regime. Finally, the general social and economic fairness of the alternative tax regime and the mark-to-market regime is explored. Although I.R.C. section 877A is an improvement over the harshness of the alternative tax regime, the mark-to-market regime still violates the tax equity objectives of horizontal and vertical equity, resulting in unintended tax winners and losers.

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INTRODUCTION

The Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act)[1] significantly altered the federal income tax treatment of individuals who relinquish their U.S. citizenship or terminate their U.S. long-term residency. The HEART Act accomplished this sea change by adding new sections 877A and 2801 to the Internal Revenue Code (I.R.C.),[2] which imposed "mark-to-market" and "succession tax" regimes on such individuals.[3] Primarily, the HEART Act was intended to provide relief for active military personnel and veterans by instituting tax cuts for members of the military receiving combat pay, saving for retirement, or purchasing homes,[4] with I.R.C. sections 877A and 2801 as part of the revenue offset.[5] These provisions are applicable to expatriations, and gifts and bequests made by expatriates, on or after June 17, 2008.[6] The "alternative tax" regime continues to apply to individuals and transfers not subject to the new provisions.[7]

As the United States taxes its citizens on worldwide income and non-resident aliens only on U.S.-source income, individuals may be enticed to renounce their U.S. citizenship to avoid U.S. income tax.[8] To prevent tax-motivated expatriation by U.S. citizens,[9] Congress enacted I.R.C. section 877 as part of the Foreign Investors Tax Act (FITA) of 1966.[10] Since 1966, I.R.C. section 877 has undergone two major revisions: the Health Insurance Portability and Accountability Act of 1996 (HIPAA)[11] and the

[1] Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110-245, 122 Stat. 1624 (codified in scattered sections of 26 U.S.C.).

[2] Unless otherwise stated, all references to the Internal Revenue Code are to the 2006 Internal Revenue Code [hereinafter I.R.C.], 26 United States Code [hereinafter U.S.C.], as amended.

[3] § 301, 122 Stat. at 1638, 1644 (adding new I.R.C. sections 877A and 2801).

[4] §§ 101–103, 122 Stat. at 1625.

[5] § 301, 122 Stat. at 1638, 1644–45.

[6] § 301, 122 Stat. at 1638, 1644, 1647 (referring to amended §§ 877A(i)(b), 2801(a), 2801(g)(2)).

[7] I.R.S. Notice 09-85, 2009-45 I.R.B. 598.

[8] Michael S. Kirsch, *Taxing Citizens in a Global Economy*, 82 N.Y.U. L. REV. 443, 490 (2007) ("Indeed, other economically developed countries that generally do not tax their citizens abroad face significant problems with citizens moving abroad to avoid tax liability.").

[9] S. REP. NO. 89-1707 (1966), *reprinted in* 1966-2 C.B. 1059, 1078.

[10] Foreign Investors Tax Act of 1966, Pub. L. No. 89-809, § 875(f)(1), 877, 80 Stat. 1539, 1551.

[11] Health Insurance Portability and Accountability Act, Pub. L. No. 104-191, §§ 511–513, 110 Stat. 1936, 2093–102 (1996).

Health Insurance Jobs Creation Act of 2004 (JOBS Act).[12] Both revisions significantly enhanced the efficiency of I.R.C. section 877 in administration and enforcement. HIPAA was the congressional response to criticism that the original version of I.R.C. section 877 was effectively unenforceable and contained loopholes that allowed wealthy expatriates to avoid its application.[13] The JOBS Act built on HIPAA and made I.R.C. section 877 a viable anti-avoidance provision.[14] Finally, the HEART Act of 2008 replaced, prospectively, the alternate tax regime imposed by I.R.C. section 877 with a mark-to-market regime under new I.R.C. section 877A.[15]

This Article begins with a description of the U.S. income tax laws that provide the incentive for expatriation. The history and rationale of citizenship-based taxation is examined, to be later compared with the history and rationale of I.R.C. section 877. Next, this Article follows the evolution of I.R.C. section 877, as Congress addressed the weaknesses of this provision until its ultimate replacement in 2008 with I.R.C. section 877A. This Article closely examines I.R.C. section 877A and Notice 2009-45, which "provides guidance for individuals who are subject to [I.R.C.] section 877A."[16] In discussing the income tax consequences of the relinquishment of citizenship and, eventually, the termination of long-term residency, the estate and gift tax consequences of such relinquishment and termination are also developed. Finally, Part VII of this Article considers the validity of I.R.C. sections 877 and 877A in relation to the U.S. Constitution, conflicts with existing income tax treaties between the United States and foreign countries, and administrative and enforcement issues remaining under each provision. The general social and economic fairness of the new mark-to-market and succession tax regimes is also analyzed. Although I.R.C. section 877A is an improvement over the harshness of the alternative tax regime, this new exit tax is broad in its application, resulting in unintended tax winners and losers.

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12 American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 804, 118 Stat. 1418, 1569–74.

13 H.R. REP. NO. 104-736, at 323 (1996) (Conf. Rep.); Emmanuelle Lee, Comment, *Will the Renunciation of U.S. Citizenship Still Be Worth Some Tax Savings? An Analysis of the Recent Reform on the Taxation of Expatriates*, 37 SANTA CLARA L. REV. 1063, 1090–91 (1997).

14 *See* Michael G. Pfeifer, *The State of Expatriation 2010*, ALI-ABA EST. PLAN. COURSE MATERIALS J., Dec. 2010, at 41; Andrew Walker, *The Tax Regime for Individual Expatriates: Whom to Impress?*, 58 TAX LAW. 555, 576 (2005).

15 Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110-245, § 301(a), 122 Stat. 1624, 1638 (adding new I.R.C. § 877A).

16 I.R.S. Notice 09-85, 2009-45 I.R.B. 598.

I. U.S. TAXATION OF U.S. CITIZENS, U.S. RESIDENTS, AND NONRESIDENT ALIENS

The United States is unique among economically developed countries in taxing its citizens[17] on worldwide income,[18] while nonresident aliens are generally taxed only with respect to income derived from sources within the United States.[19] The United States taxes its citizens and resident aliens[20] on their worldwide income regardless of where the individual is residing and regardless of the country from which the income is derived.[21]

The United States' taxation of its citizens and resident aliens on worldwide income invariably results in the potential for double taxation. Of the devices available for mitigating the impact of international double taxation, the unilateral approach used primarily by the United States is the foreign tax credit.[22] The foreign tax credit allows a dollar-for-dollar credit

[17] Treas. Reg. § 1.1-1(c) (as amended in 2008) ("Every person born or naturalized in the United States and subject to its jurisdiction is a citizen."). The regulation further provides that the Immigration and Nationality Act, 8 U.S.C. §§ 1401–1459, governs the determination of when U.S. citizenship is acquired or lost for federal tax purposes. *Id.* The JOBS Act added I.R.C. § 7701(n), which uses tax-based, rather than immigration-based, standards for determining when an individual ceases to be a U.S. citizen or resident alien for U.S. tax purposes. An individual will continue to be treated as a citizen of the United States until the individual gives notice of an expatriating act to the Secretary of State, and a long-term resident will continue to be treated as a lawful permanent resident until the individual gives notice of termination of residency to the Secretary of Homeland Security. I.R.C. § 7701(n)(1). Both must provide a statement in accordance with I.R.C. § 6039G. I.R.C. § 7701(n) (2004) (amended 2005, repealed 2006).

[18] Reuven S. Avi-Yonah, *The Case Against Taxing Citizens*, 58 TAX NOTES INT'L 389, 389 & n.3 (2010), *reprinted in* 127 TAX NOTES 680 (2010); Kirsch, *supra* note 8, at 445 & n.5.

[19] I.R.C. § 871.

[20] *Id.* § 7701(b). An individual is considered a resident of the United States if the individual is a permanent resident of the United States under the immigration laws (green-card test), meets the substantial presence test, or makes a first-year election to be treated as a U.S. resident. *Id.* § 7701(b)(1). An individual meets the "substantial presence test" if the individual is present in the United States for at least thirty-one days during the current tax year and at least 183 days for the three-year period ending on the last day of the current tax year under the following formula: days present in the current year are multiplied by one, days present in the immediate preceding year are multiplied by one-third, and days present in the next preceding year are multiplied by one-sixth. *Id.* § 7701(b)(3). Even if the individual satisfies the substantial presence test, the individual is not a U.S. resident if the individual is present in the United States fewer than 183 days and has a tax home and a closer connection to a foreign country. *Id.*

[21] *Id.* § 61(a); Cook v. Tait, 265 U.S. 47, 56 (1924).

[22] *See* I.R.C. §§ 901–908. The unilateral approaches for mitigating the impact of double taxation also include the deduction for foreign taxes paid on foreign-source income

against the U.S. tax liability on worldwide income for foreign taxes paid on foreign-source income.[23] The bilateral approach for mitigating the impact of international double taxation is the income tax treaty.[24] The fundamental purpose of a bilateral income tax treaty is "to prevent taxes from interfering with the free flow of international trade and investment."[25] In addition to providing for a foreign tax credit against U.S. income tax,[26] income tax treaties attempt to mitigate double taxation by requiring the country of source to relinquish to the country of residence the jurisdiction to tax specified items of income.[27]

Generally, the manner in which a nonresident alien is taxed by the United States on U.S.-source income[28] depends on whether the income is derived from a trade or business or from passive investments.[29] Income effectively connected with the conduct of a trade or business within the United States is subject to a tax at graduated rates on net income,[30] while income not effectively connected is subject to a thirty percent withholding tax on gross income.[31]

An activity will be considered the conduct of a trade or business within the United States if the activity is regular, continuous, and conducted with the primary purpose of obtaining income or profit.[32] The trade or business income of a nonresident alien includes only "effectively connected income"—income actually related to the conduct of the U.S. trade or business—and does not include unrelated investment income and capital gains.[33] The performance of services within the United States is treated as

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and the exemption for a limited amount of foreign-source income earned by U.S. citizens and resident aliens living abroad. *Id.* §§ 164(a)(3), 911.

[23] *Id.* § 904(a). The foreign tax credit is limited by the amount of U.S. tax imposed on the foreign-source income. *Id.*

[24] CHARLES H. GUSTAFSON, ROBERT J. PERONI & RICHARD CRAWFORD PUGH, TAXATION OF INTERNATIONAL TRANSACTIONS 63 (4th ed. 2011).

[25] *Id.*

[26] U.S. DEP'T OF THE TREASURY, UNITED STATES MODEL INCOME TAX CONVENTION OF NOVEMBER 15, 2006, art. 23, *available at* http://www.treasury.gov/press-center/press-releases/Documents/hp16801.pdf [hereinafter U.S. MODEL TREATY].

[27] GUSTAFSON ET AL., *supra* note 24, at 67.

[28] *See* I.R.C. §§ 861–865 (defining income sourced within the United States and without the United States).

[29] *Id.* § 871.

[30] *Id.* § 871(b).

[31] *Id.* §§ 871(a), 1441–1442.

[32] Comm'r v. Groetzinger, 480 U.S. 23, 35 (1987).

[33] I.R.C. § 864(c). The "force-of-attraction" doctrine that taxed all income as effectively connected income if the nonresident alien conducted a trade or business within the United States, whether or not related to the trade or business, "was largely replaced in

a U.S. trade or business.[34] Income tax treaties entered into by the United States with a foreign country provide that business profits will only be taxed by the United States if the business is carried out within the United States through a permanent establishment.[35] Generally, a "permanent establishment" is "a fixed place of business [located within the United States] through which the business [is conducted]."[36]

Income received by a nonresident alien from U.S. investments not effectively connected with the conduct of a trade or business within the United States is subject to a tax of thirty percent on the gross amount of the payment.[37] The tax applies to amounts received as "interest, ... dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodic gains, profits, and income"[38] (FDAP income). The tax imposed upon FDAP income is collected and enforced through withholding provisions that require the payor to withhold and remit the tax owed to the U.S. Treasury Department.[39] Generally, U.S. income tax treaties provide for a reduction or elimination of withholding taxes on specified items of U.S.-sourced FDAP income not attributable to a permanent establishment in the United States.[40]

To understand the motivation of Congress in enacting I.R.C. section 877A, and its predecessor I.R.C. section 877, the potential tax benefits of expatriation must be fully appreciated. As stated, the United States' exer-

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1966 by [the Foreign Investors Tax Act of 1966 which has] a mechanism that ... [distinguishes] the treatment of income from the active conduct of [the trade or] business and passive income unrelated to the [trade or] business." GUSTAFSON ET AL., *supra* note 24, at 166. I.R.C. § 864(c)(2) prescribes factors for analysis: whether the income, gain or loss is derived from assets used, or held for use, in the conduct of the trade or business (asset-use test) and whether the activities of the trade or business constituted a material factor in the realization of the income, gain or loss (business-activity test). *Id.*; *see also* Treas. Reg. § 1.864-4(c)(2) to -4(c)(3) (describing the application of the asset-use test and the business-activity test).

[34] I.R.C. § 864(b). A de minimis exception exists for a nonresident alien who is working for a foreign employer not engaged in trade or business within the United States or for a U.S. person, if the business is maintained outside the United States, who earns no more than $3,000 during the tax year and who is present in the United States ninety days or less. *Id.* § 864(b)(1).

[35] U.S. MODEL TREATY, *supra* note 26, art. 7(1).

[36] *Id.* art. 5.

[37] I.R.C. § 871(a).

[38] *Id.* § 871(a)(1)(A).

[39] *Id.* § 1441(a).

[40] *See generally* U.S. MODEL TREATY, *supra* note 26, arts. 10–12 (establishing tax jurisdiction and reduction of tax rates; art. 10 (Dividends), art. 11 (Interest), art. 12 (Royalties)).

cise of its jurisdiction to tax based on citizenship, in addition to residency and source, is unique among other economically developed countries.[41] U.S. citizens and long-term residents are taxed on their worldwide income, regardless of where the income arises or where the individual lives.[42] In contrast, foreign countries typically tax individuals based on residency[43] and operate under tax systems that exclude foreign-source income.[44] A nonresident alien is subject to U.S. taxation only upon U.S.-source income effectively connected with a U.S. trade or business and certain U.S. investments.[45] Thus, "a nonresident alien generally is not subject to United States income taxation on income from sources outside the United States."[46] With the significant exception of U.S. real property interests,[47] "a nonresident alien generally is [also] not subject to [U.S. tax] on gains from the sale of capital assets, regardless of where the capital asset[s are] located."[48] Further, U.S. citizens and residents are also taxed on their worldwide estates, gifts, and generation-skipping transfers while nonresident aliens are generally subject to U.S. transfer taxes only on transfers of property situated within the United States.[49]

II. THE HISTORY OF CITIZENSHIP-BASED TAXATION IN THE U.S.

The United States is among the minority of countries that taxes its citizens on their worldwide income regardless of the source of the income;[50] most countries tax individuals based on residency.[51] The United States first taxed U.S. citizens living abroad during the American Civil War.[52] Enacted in 1861 to finance that war, the legislation imposed an income tax

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[41] Kirsch, *supra* note 8, at 445 & n.5.

[42] I.R.C. § 61(a); Cook v. Tait, 265 U.S. 47, 56 (1924); Michael S. Kirsch, *Alternative Sanctions and the Federal Tax Law: Symbols, Shaming, and Social Norm Management as a Substitute for Effective Tax Policy*, 89 IOWA L. REV. 863, 870 (2004).

[43] Walker, *supra* note 14, at 556.

[44] *Id.* at 560.

[45] Kirsch, *supra* note 42, at 870.

[46] *Id.* at 871.

[47] *See* I.R.C. § 897(a)(1) (taxing nonresident aliens and foreign corporations on the disposition of investments in U.S. real property).

[48] Kirsch, *supra* note 42, at 871 (footnote omitted).

[49] Jeffrey M. Colon, *Changing U.S. Tax Jurisdiction: Expatriates, Immigrants, and the Need for a Coherent Tax Policy*, 34 SAN DIEGO L. REV. 1, 5 (1997).

[50] Avi-Yonah, *supra* note 18, at 389 n.4; Kirsch, *supra* note 8, at 445 & n.5.

[51] Elise Tang, Note, *Solving Taxpatriation: "Realizing" It Takes More Than Amending the Alternative Tax*, 31 BROOK. J. INT'L L. 615, 619 (2006).

[52] Act of Aug. 5, 1861, ch. 45, § 49, 12 Stat. 292, 309; Avi-Yonah, *supra* note 18, at 390; Kirsch, *supra* note 8, at 454.

on all the income of residents, and on the U.S.-source income of nonresident citizens.[53] In 1864, the legislation was amended to include the income of every person residing within the United States and every U.S. citizen residing outside the United States, regardless of the source of the income.[54] Although enforcement was difficult and the tax collected was negligible,[55] the application of the income tax to citizens living abroad reflected congressional disapproval of the perception that wealthy citizens were living abroad not only to avoid the tax that was necessary to finance the Civil War, but also to avoid the draft or paying for a substitute if drafted.[56] The public perception was that wealthy citizens fled to Europe to avoid serving their country in its time of crisis.[57]

The income tax on worldwide income of nonresident citizens expired in 1872 but was revived in the Income Tax Act of 1894, as serious economic conditions required new revenue sources.[58] Again the rationale focused on wealthy persons who resided abroad in luxury while escaping the U.S. income tax and the voluntary contributions of citizenship.[59] In *Pollock v. Farmers' Loan & Trust Co.*, the Supreme Court held the Income Act of 1894 unconstitutional, as it included rent from real property in income and thereby imposed a direct tax on income without apportionment among the States.[60] After the passage of the Sixteenth Amendment to the U.S. Constitution,[61] the Income Tax Act of 1913 again included a provision that taxed nonresident citizens on worldwide income.[62] Thus, the taxation of U.S. citizens living abroad on their worldwide income, which originated during a period in which only wealthy persons paid income tax and against the backdrop of the Civil War, has persisted into the

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[53] § 49, 12 Stat. 292, 309; Avi-Yonah, *supra* note 18, at 390; Kirsch, *supra* note 8, at 451–52. U.S. citizens residing abroad were taxed at a higher rate of tax with no exemption amount, which resulted in a higher effective rate of tax. Avi-Yonah, *supra* note 18, at 390.

[54] Act of June 30, 1864, ch. 173, § 116, 13 Stat. 223, 281; Avi-Yonah, *supra* note 18, at 390; Kirsch, *supra* note 8, at 451.

[55] Avi-Yonah, *supra* note 18, at 390. "[F]rom 1863 to 1865, U.S. citizens living [abroad] paid $230,470 of the $84,015,918 of income tax collected, or 0.003 percent." *Id.* at 390 n. 10 (citing Kirsch, *supra* note 8, at 452 n. 32); *see also* Kirsch, *supra* note 8, at 454–55.

[56] Avi-Yonah, *supra* note 18, at 390.

[57] *Id.*; Kirsch, *supra* note 8, at 451.

[58] Tariff Act of 1894, ch. 349, § 27, 28 Stat. 509, 553.

[59] Avi-Yonah, *supra* note 18, at 390; Kirsch, *supra* note 8, at 453.

[60] Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429, 583 (1895).

[61] U.S. CONST. amend. XVI.

[62] Revenue Act of 1913, ch. 16, § II(A)(1), 38 Stat. 114, 166.

current period in which all but the poor pay income tax and the economy is global.[63]

In 1924, the Supreme Court upheld the constitutionality of the taxation of U.S. citizens on their worldwide income, regardless of where they reside or are domiciled.[64] In *Cook v. Tait*, a U.S. citizen who resided and became domiciled in Mexico challenged the power of the U.S. Congress to impose a tax on the income from real and personal property located in Mexico.[65] The Supreme Court stated that the scope and extent of the United States' power to tax "is based on the presumption that government by its very nature benefits the citizen and his property wherever found."[66] "One of the earliest [justifications] for taxing [U.S.] citizens [on their worldwide income while living] abroad [was the belief] that these individuals continue to enjoy the benefits of citizenship ... [and, therefore], should continue to bear the corresponding burdens."[67] The possible benefits of U.S. citizenship include personal and property protection, the right to vote and reenter the United States, and the past benefits associated with prior residency in the United States.[68] U.S. resident aliens benefit from the protection of the government, the rule of law, and the opportunities of a free market.[69]

III. FOREIGN INVESTORS TAX ACT OF 1966

A. Expatriation Tax Enacted

Enacted in 1966, the Foreign Investors Tax Act (FITA)[70] was a comprehensive overhaul of the provisions governing the U.S. taxation of nonresident aliens and foreign corporations. FITA was intended to eliminate the confusion and complexity of the U.S. system of taxing foreign investors and to strengthen the U.S. economy by improving the balance of pay-

[63] Avi-Yonah, *supra* note 18, at 390–91.
[64] Cook v. Tait, 265 U.S. 47, 56 (1924).
[65] *Id.* at 54.
[66] *Id.* at 56.
[67] Kirsch, *supra* note 8, at 470.
[68] *Id.* at 472, 474; Walker, *supra* note 14, at 559. *But see* Avi-Yonah, *supra* note 18, at 389 (arguing that the benefits of citizenship to a nonresident citizen are not sufficient to justify citizenship-based taxation because other countries provide these same benefits to their citizens living abroad yet do not tax them).
[69] Avi-Yonah, *supra* note 18, at 392; Walker, *supra* note 14, at 556–57.
[70] Foreign Investors Tax Act of 1966, Pub. L. No. 89-809, § 103(f)(1), 80 Stat. 1539, 1551.

ments.[71] Generally, the current system for the U.S. taxation of foreign persons was established in FITA.[72] After 1966, all U.S.-source income effectively connected with the conduct of a trade or business within the United States generated by a nonresident alien is taxed at the same graduated rates on taxable income as applicable to U.S. citizens or residents.[73] FDAP income is taxed at a flat thirty percent rate (or lower applicable treaty rate), whether or not the recipient engages in a trade or business in the United States, provided that the income is not effectively connected with a U.S. trade or business.[74] The concept of effectively connected income was first established in FITA.[75]

Prior to FITA, the investment income of foreign persons conducting a U.S. trade or business was taxed at regular, graduated rates, whether or not effectively connected with a U.S. trade or business, while a foreign person not conducting a U.S. trade or business was taxed at a thirty percent rate on investment income.[76] FITA provided that nonresident aliens will be taxed at a thirty percent rate on FDAP income regardless of the amount of their U.S.-source income and whether or not they conducted a U.S. trade or business.[77] Prior to FITA, nonresident aliens not engaged in trade or business within the United States were treated differently if their income was over $21,200.[78] If the aggregate annual U.S.-source income from specified items of income was $21,200 or less, the nonresident alien was taxed at a flat rate of thirty percent; however, if such U.S.-source income was more than $21,200, the nonresident alien was taxed at the greater of either the graduated rates applicable to individuals or a flat thirty percent rate.[79]

With the enactment of FITA, Congress significantly limited the scope of U.S. taxation of nonresident aliens who, prior to FITA, had been taxed similarly to U.S. citizens and residents.[80] By reducing the tax on nonresi-

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[71] President Lyndon B. Johnson, Statement by the President Upon Signing the Foreign Investors Tax Act and the Presidential Election Fund Act (Nov. 13, 1966), *available at* http://www.presidency.ucsb.edu/ws/index.php?pid=28030.

[72] *See supra* text accompanying notes 28–40 (describing the U.S. taxation of U.S.-source income generated by foreign persons).

[73] § 103(a)–(d), 80 Stat. at 1547–51 (codified as amended at I.R.C. § 871).

[74] I.R.C. § 871(a)(1).

[75] § 102(d), 80 Stat. at 1544–45 (adding I.R.C. § 864(c)(1)–(3)).

[76] § 103(a), 80 Stat. at 1547 (codified as amended at I.R.C. § 871); S. REP. NO. 89-1707 (1966), *reprinted in* 1966-2 C.B. 1059, 1064.

[77] § 103(a), 80 Stat. at 1547 (codified as amended at I.R.C. § 871).

[78] *See id.* at 1548; S. REP. NO. 89-1707 at 1074.

[79] § 103(a), 80 Stat. at 1548; S. REP. NO. 89-1707 at 1074.

[80] *See supra* notes 76–79 and accompanying text.

dent aliens, Congress intended to encourage investment in the United States by foreign individuals, and may have also recognized the difficulty of enforcing broad tax provisions against foreign persons.[81] However, Congress feared that with this reduction in U.S. tax imposed on nonresident aliens, U.S. citizens might be induced to renounce U.S. citizenship in order to be subject to the more favorable taxing provisions. Thus, as part of FITA, I.R.C. section 877 was enacted[82] with the objective of preventing U.S. citizens from expatriating to avoid U.S. taxes.[83] This disparate treatment "may encourage some individuals to surrender their U.S. citizenship and move abroad."[84]

I.R.C. section 877 applied to former U.S. citizens, who relinquished their citizenship in a large part to avoid U.S. income tax for a period of at least ten years following the date of their relinquishment.[85] The provision specifically focused on the subjective intent of the former U.S. citizens and placed upon the Secretary of the Treasury (Secretary) the initial burden of showing that one of the principal purposes for expatriation was tax avoidance.[86] To meet that burden, the Secretary was required to establish only that it was reasonable to believe, based on the expatriate's probable income for the taxable year, that the individual's loss of U.S. citizenship resulted in a substantial reduction in his or her taxes.[87] Once this fact was established, the burden of disproving a tax avoidance motive shifted to the former citizen.[88] However, not all former U.S. citizens were subjected to the new regime.[89] Exceptions were carved out for individuals "whose loss of citizenship occur[red] under circumstances [in which] it [was] unlikely that tax avoidance was a principal purpose,"[90] as would be the case for individuals who acquired dual citizenship at birth, and resided in the other country of citizenship for a certain period of time.[91]

If applicable, I.R.C. section 877 modified the tax consequences that would have otherwise applied to nonresident aliens. The provision expanded the types of U.S.-source investment income included in the former

[81] Kirsch, *supra* note 42, at 877–78.
[82] § 103(f), 80 Stat. at 1551 (codified as amended at I.R.C. § 877).
[83] S. REP. NO. 89-1707 at 1078.
[84] *Id.*
[85] § 103(f), 80 Stat. at 1551 (adding I.R.C. § 877); S. REP. NO. 89-1707 at 1060.
[86] S. REP. NO. 89-1707 at 1078.
[87] *Id.*
[88] § 103(f), 80 Stat. at 1552 (adding I.R.C. § 877); S. REP. NO. 89-1707 at 1078–79.
[89] *See* § 103(f), 80 Stat. at 1551–52 (adding I.R.C. § 877).
[90] S. REP. NO. 89-1707 at 1079.
[91] § 103(f), 80 Stat. at 1552 (adding I.R.C. § 877); S. REP. NO. 89-1707 at 1079.

citizen's gross income.[92] For the purposes of the expatriate tax, U.S.-source income included gain from the sale or exchange of property located within the United States, stock of U.S. corporations, and debt obligations of U.S. persons, including federal, state, or local government.[93] Deductions were allowed to the extent that the deduction was allocable to the gross income of the former citizen; however, capital loss carryovers were not permitted.[94] The former U.S. citizen was taxed on this income at the same rates as applicable to a U.S. citizen.[95]

B. Estate and Gift Tax Provisions

FITA also contained new estate and gift tax provisions. The U.S. estate tax applies to the estates of U.S. citizens and residents regardless of where the property is situated,[96] mitigated by the foreign estate tax credit with respect to foreign death taxes paid in the case of property situated outside the United States.[97] The estate tax also applies to nonresident aliens, but only to the property situated within the United States at the time of the death,[98] with the notable exception of stock held in domestic corporations.[99] FITA expanded the definition of "property within the United States" to include debt instruments of U.S. persons and government entities.[100] In addition, new and radically reduced schedules of estate tax rates and an increased exemption amount were made available to nonresident aliens.[101] Congress made the changes in order to equate the estate tax treatment of nonresident aliens with the treatment of U.S. citizens with similarly sized estates.[102] The concern was that "the high U.S. estate tax on the U.S. assets of a nonresident alien ... discourage[d] foreign [individuals] from investing in the United States."[103] FITA also excepted from the

[92] *See* § 103(f), 80 Stat. at 1552 (adding I.R.C. § 877).
[93] *Id.*
[94] *Id.*
[95] Lee, *supra* note 13, at 1074.
[96] I.R.C. §§ 2001, 2031; *see also id.* §§ 2033–2046 (requiring the inclusion into the gross estate of certain property interests).
[97] *Id.* § 2014.
[98] *Id.* §§ 2101, 2106.
[99] *Id.* § 2104(a).
[100] Foreign Investors Tax Act of 1966, Pub. L. No. 89-809, § 108(c), 80 Stat. 1539, 1572 (codified as amended at I.R.C. § 2104(c)).
[101] § 108(a), (e), 80 Stat. at 1571–73 (codified as amended at I.R.C. §§ 2101(a), 2106(a)(3)).
[102] *See* S. REP. NO. 89-1707 (1966), *reprinted in* 1966-2 C.B. 1061.
[103] *Id.*

U.S. gift tax gratuitous transfers of all U.S.-situs intangible property,[104] as the existing law, which imposed a gift tax on transfers of intangibles by a nonresident alien engaged in a U.S. trade or business, was impossible to enforce.[105]

Because the newly reduced estate tax rates and increased exemption amount for nonresident aliens on U.S.-situs property might create an incentive for U.S. citizens to relinquish their citizenship, Congress sought to eliminate any incentive for tax-motivated expatriation because it believed that wealth accumulated in the United States by an expatriate should remain subject to U.S. estate tax.[106] As a result, FITA added I.R.C. section 2107, which imposed the regular U.S. estate tax rates on the U.S. property owned by a nonresident alien who died within ten years after relinquishing U.S. citizenship if one of the principal purposes of the loss of citizenship was the avoidance of U.S. income, estate, or gift tax.[107] To prevent the expatriate from avoiding the U.S. estate tax by transferring assets with a U.S.-situs to a foreign corporation, the new provision provided that, if, at the time of death, the expatriate directly owned ten percent or more of the voting power or directly or indirectly owned fifty percent or more of the voting power of the foreign corporation, the value of the expatriate's gross estate would include the same proportion of the value of the stockholdings of the expatriate in the foreign corporation as its property having a U.S.-situs bears to all property.[108] However, as was the case for the income tax expatriation provision, I.R.C. section 2107 exempted persons whose loss of citizenship occurred under circumstances where it was unlikely that tax avoidance was a principal purpose.[109]

C. Judicial Decisions

Prior to the renewed interest in the taxation of expatriates that ultimately led to the HIPAA amendments to I.R.C. section 877, only two significant cases were published involving I.R.C. section 877. In *Kronenberg v. Commissioner*,[110] the Commissioner of Internal Revenue (Commissioner) prevailed in his claim that the principal motive of the taxpayer was tax avoidance, as the taxpayer expatriated one day before receiving a

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[104] § 109(a), 80 Stat. at 1574–75 (codified as amended at I.R.C. § 2501(a)).
[105] S. REP. NO. 89-1707 at 1099.
[106] *Id.*
[107] § 108(f), 80 Stat. at 1573 (codified as amended at I.R.C. § 2107).
[108] *Id.*
[109] *Id.*
[110] Kronenberg v. Comm'r, 64 T.C. 428 (1975).

large corporate distribution.[111] The facts of the second case, *Furstenberg v. Commissioner*,[112] illustrate the tax advantages of expatriation.[113] Petitioner Cecil Furstenberg expatriated to become a citizen of her husband's country of birth.[114] By expatriating, Furstenberg avoided a significant portion of her U.S. tax liability on income generated from U.S. sources, including gains from the sale of stock in a U.S. corporation.[115] As a U.S. citizen taxed on worldwide income, Furstenberg's tax liability would have been approximately $719,000; however, her U.S. tax liability as a nonresident alien was approximately $282,000.[116] In *Furstenberg*, despite having sought tax advice prior to expatriation, the taxpayer convinced the court that tax avoidance was not her principal motive in expatriating.[117] Rather, she successfully demonstrated the she was motivated by her "life-long ties to Europe" and her marriage to a foreign aristocrat.[118] In order to fall within the ambit of I.R.C. section 877, an expatriate's tax avoidance motive required more than just an important purpose; the tax avoidance purpose must have been "first in importance."[119] The decision in *Furstenberg* demonstrates the difficulty of proving that one of the principal purposes of expatriation was the avoidance of U.S. income, estate, or gift tax. The limited number of pre-1995 cases involving I.R.C. section 877 likely reflects the Treasury Department's recognition that I.R.C. section 877 cases often presented instances where a taxpayer's subjective motivation was difficult—if not impossible—to prove.[120]

D. Criticisms of the Expatriation Tax

Administration and enforcement were recognized early as the primary problems with I.R.C. section 877.[121] The Secretary held the burden of proving that one of the principal purposes of the individual in relinquish-

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[111] *Id.* at 435.
[112] Furstenberg v. Comm'r, 83 T.C. 755 (1984).
[113] *See id. passim*.
[114] *Id.* at 776.
[115] *Id.* at 769, 772.
[116] *Id.* at 772 (combining Furstenberg's tax liabilities for 1976 of $155,352 and for 1977 of $126,075).
[117] *Id.* at 771, 776.
[118] *Furstenberg*, 83 T.C. at 776 (1984).
[119] *Id.*
[120] *See* Michael G. Pfeifer, *The Final State of Expatriation?*, 2008 ALI-ABA COURSE STUDY JULY 31–AUG. 1, 2008, INT'L TR. & EST. PLAN. 877, 881 (2008) (noting the lack of cases since the *Furstenberg* decision and the difficulty involved even after the court's clarification of the principal motivation rule).
[121] *See* Kirsch, *supra* note 42, at 881.

ing U.S. citizenship was a tax-motivated purpose.[122] Although the Secretary's initial burden was met merely by showing that the individual realized a substantial tax benefit, to ultimately succeed, the Secretary had to overcome an individual's proof that a principal purpose for expatriation was *not* the avoidance of U.S. taxes.[123] Proving subjective intent is difficult, especially when, as here, the information is in the control of the individual relinquishing citizenship.[124] The Internal Revenue Service (Service) apparently realized that enforcement of I.R.C. section 877 was neither time nor cost efficient. During the thirty-year interval between its enactment in FITA and its revision in HIPAA, the Service issued no Internal Revenue Bulletins, one revenue ruling,[125] and one general counsel memorandum,[126] and minimally enforced I.R.C. section 877, resulting in only two published cases.[127] The Tax Courts in these two cases, *Kronenberg v. Commissioner*[128] and *Furstenberg v. Commissioner*,[129] both discussed above, reached different outcomes.[130] On a more practical level, the Service faced difficulties with enforcing I.R.C. section 877 because of its inability to effectively determine which individuals relinquished U.S. citizenship. FITA did not include any mandatory reporting requirements, nor did the State Department voluntarily share with the Service the names of individuals who had expatriated.[131] As a result, compliance with I.R.C. section 877 was largely voluntary.[132]

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[122] *Id.* at 881–82.

[123] *See id.* (discussing the burdens of proof under I.R.C. § 877).

[124] *See id.* (discussing the difficulties of the Secretary in establishing that the individual's principal purpose for relinquishing U.S. citizenship was the avoidance of U.S. taxes).

[125] Rev. Rul. 79-152, 1979-1 C.B. 237.

[126] I.R.S. Gen. Couns. Mem. 34,298 (June 3, 1970). The memorandum was issued in response to the Supreme Court's decision in Schneider v. Rusk, 377 U.S. 163 (1964), "with respect to an individual who had been notified by the State Department, prior to the decision, that he had lost his U.S. citizenship under I.R.C. § 352(a)(1) of the Immigration and Naturalization Act of 1952 and who took no affirmative effective action to establish his non-citizen status." *Id.* at 1. The Service concluded that even if an individual within the scope of Schneider took steps before January 1, 1971 "to establish non-citizen status," this fact "will not alone be considered evidence of a tax avoidance motive for purposes of Code § 877." *Id.*; *see also id.* at 2.

[127] *See* Furstenberg v. Comm'r, 83 T.C. 755 (1984); Kronenberg v. Comm'r, 64 T.C. 428 (1975).

[128] *Kronenberg*, 64 T.C. at 428.

[129] *Furstenberg*, 83 T.C. at 755.

[130] *See supra* text accompanying notes 110–20 (discussing the facts and holdings of the *Kronenberg* and *Furstenberg* cases).

[131] Kirsch, *supra* note 42, at 889 & n.121 (citing Letter from Wendy R. Sherman, Assistant Sec'y for Legis. Affairs, Dep't of State, to Sen. Robert Packwood (Apr. 28,

A 1994 Forbes Magazine article entitled, "The New Refugees" sparked the movement to reform I.R.C. section 877.[133] The article brought attention to a number of American millionaires who had renounced their U.S. citizenship in an effort to escape U.S. income and estate taxes.[134] Perhaps most troubling to the Clinton administration was the article's suggestion that this method of tax avoidance accelerated in direct response to "an Administration that campaigned for office on a tax-the-rich platform."[135] The author analogized the concerns of wealthy Americans to those of wealthy individuals who, throughout history, have sent their money overseas in an effort to "buffer their fortunes against expropriation, political unrest, [and] economic instability .... What is new is that Americans are beginning to feel the same sort of residual uncertainty about their possessions."[136] The article remarked on the unpredictability of ever-changing American tax rules and increased economic competition from developing nations, and concluded, "[t]hose who give up their citizenship

1995)). "The Department has a long-standing policy of protecting information it acquires about individuals in the administration of its consular responsibilities. It generally refuses to confirm or to deny an individual's citizenship status in response to inquiries from third parties." Letter from Wendy R. Sherman, Assistant Sec'y for Legis. Affairs, Dep't of State, to Sen. Robert Packwood (Apr. 28, 1995), *reprinted in* STAFF OF J. COMM. ON TAXATION, 104TH CONG., ISSUES PRESENTED BY PROPOSALS TO MODIFY THE TAX TREATMENT OF EXPATRIATION G-32 (Comm. Print 1995) [hereinafter 1995 JCT REPORT].

[132] Lee, *supra* note 13, at 1091; Renee S. Liu, *Expatriate Exclusion Clause: An Inappropriate Response to Relinquishing Citizenship for Tax Avoidance Purposes*, 12 GEO. IMMIGR. L.J. 689, 695 (1998) (citing 1995 JCT REPORT, *supra* note 131, at 62).

[133] *See* Robert Lenzner & Philippe Mao, *The New Refugees: Americans Who Give Up Citizenship to Save on Taxes*, FORBES, Nov. 21, 1994.

[134] *Id.* (indicating that the heirs to fortunes generated by prominent American corporations had already renounced their citizenship). These individuals included John Dorrance III, an heir to the Campbell Soup fortune; Kenneth Dart, an heir to Dart Container; Ted Arison, founder of Carnival Cruise Lines; Robert Miller, then the co-owner of Duty Free Shoppers International Ltd.; and J. Mark Mobius, a prominent market investment manager. *Id.*; *see also* Robert W. Wood, *Ten Facts About Tax Expatriation*, FORBES.COM (Mar. 23, 2010, 1:15 PM), http://www.forbes.com/2010/03/23/expatriation-exit-tax-limbaugh-obamacare-personal-finance-robert-wood.html ("Perhaps the most clever was Dart, who managed to come back 'home' as the Belize Ambassador to the U.S., manning a newly opened Belize embassy in Sarasota, Fla.—right where he had previously lived!").

[135] Lenzner & Mao, *supra* note 133. Wealthy Americans were deeply concerned by courts eroding property rights, bureaucrats referring to after-tax dollars as "tax expenditures," and the "retroactive taxation" imposed under the Clinton "deficit reduction bill." *Id.* The changes in the tax law were so frequent that long-term tax planning was almost impossible. *Id.*

[136] *Id.*

to escape Clintonomics and wealth redistribution are only the extreme part of a worrisome trend."[137]

In response to the public outrage arising from stories of wealthy Americans renouncing their U.S. citizenship in an effort to avoid U.S. taxes, Congress and the Clinton administration set out to strengthen the expatriation tax.[138] President Clinton addressed the issue in his fiscal 1996 budget message.[139] Two proposals arose from this effort: an exit tax favored by the Clinton administration and a proposal by Representative Archer to simply strengthen I.R.C. section 877.[140] This latter proposal won favor and was passed in 1996 as part of HIPAA.[141]

IV. HEALTH INSURANCE PORTABILITY AND ACCOUNTABILITY ACT OF 1996

A. Expatriation Tax as Amended

Because Congress was concerned that the original version of I.R.C. section 877 was difficult to administer and enforce, and that wealthy expatriates avoided its application too easily, HIPAA amended I.R.C. section 877 in an effort to enhance the effectiveness of the provision and to remove any perceived tax incentives for individuals seeking to renounce their citizenship for tax avoidance purposes.[142]

The Senate debate over the expatriation issue was surprisingly fierce. Democrats supporting an exit tax painted expatriates as un-American.[143] Representative Gibbons stated: "This proposal appropriately taxes the economic Benedict Arnolds of this country."[144] Dismissing the human rights issue of freedom to expatriate and the possibility of double taxation

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[137] *Id.*

[138] *See* Kirsch, *supra* note 42, at 889 (citing 141 CONG. REC. H3996 (Mar. 30, 1995) (141 CONG. REC. 9792 (1995)), in which Rep. Charles B. Rangel, D-New York, expresses his "hope that one day we will just publish the names of people that America has given so much to and that they care so little about that citizenship that they would flee in order to avoid taxes."); *see also* Alice G. Abreu, *Taxing Exits*, 29 U.C. DAVIS L. REV. 1087, 1091 (1996) ("It offends people to think that some individuals think so little of their U.S. citizenship that they renounce it for mere pecuniary gain. That sense of indignation, or offense, leads quite naturally to a desire to exact retribution.").

[139] Kirsch, *supra* note 42, at 883–84; *see also* Pfeifer, *supra* note 14, at 611.

[140] Lee, *supra* note 13, at 1090.

[141] *Id.*

[142] H.R. REP. NO. 104-496, at 68 (1996).

[143] Kenneth D. Heath, *The Symmetries of Citizenship: Welfare, Expatriate Taxation, and Stakeholding*, 13 GEO. IMMIGR. L.J. 533, 562 (2009).

[144] 141 CONG. REC. 9515 (1995) (statement of Rep. Samuel Gibbons).

on expatriates under a revised I.R.C. section 877, Representative Abercrombie stated:

> Why should I give two hoots about somebody that wants to give up their citizenship and shift their assets to another country and then say that they demand human rights, demand human rights as a citizen? ... 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.[145]

While the Clinton administration pushed hard for an exit tax on expatriates, Congress rejected a mark-to-market tax and implemented a less drastic change in the form of amendments to existing I.R.C. section 877.[146]

In HIPAA, Congress expanded and substantially strengthened the expatriation tax. Congress established an objective standard to apply to individuals who relinquished U.S. citizenship or terminated long-term residency.[147] The expatriation tax was extended to apply not only to U.S. citizens who relinquished their citizenship, but also to U.S. residents who terminated their long-term residency.[148] Congress expanded the categories of gain and income treated as U.S.-source income subject to the expatriation tax.[149] Finally, relief from double taxation of income was provided by a credit for foreign taxes paid on income subject to U.S. taxation solely by reason of the expatriation tax.[150]

First, for individuals who terminated U.S. citizenship or long-term residency, a tax-avoidance motive was *presumed* if the individual met either the tax liability test or the net worth test.[151] The individual was presumed to have a principal purpose of tax avoidance if the individual had an average annual net income tax that exceeded $100,000 for the five-year period prior to expatriation (the tax liability test), or the individual had a net

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[145] *Id.* at 9518 (statement of Rep. Neil Abercrombie).

[146] Lee, *supra* note 13, at 1087. For details regarding such amendments to I.R.C. § 877, *see id.* at 1083–86.

[147] Kirsch, *supra* note 42, at 886.

[148] H.R. REP. NO. 104-496, at 149 (1996).

[149] *Id.* at 149–50. *See generally* I.R.S. Notice 98-34, 1998-2 C.B. 29 (providing guidance for expatriation under I.R.C. §§ 877, 2107, 2501, 6039F).

[150] Health Insurance Portability and Accountability Act, Pub. L. No. 104-191, § 511(d), 110 Stat. 1936, 2097 (1996) (codified as amended at I.R.C. § 877(a)–(b)); H.R. REP. NO. 104-496, at 154.

[151] § 511(a), 110 Stat. at 2093 (codified as amended at I.R.C. § 877(a)); *see also* Kirsch, *supra* note 42, at 883–84 (indicating that before the enactment of HIPAA, Congress considered completely overhauling the tax treatment of expatriates, such as by using a mark-to-market approach, but opponents challenged these alternatives on "tax policy and other grounds").

worth that exceeded $500,000 as of the date of expatriation (the net worth test).[152] If an individual fell below the thresholds of the tax liability test and net worth test, the individual was subject to the expatriation tax "unless the individual's loss of citizenship or termination of residency did not have as a principal purpose the avoidance of tax."[153] Consequently, the statute still contained both an objective and subjective test.[154]

As before, Congress excluded certain U.S. citizens who were least likely to have expatriated for tax-motivated reasons from the reach of the expatriation tax.[155] Even though an individual met the objective tax liability test or net worth test, the presumption did not apply if the individual was within an exception and could demonstrate that one of the principal purposes for relinquishment of U.S. citizenship was not tax avoidance.[156] In order to qualify for one of the exceptions, the former U.S. citizen, within one year from the date of the relinquishment of citizenship, must have submitted a ruling request for a determination by the Secretary as to whether the relinquishment of citizenship had as one of its principal purposes the avoidance of tax.[157] The U.S. citizens that could qualify for the exception to the presumption included:

- individuals who had dual citizenship at birth and remained citizens of the other country;[158]
- individuals who obtained citizenship of their country of birth or of the country in which a spouse or parent was born;[159]

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152 § 511(a), 110 Stat. at 2093 (codified as amended at I.R.C. § 877(a)). The presumption amounts were indexed for inflation. *Id.*

153 *Id.*; H.R. REP. NO. 104-496, at 150–51.

154 § 511(a), 110 Stat. at 2093 (codified as amended at I.R.C. § 877(a)); H.R. REP. NO. 104-496, at 150–51; *see also* I.R.S. Notice 98-34, 1998-2 C.B. 29, § III (providing guidance for the net income tax and net worth tests).

155 *See* § 511(b), 110 Stat. at 2093–94 (adding I.R.C. § 877(c)).

156 *Id.*; H.R. REP. NO. 104-496, at 151.

157 § 511(b), 110 Stat. at 2093–94 (adding I.R.C. § 877(c)); *see also* I.R.S. Notice 98-34, 1998-2 C.B. 29, § III (providing that, in order to rebut the presumption of a principal tax motive, the former U.S. citizen was no longer required to obtain a substantive ruling; instead, the presumption was rebutted if the individual's submission was complete and made in good faith; nevertheless, the individual must have ultimately obtained a substantive ruling or become subject to the expatriation tax at a later time); I.R.S. Notice 97-19, 1997-1 C.B. 394, § IV (providing guidance regarding the timing and requirements of any ruling request; making it clear that any former U.S. citizen that satisfies the tax liability test or the net worth test is subject to the expatriation tax unless a favorable ruling is obtained from the Secretary).

158 § 511(b), 110 Stat. at 2094 (adding I.R.C. § 877(c)(2)(A)(i)).

- individuals who were present in the United States no more than thirty days during any year for the ten years preceding the loss of citizenship;[160]
- individuals who renounced their citizenship before the age of eighteen and one-half years;[161] or
- individuals exempted by the Treasury Regulations.[162]

The second significant amendment to I.R.C. section 877 was the extension of the expatriation tax to long-term legal residents who terminated their U.S. residency or who commenced to be treated as residents of a foreign country pursuant to a tax treaty and failed to waive treaty benefits.[163] The expatriation tax became applicable to lawful permanent residents residing in the United States for at least eight tax years in a fifteen-year period prior to the termination of U.S. residency.[164] The expatriation tax was extended to such long-term residents for a ten-year period if tax avoidance was one of the principal purposes for terminating their U.S. residency.[165] Congress did not include long-term residents in the provision that excepted from the expatriation tax certain individuals who failed the tax liability test or net worth test; however, Congress indicated that regulations would be promulgated to provide similar exceptions for long-term residents.[166] For the purposes of determining gain subject to the expatriation tax, long-term residents were generally treated as having a basis equal to the fair market value of the property as of the date of U.S. residency.[167]

The third major change Congress made was the expansion of the income source rules.[168] Under the law prior to HIPAA, individuals who terminated U.S. citizenship were generally taxed as nonresident aliens; nevertheless, for the purpose of the expatriation tax, U.S.-source income also included gains from the sale or exchange of property located in the United States, stock of U.S. corporations, and debt instruments of U.S.

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[159] *Id.* (adding I.R.C. § 877(c)(2)(A)(ii)).
[160] *Id.* (adding I.R.C. § 877(c)(2)(B)).
[161] *Id.* (adding I.R.C. § 877(c)(2)(C)).
[162] *Id.* (adding I.R.C. § 877(c)(2)(D)).
[163] *Id.* at 2099 (adding I.R.C. § 877(e)(1)(B)).
[164] § 511(b), 110 Stat. at 2099 (adding I.R.C. § 877(e)(2)).
[165] § 511(a), 110 Stat. at 2093 (codified as amended at I.R.C. § 877(a)(1)).
[166] § 511(f), 110 Stat. at 2099 (codified as amended at I.R.C. § 877(e)(3)–(5)); *see also* I.R.S. Notice 97-19, 1997-1 C.B. 394, § IV (setting out specific categories of U.S. long-term residents who may submit rulings).
[167] § 511(f), 110 Stat. at 2099 (adding I.R.C. § 877(e)(3)(B)).
[168] *See* H.R. REP. NO. 104-496, at 208 (1996).

persons (including federal, state, or local government).[169] HIPAA added income derived from the sale or exchange of stock in a foreign corporation to income subject to the expatriation tax.[170] The gain from the sale or exchange of stock of a foreign corporation is reached if the individual owns, directly, indirectly, or constructively, more than fifty percent of the total combined voting power of all classes of stock entitled to vote or the total value of the stock of the corporation at any time during the two-year period ending on the date of the loss of U.S. citizenship or long-term residency.[171] This source rule applies only to the extent of earnings and profits earned or accumulated before termination of citizenship or long-term residency, and during any period in which the individual met the ownership tests.[172]

Congress also modified I.R.C. section 877 to reach gain realized on otherwise nontaxable exchanges.[173] If the unrecognized gain changed from U.S.-source to foreign-source and was otherwise within a non-recognition provision, the amended I.R.C. section 877 was revised to tax any realized gain with respect to an exchange of property during the ten-year period following expatriation.[174] The property exchanged is treated as if sold for its fair market value on the date of exchange, with the property received being accorded a corresponding fair market value basis.[175] I.R.C. section 877 allows the individual to enter into an agreement with the Secretary to defer recognition of the gain if the individual agrees to treat as U.S.-source income any income or gain derived from the property received in the exchange for the remainder of the ten-year period.[176] Also, the Secretary has the discretion to extend the ten-year period for immediate recognition of gain to fifteen years beginning five years prior to the date the individual terminates citizenship or long-term residency.[177]

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[169] *Id.*

[170] § 511(b)(1), (c), 110 Stat. at 2093–95 (codified as amended at I.R.C. § 877(c), (d)(1)(C), respectively).

[171] § 511(a), 110 Stat. at 2095 (codified as amended at I.R.C. § 877(c)).

[172] *Id.*

[173] § 511(c) (codified as amended at I.R.C. § 877(d)); *see also* I.R.S. Notice 97-19, 1997-1 C.B. 394, § V (providing detailed guidance on how to gain recognition on certain exchanges and gains); Colon, *supra* note 49, at 50–52.

[174] § 511(b)(1), (c), 110 Stat. at 2094–95 (codified as amended at I.R.C. § 877(c), (d)(2), respectively).

[175] § 511(b), 110 Stat. at 2095 (codified as amended at I.R.C. § 877(c)).

[176] *Id.*

[177] § 511(a), 110 Stat. at 2095–96 (codified as amended at I.R.C. § 877(c)).

The expatriation tax was further strengthened by treating the income or gain of a controlled foreign corporation (CFC),[178] with respect to property transferred to the CFC by a U.S. shareholder[179] within the ten-year period, as received by the U.S. shareholder and not the CFC.[180] The ten-year period begins on the date the individual relinquishes U.S. citizenship or terminates U.S. long-term residency.[181] This provision applies only if the income or gain received by the foreign corporation would have been treated as U.S.-source income, and if the income or gain was generated by property owned by the CFC with a basis determined by reference to the basis of the property transferred by the expatriate.[182] On the sale of the stock of the CFC by the expatriate, a pro rata share of the property is treated as sold on the date the stock is sold.[183] The Secretary also has the regulatory authority to extend the ten-year period to fifteen years, which would begin five years before the date of expatriation.[184]

These amendments curbed many of the tax planning techniques utilizing foreign investments. When first enacted, I.R.C. section 877 did not capture any foreign-source income and "one of the principal criticisms ... was that it was easy to convert taxable U.S. source gains into non-taxable foreign-source gains through elementary tax planning."[185] For instance, if an expatriate was "a controlling shareholder in a parent corporation[, the expatriate] could create a ... foreign subsidiary by exchanging [stock] in the parent corporation for [stock] in the foreign subsidiary."[186] No gain would be recognized on the exchange or the subsequent conversion of the investment into cash by the sale of the stock of the foreign corporation.[187] The source rules, as created by HIPAA and in effect today, limit this

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[178] *See* I.R.C. § 957(a)(1) (defining, generally, the term "controlled foreign corporation" (CFC) as a foreign corporation with more than fifty percent of its stock (voting power or value) owned, or considered as owned, by U.S. shareholders).

[179] *See id.* § 951(b) (defining, generally, the term "U.S. shareholder" as a U.S. person who owns, or is considered as owning, ten percent or more of the voting power of a foreign corporation).

[180] § 511(b)(1), (c), 110 Stat. at 2096 (codified as amended at I.R.C. § 877(c)(4)(B), (d)(4), respectively); *see also* I.R.S. Notice 97-19, 1997-1 C.B. 394, § VI (providing detailed guidance as to gain recognition on contributions to CFCs).

[181] § 511(a), (b)(1), 110 Stat. at 2093–94 (codified as amended at I.R.C. § 877(a)(1), (c)(2)(B), respectively).

[182] § 511(c), 110 Stat. at 2096 (codified as amended at I.R.C. § 877(d)(4)(A)(ii)).

[183] *Id.* at 2096–97 (codified as amended at I.R.C. § 877(d)(4)(C)).

[184] I.R.S. Notice 97-19, 1997-1 C.B. 394, § VI.

[185] Colon, *supra* note 49, at 50.

[186] Christine L. Agnew, Comment, *Expatriation, Double Taxation, and Treaty Override: Who Is Eating Crow Now?*, 28 U. MIAMI INTER-AM. L. REV. 69, 80 (1996).

[187] *Id.* at 80–81.

abuse, as certain foreign-source income and otherwise nontaxable exchanges fall within their provisions.[188] Thus, tax planning to avoid the expatriation tax through foreign investments became more difficult and required more forethought.

B. Reporting Requirements

In addition to the amendments made directly to I.R.C. section 877, HIPAA also created new reporting requirements to aid the Service's administration and enforcement of the expatriation tax.[189] I.R.C. section 6039G requires U.S. citizens who relinquish citizenship, and former long-term residents who terminate residency, to provide a statement that includes a taxpayer identification number, foreign mailing address, foreign country of residence, foreign country of citizenship, and a detailed list of assets and liabilities if the expatriate's net worth exceeds $500,000.[190] The expatriate is required to submit the information soon after renouncing U.S. nationality, with penalties imposed for noncompliance.[191]

"Prior to [HIPAA] ... an individual's renunciation or ... loss of citizenship was not a matter of public record."[192] Echoing Representative Gibbon's characterization of tax-motivated expatriates as "economic Benedict Arnolds,"[193] Representative Rangel urged that the names of such expatriates be published.[194] He went on to state that tax-motivated expatriation

[188] *See* Colon, *supra* note 49, at 51 (criticizing the source rules as applied to long-term residents who own an interest in a foreign company before their arrival in the United States but would be taxed on it upon leaving).

[189] Health Insurance Portability and Accountability Act, Pub. L. No. 104-191, § 512(a), 110 Stat. 1936, 2100–01 (1996) (adding I.R.C. § 6039F); *see also* I.R.S. Notice 97-19, 1997-1 C.B. 394, § IX (providing detailed guidance as to the reporting requirement under then I.R.C. § 6039F). In 1997, I.R.C. § 6039F was amended and became I.R.C. § 6039G. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 1602(h)(3), 111 Stat. 788, 1096.

[190] § 512(a), 110 Stat. at 2101 (adding I.R.C. § 6039F; later recodified as I.R.C. § 6039G); H.R. REP. NO. 104-496, at 155 (1996); *see also* I.R.S. Notice 97-19, 1997-1 C.B. 394, § IX (requiring a long-term resident whose U.S. residency is terminated to attach a similar statement to the U.S. tax return for the year of termination).

[191] § 512(a), 110 Stat. at 2101 (adding I.R.C. § 6039F; later recodified as I.R.C. § 6039G). The penalty for failure to file the required statement equals the greater of five percent of the expatriation tax or $1,000 for each tax year in which the failure continues. *Id.*; *see also* H.R. REP. NO. 104-496, at 155.

[192] Kirsch, *supra* note 42, at 889.

[193] 141 CONG. REC. 9515 (1995) (statement of Rep. Samuel Gibbons).

[194] *Id.* at 9792 (statement of Rep. Charles Rangel) ("I would hope that one day we will just publish the names of people that America has given so much to and that they care so

"is wrong, it is unpatriotic, it is immoral for someone to enjoy all of the benefits of the United States and renounce their citizenship and then run off to some foreign island to enjoy it."[195] Not to be outdone, Representative Doggett considered expatriation for the purpose of avoiding U.S. tax to be a form of American flag burning, stating: "[I]s it not a form of flag desecration when people burn their American citizenship and burn the American taxpayer at the same time? ... I do not think people who defile this flag by rejecting their American citizenship have any class at all."[196] After this colorful debate on the floor of the Congress, Congress codified their intent to prevent expatriation for tax purposes in the form of I.R.C. section 6039G.[197]

I.R.C. section 6039G requires the name of each individual who loses U.S. citizenship to be published in the Federal Register within thirty days of the end of the calendar quarter in which the individual's name is reported to the Secretary.[198] This provision, enacted as part of the response to tax-motivated expatriation, removed the confidentiality enjoyed by persons relinquishing their citizenship for tax-avoidance reasons.[199] "In requiring the names to be made public, Congress may have wanted to shame or embarrass those individuals who expatriated to avoid United States taxes."[200] However, the publication mandate is not limited to former citizens whose loss of U.S. citizenship was tax-motivated.[201] Due to practical necessity, the section mandates publication of the names of all individuals who renounce or otherwise lose citizenship, regardless of the reason for

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little about that citizenship that they would flee in order to avoid taxes."); Kirsch, *supra* note 42, at 889.

[195] 141 CONG. REC. 9798 (statement of Rep. Charles Rangel).

[196] *Id.* at 9794.

[197] Health Insurance Portability and Accountability Act, Pub. L. No. 104-191, § 512(a), 110 Stat. 1936, 2100–02 (1996) (adding I.R.C. § 6039F; later recodified as I.R.C. § 6039G).

[198] *Id.* at 2102 (adding I.R.C. § 6039F; later recodified as I.R.C. § 6039G). The State Department is required

> to provide the Secretary ... with a copy of each certificate of loss of nationality (CLN) approved by the State Department. ... [Further,] the agency administrating the immigration laws [is] to provide the Secretary ... with the name of each individual whose status as a lawful permanent resident has been revoked or ... determined to have been abandoned.

H.R. REP. NO. 104-496, at 155 (1996).

[199] Kirsch, *supra* note 42, at 889.

[200] *Id.* at 906 (footnote omitted).

[201] *Id.* at 909.

the loss.[202] Between 1995 and 2001, approximately 600 individuals lost U.S. citizenship annually.[203] These rates remained steady from 2002 through 2004, with an average annual expatriation rate of approximately 568 individuals.[204]

C. Estate and Gift Provisions

In addition to amending income tax provisions, HIPAA made similar changes to the estate and gift tax treatment of U.S citizens who renounce their citizenship, or U.S. long-term residents who terminate their residency.[205] The presumptions and exceptions applicable to a tax avoidance motive under the income tax expatriation provisions were applied to the estate and gift tax expatriation provisions.[206] The gross estate of a decedent dying within ten years of the event terminating citizenship or long-term residency was modified to include stock of certain closely-held foreign corporations if at the time of death the decedent owns, directly or indirectly, ten percent or more of the total combined voting power of all classes of stock entitled to vote and, directly, indirectly, or constructively, more than fifty percent of the total combined voting power of all classes of stock entitled to vote or the total value of the stock of the foreign corporation.[207] The value of the stock for U.S. estate tax purposes is the expatriate's proportionate share of the U.S. asset value of the stock at the time of transfer.[208] Gratuitous transfers of intangible property by a nonresident alien who terminated U.S. citizenship or residency within the ten-year

[202] *Id.*

[203] Kirsch, *supra* note 8, at 484 n.170; *see also* Kirsch, *supra* note 42, at 890 n.127 (providing the number of individuals whose relinquishment of U.S. citizenship was published between 1995 and 2003 pursuant to I.R.C. § 6030G).

[204] As reported in the Federal Register, there were 503 expatriations in 2002 (67 Fed. Reg. 19621–22 (Apr. 2, 2002); 67 Fed. Reg. 47889–90 (July 22, 2002); 67 Fed. Reg. 66456–57 (Oct. 31 2002); 68 Fed. Reg. 4549–51 (Jan. 29, 2003)); 571 expatriations in 2003 (68 Fed. Reg. 23180–81 (Apr. 30, 2003); 68 Fed. Reg. 44840–41 (July 30, 2003); 69 Fed. Reg. 61906–07 (Oct. 21, 2004); 69 Fed. Reg. 61910–11 (Oct. 21, 2004)); and 631 expatriations in 2004 (69 Fed. Reg. 61907–08 (Oct. 21, 2004); 69 Fed. Reg. 61908–09 (Oct. 21, 2004); 69 Fed. Reg. 61909–10 (Oct. 21, 2004); 70 Fed. Reg. 5511–13 (Feb. 2, 2005)).

[205] *See* Health Insurance Portability and Accountability Act, Pub. L. No. 104-191, § 511(e), 110 Stat. 1936, 2097–98, (codified as amended at I.R.C. §§ 2107, 2501).

[206] *Id.* at 2097 (codified as amended at I.R.C. § 2107(a)(2)).

[207] § 511(e)(1)(C), 110 Stat. at 2098 (codified as amended at I.R.C. § 2107(b)).

[208] § 511(e)(1)(B), 110 Stat. at 2098 (codified as amended at I.R.C. § 2107(b)(2)(B), (C)).

period ending on the date of transfer are subject to U.S. gift tax.[209] For estate tax purposes, a limited credit was permitted for foreign estate, legacy, inheritance, or succession taxes actually paid with respect to property included in the gross estate of an individual solely by reason of the expatriation tax provisions.[210] For gift tax purposes, a credit is permitted for any foreign gift tax actually paid with respect to a gift subject to tax solely by reason of the expatriation tax provisions.[211]

D. Reed Amendment

One month after the enactment of HIPAA, Congress passed the Illegal Immigration Reform and Immigration Responsibility Act of 1996 (IIRIRA),[212] which "focused primarily on improved enforcement of the immigration laws and restrictions on ... benefits for aliens."[213] The IIRIRA contained a provision sponsored by Representative Reed[214] (the Reed Amendment) that amended section 212 of the Immigration and Nationality Act,[215] which lists categories of aliens who are inadmissible under the immigration laws. Under the Reed Amendment, the U.S. Attorney General can deny a former citizen reentry into the United States if the Attorney General determines that the former citizen renounced U.S. citizenship for purposes of avoiding tax.[216] In proposing the amendment, Representative Reed stated that, "in an instrumental way, I would hope in the future if those very slick and smart tax lawyers advising their clients about how to avoid their taxes suggest expatriation they should also indicate very clearly that the consequences are you cannot return at will to the United States."[217] The Reed Amendment introduced another potential weapon

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[209] § 511(e)(2)(A), 110 Stat. at 2098 (codified as amended at I.R.C. § 2501(a)(3)(A), (B)).

[210] § 511(e)(1)(B), 110 Stat. at 2097–98 (codified as amended at I.R.C. § 2107(c)(2)(A)).

[211] § 511(e)(2)(A), 110 Stat. 1936, 2098 (codified as amended at I.R.C. § 2501(a)(3)(D)).

[212] Illegal Immigration Reform and Immigrant Responsibility Act of 1996, Pub. L. No. 104-208, 110 Stat. 3009–546 (codified as amended at 8 U.S.C. §§ 1101, 1182, 1481, 1483).

[213] Kirsch, *supra* note 42, at 890.

[214] § 352, 110 Stat. at 3009–641 (codified as amended at 8 U.S.C. § 1182(a)(10)).

[215] Immigration and Nationality Act, Pub. L. No. 82-414, § 212(a), 66 Stat. 163, 182 (1996).

[216] 8 U.S.C. § 1182(a)(10)(E); Michael G. Pfeifer & Joseph S. Henderson, *Expatriation: The Ultimate Estate Planning Tool?*, *in* EST. PLAN. & ADMIN. 205, 235 (PLI Tax L. & Est. Plan. Course Handbook Ser., 2000).

[217] Tang, *supra* note 51, at 623 n.56 (citing *Hearing Before the House Judiciary Committee: Mark-Up of Immigration Legislation*, 104th Cong. (Nov. 15, 1995) in FED. NEWS SERV., Nov. 15, 1995, at 50).

against expatriation motivated by tax avoidance.[218] Under the provisions of the Reed Amendment, former citizens become excludable aliens "deemed inadmissible alongside terrorists, former-Nazis, international child abductors and government officials who severely violated religious freedom, to name a few."[219]

Even though the provision has never been used as grounds to deny readmission,[220] the Reed Amendment still constitutes a significant threat.[221] It has been speculated that the Attorney General has not used the authority provided by the Reed Amendment to deny readmission because an adequate system is not in place for the U.S. government to determine whether the individual expatriated for tax-avoidance reasons.[222] Nevertheless, "if the expat[riate] fails to file Form[] 8854 or pay the required tax under the alternative tax [regime] for the subsequent ten-year[period], ... the Attorney General ... [apparently has] sufficient grounds to deny ... readmission to the U.S."[223] This rather harsh provision serves as a non-monetary form of deterrence. Expatriates who wish to visit the United States after expatriating are obligated to comply with I.R.C. section 877.[224] The law seems to have a significant penal intent as it expressly forbids an expatriate who expatriated for tax-avoidance reasons from ever reentering the United States.[225]

The constitutional validity of the Reed Amendment remains unclear. The right to expatriate was originally granted by Congress in the Expatriation Act of 1868,[226] which states: "[T]he right of expatriation is a natural and inherent right of all people, indispensable to the enjoyment of rights of life, liberty and the pursuit of happiness."[227] Because of this long history, some scholars argue that barring citizens who expatriate for tax-avoidance reasons from reentering the United States is an unconstitutional violation

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218 *See* Pfeifer & Henderson, *supra* note 216, at 235.

219 Tang, *supra* note 51, at 623–24.

220 Kevin E. Packman, *The Tax Rules Just Changed: Emotions Aside, Does Expatriation Make Financial Sense?*, J. TAX'N, Aug. 2008, at 68, 71. As of February 2006, the Reed Amendment had not been enforced. STAFF OF J. COMM. ON TAX'N, 108TH CONG., REVIEW OF PRESENT-LAW TAX AND IMMIGR. TREATMENT OF RELINQUISHMENT OF CITIZENSHIP AND TERMINATION OF LONG-TERM RESIDENCY 72 (Comm. Print 2003) [hereinafter 2003 JCT REPORT]; Tang, *supra* note 51, at 628.

221 Packman, *supra* note 220, at 71.

222 *Id.*

223 *Id.* at 71–72.

224 *Id.* at 71; *see also* Tang, *supra* note 51, at 628.

225 Liu, *supra* note 132, at 700.

226 *See* Expatriation Act of 1868, 15 Stat. 223–24.

227 *Id.* at 223.

of their due process and equal protection rights under both the Fifth and Fourteenth Amendments.[228] The theory behind this argument is that "[t]he right to expatriate is a fundamental right recognized throughout history through statutes and court decisions, and, as a fundamental right, it should be protected by the Constitution."[229]

Even some of the legislators who supported the expatriate tax reforms contained in HIPAA criticized the Reed Amendment.[230] Speaking on the floor of the Senate just days after the passage of the Reed Amendment, Senator Moynihan declared: "The provision imposes an extraordinary penalty on certain persons who exercise the legal prerogative of expatriation: permanent exile from the United States."[231] While acknowledging that tax-motivated expatriation was a "genuine abuse,"[232] Moynihan expressed concern that the provision conflicted with Article 12 of the International Covenant on Civil and Political Rights[233] and concluded that "we have enacted a measure that does not reflect well on a free society."[234]

E. Criticisms of the Expatriation Tax as Amended

It was clear that with passage of HIPAA, Congress intended to enhance compliance with the expatriation tax.[235] It was also clear that the Service intended to begin enforcing the expatriation tax.[236] In 1997, the Service, for the first time, issued a notice regarding I.R.C. section 877.[237] To some degree, the objective standard introduced by HIPAA made enforcement easier. Many expatriates were above the objective income tax liability and net worth thresholds and unable to qualify for any of the ex-

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[228] *See, e.g.*, Michelle Leigh Carter, *Giving Taxpatriates the Boot—Permanently?: The Reed Amendment Unconstitutionally Infringes on the Fundamental Right to Expatriate*, 36 GA. L. REV. 835, 839 (2002) (arguing that the Reed Amendment violates citizens' due process and equal protection under both the Fourteenth and Fifth Amendments).

[229] *Id.*

[230] *See* 142 CONG. REC. 27, 219 (1996) (statement by Sen. Daniel Patrick Moynihan showing that although he supported HIPAA, he does not support the Reed Amendment).

[231] *Id.*

[232] *Id.*

[233] *Id.*

[234] *Id.*

[235] *See* H.R. REP. NO. 108-548, pt. 1, at 62–65 (2004) (amending and strengthening prior provisions in order to increase compliance).

[236] *See* Kirsch, *supra* note 42, at 885–86 (describing the motivations behind the enactment of HIPAA, and explaining the Act's primary changes to make determination of citizenship a more objective process).

[237] I.R.S. Notice 97-19, 1997-1 C.B. 39 (as amended by I.R.S. Notice 98-34, 1998-2 C.B. 29).

ceptions that allowed them to seek a revenue ruling, obviating the need for the Secretary to consider the subjective intent of the expatriate.[238] However, administration under the revised statute was not as efficient as had been hoped, which again generated criticism of inadequate enforcement by the Service.[239] The Service was still required to make subjective determinations as to motive in cases involving individuals who fell below the income tax liability and net worth thresholds, and in cases involving the individuals who exceeded the thresholds and were seeking a ruling from the Secretary as to the applicability of an exception to the expatriate tax.[240] In the latter case, the Secretary was hindered by the administration of this ruling requirement.[241]

On a more practical level, before HIPAA, it was difficult for the Service to enforce I.R.C. section 877 because of its inability to effectively determine whether an individual relinquished U.S. citizenship or terminated residency.[242] FITA did not include any mandatory reporting requirements, nor did the State Department voluntarily share with the Service the names of individuals who expatriated.[243] As a result, compliance with

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[238] *See supra* notes 156–62 and accompanying text (discussing the requirement of a ruling from the Secretary as to principal motive in order for an expatriate to qualify for an exception to the expatriation tax).

[239] *See* Kirsch, *supra* note 42, at 886–87 (noting the serious enforcement problems that remained, despite HIPAA's enactment); Walker, *supra* note 14, at 589–90 (discussing the difficulties with the enforcement of an expatriate tax).

[240] *See* 2003 JCT REPORT, *supra* note 220, at 115–16 (explaining the process for former citizens and former long-term residents falling below or above the income tax liability and net worth thresholds); *see also* H.R. REP. NO. 108-548, pt. 1, at 62–63 (listing the objective requirements to be subject to the expatriation tax); Eva Farkas-DiNardot, *Is the Nation of Immigrants Punishing its Emigrants: A Critical Review of the Expatriation Rules Revised by the American Jobs Creation Act of 2004*, 7 FLA. TAX REV. 5, 25–26, 30 (2005) (stating that the IRS continued to make subjective decisions on the applicability of the expatriation tax under the provisions of HIPAA).

[241] *See* 2003 JCT REPORT, *supra* note 220, at 92–95 (explaining the enforcement problems within the ruling context); Kirsch, *supra* note 42, at 887. The IRS issued 270 private letter rulings after the enactment of HIPAA, during the period from January 1, 1997 through July 1, 2002. 2003 JCT REPORT, *supra* note 220, at 92. However, half of the applicants obtained favorable rulings and only eleven received unfavorable decisions. The remainder were granted neutral rulings, which supposedly meant the IRS could audit them later, but there is no indication that any such audits occurred. Ashlea Ebeling, *The Long Good-Bye*, FORBES, Mar. 28, 2005, at 92.

[242] *See supra* notes 131–32 and accompanying text; *see also* Kirsch, *supra* note 42, at 888–89.

[243] *See* Kirsch, *supra* note 42, at 889 (stating that prior to the passage of HIPAA's publication requirement reporting loss of citizenship, the State Department resisted disclosing such information about expatriates); *see also* Letter from Wendy R. Sherman, Assistant Sec'y for Legis. Affairs, Dep't of State, to Sen. Robert Packwood (Apr. 28,

I.R.C. section 877 was primarily voluntary.[244] With the passage of HIPAA, Congress for the first time created reporting rules so that the Service could monitor expatriates, and imposed penalties for the failure to report. Also, Congress enacted provisions requiring quarterly publication of the names of individuals who expatriated.[245] Finally, with the Reed Amendment, the U.S. government could exclude aliens who expatriated for the purpose of avoiding taxes.[246] Nevertheless, the reporting requirements proved far from adequate for effective enforcement,[247] especially as the expatriate was required to provide the requisite information to the Secretary only in the year of expatriation.[248]

To improve compliance with, and the enforcement of, the expatriation tax, Congress directed the Treasury Department to conduct a study of the tax compliance of U.S. citizens and green card holders living outside of the United States.[249] In addition, Congress ordered the Joint Committee on Taxation (Joint Committee) to study the effectiveness of the revised I.R.C. section 877 and the related immigration provisions.[250]

The Joint Committee found that the revised I.R.C. section 877 showed little improvement over its predecessor. Citing the 2000 Report of the Government Accounting Office,[251] the Joint Committee concluded that the Service did not have a systematic compliance effort in place to enforce the expatriation tax.[252] The Joint Committee also found that, other than compiling a Certificate of Loss Nationality (CLN) database and publishing the

1995), *reprinted in* 1995 JCT REPORT, *supra* note 131, at G-32 ("The Department [of State] has a long-standing policy of protecting information it acquires about individuals in the administration of its consular responsibilities. It generally refuses to confirm or to deny an individual's citizenship status in response to inquiries from third parties.").

[244] Lee, *supra* note 13, at 1091 (declaring that there was little voluntary compliance with I.R.C. § 877); *see also* 1995 JCT REPORT, *supra* note 131, at 62 (noting that much of the effectiveness of the United States tax system depends on voluntary compliance).

[245] I.R.C. § 6039G; Kirsch, *supra* note 42, at 888.

[246] Illegal Immigration Reform and Immigrant Responsibility Act of 1996, Pub. L. No. 104-208, § 352, 110 Stat. 3009–546, 3009–641 (1996). For a thorough discussion of IIRIRA and its consequences, see generally Liu, *supra* note 132; *see also* Carter, *supra* note 228, at 837–39.

[247] H.R. REP. NO. 108-548, pt. 1, at 65 (2004) (laying out the reporting requirements); *see also* GUSTAFSON ET AL., *supra* note 24, at 50 (noting that there was little to no enforcement of these requirements).

[248] *See* H.R. REP. NO. 108-548, pt. 1, at 65.

[249] Health Insurance Portability and Accountability Act, Pub. L. No. 104-191, § 513, 110 Stat. 1936, 2102 (1996).

[250] 2003 JCT REPORT, *supra* note 220, at 1.

[251] United States General Accounting Office, *General Accounting Office Report*, *reprinted in* 2003 JCT REPORT, *supra* note 220, at A-256.

[252] 2003 JCT REPORT, *supra* note 220, at 5.

names of expatriates in the Federal Register as required by I.R.C. section 6039G, the Service had generally stopped all compliance efforts.[253] Further, according to the same report, despite the new immigration rules, "the [Immigration and Nationalization Services (INS)] and the Department of State had not denied reentry into the United States to a single former citizen."[254] These studies strongly influenced Congress, and provided much of the motivation for the Legislature's decision to revisit I.R.C. section 877 as part of its 2004 legislation.[255] Thus, many of the Joint Committee's recommendations to increase enforcement, ease administration, and deter expatriation[256] were codified in the JOBS Act.[257]

V. American Jobs Creation Act of 2004

A. Alternative Tax Regime

In 2004, Congress passed the JOBS Act in response to the Joint Committee's hearings and recommendations.[258] I.R.C. section 877 was amended to reflect the following alterations:

> First, it institutes objective rules regarding whether a U.S. citizen who desires to relinquish citizenship should be subjected to the alternative tax regime established by I.R.C. section 877. Second, it provides a tax-based, instead of immigration-based, set of rules for determining when an individual is no longer a U.S. citizen for federal tax purposes. Third, the 2004 Jobs Act subjects individuals determined to have expatriated to avoid taxes to full U.S. taxation if they return to the United States for extended periods of time. Lastly, it provides that an annual information return be filed for each of the ten years following expatriation.[259]

The alternative tax regime continues to apply to expatriates who expatriated prior to June 17, 2008 for the balance of the ten-year period from the date of expatriation.[260]

Addressing concerns that the difficulty in administering I.R.C. section 877 was due to its subjective nature and its numerous exceptions,[261] the

[253] *Id.*
[254] *Id.*
[255] GUSTAFSON ET AL., *supra* note 24, at 50.
[256] 2003 JCT REPORT, *supra* note 220, at 75.
[257] Tang, *supra* note 51, at 629.
[258] *Id.*; *see also* American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 804, 118 Stat. 1418, 1569 (codifying the recommended changes).
[259] Tang, *supra* note 51, at 629–30 (footnotes omitted).
[260] Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110-245, § 301(d), 122 Stat. 1624, 1646 (adding I.R.C. § 877(h)).

JOBS Act eliminated subjective intent as a consideration.[262] The thresholds of I.R.C. section 877 that combined an objective standard for determining tax-avoidance purpose with a subjective standard for individuals below the objective tests were replaced by a purely objective standard.[263] An expatriate falls within the provisions of I.R.C. section 877, regardless of tax motivation, if the expatriate has an average annual net income tax liability greater than $124,000 for the preceding five years; has a net worth of more than $2 million at the time of expatriation; or fails to certify—under penalty of perjury—that all U.S. tax obligations for the preceding five years have been met, or fails to submit evidence of compliance as required by the Secretary.[264] If one of these thresholds applies to an expatriate, the expatriate is no longer presumed to have expatriated for tax-motivated reasons, but is instead conclusively subject to the alternate tax regime of I.R.C. section 877.[265]

With the JOBS Act, Congress also significantly narrowed the categories of expatriates who are exempt from the alternate tax regime.[266] However, if an exception applies, the expatriate is no longer required to seek a ruling to determine if one of the principal purposes for expatriation was avoidance of U.S. income tax.[267] The first exception applies to expatriates who have dual citizenship at birth, continue to be citizens of the other country, and have "no substantial contacts with the United States."[268] To be treated as having no substantial contacts, an individual must have never been a resident of the United States, must have never held a U.S. passport, and must not have been present in the United States for more than thirty days in each of the preceding ten years.[269] The second exception applies to certain minors who meet the following four requirements:

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261 *See* Tang, *supra* note 51, at 630 (explaining that the JOBS Act of 2004 was enacted in part to remedy the problem of using a subjective standard).

262 *See* H.R. REP. NO. 108-548, pt. 1, at 62 (2004) (codifying the objective standard).

263 *Id.* at 62–63 (providing the requirements for falling within the provisions of I.R.C. § 877).

264 American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 804(a)(1), 118 Stat. 1418, 1569 (codified as amended at I.R.C. § 877(a)). After 2004, the $124,000 amount is increased by a cost-of-living adjustment under I.R.C. § 1(f)(3). *Id.* The amount is $145,000 for calendar year 2010. Rev. Proc. 09-50, 2009-45 I.R.B. 617, 624.

265 § 804(a)(1), 118 Stat. at 1569 (codified as amended at I.R.C. § 877(a)).

266 *See* GUSTAFSON ET AL., *supra* note 24, at 51.

267 *See* § 804(a)(2), 118 Stat. at 1569–70 (amending I.R.C. § 877(c)).

268 *Id.* (codified as amended at I.R.C. § 877(c)(2)).

269 *Id.* (codified as amended at I.R.C. § 877(c)(2)(B)).

- the individual became a U.S. citizen at birth;[270]
- neither of the individual's parents were U.S. citizens at the time of the individual's birth;[271]
- the individual expatriates before the age of eighteen and one-half years;[272] and
- the individual must not have been present in the United States for more than thirty days in each of the preceding ten years.[273]

For the purposes of the alternative tax regime, the JOBS Act established tax-based, instead of immigration-based, rules for determining when an individual is no longer a U.S. citizen or long-term resident.[274] Despite the fact that an individual might otherwise be subject to the alternative tax regime, that individual will continue to be taxed as a U.S. citizen or long-term resident until notice of an expatriating act or termination of residency is given to the Secretary of State or the Secretary of Homeland Security, and the statement required by I.R.C. section 6039G is provided.[275] The statement must include the individual's taxpayer identification number; mailing address of principal foreign residence; foreign country of citizenship; information regarding income, assets, and liabilities; number of days physically present within the United States during the tax year; and any other information the Secretary requires.[276] If the statement is not filed, the expatriate will not be taxed under the alternative tax regime but will instead be taxed as a U.S. citizen or resident on his or her worldwide income.[277] In order to ensure compliance with the alternative tax regime, the statement required by I.R.C. section 6039G must be filed annually by an expatriate for each of the ten years that the expatriate is subject to the alternative tax regime.[278]

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[270] *Id.* (codified as amended at I.R.C. § 877(c)(3)(A)).

[271] *Id.* (codified as amended at I.R.C. § 877(c)(3)(B)).

[272] *Id.* (codified as amended at I.R.C. § 877(c)(3)(C)).

[273] § 804(a)(2), 118 Stat. at 1569-70 (codified as amended at I.R.C. § 877(c)(3)(D)).

[274] *See* H.R. REP. NO. 108-548, pt. 1, at 62–64 (2004).

[275] § 804(b), 118 Stat. at 1570 (adding I.R.C. § 7701(n)).

[276] § 804(e)(2), 118 Stat. at 1572–73 (codified as amended at I.R.C. § 6039G(b)).

[277] § 804(b), 118 Stat. at 1570 (adding new I.R.C. § 7701(n)); *see also* I.R.S. Notice 05-36, 2005-19 C.B. 1007, 1007 (stating that the Service has amended Form 8854 to mirror requirements set forth in I.R.C. §§ 7701(n) and 6039G).

[278] § 804(e), 118 Stat. at 1572–73 (codified as amended at I.R.C. § 6039G(a), (b)); H.R. REP. NO. 108-548, pt. 1, at 65.

Finally, Congress also focused on expatriates who maintain ties with the United States after expatriation.[279] I.R.C. section 877 now provides that if an expatriate is present in the United States for more than thirty days in any calendar year during the ten-year period following expatriation, the expatriate will be taxed on worldwide income as a citizen or resident of the United States.[280] An individual is considered "present" in the United States on any day in which the individual is physically present in the United States at any time during the day.[281] However, in calculating the thirty-day period, some days are disregarded:[282] a maximum of thirty days during the calendar year are disregarded if the expatriate is present in the United States to perform services for an unrelated employer,[283] or if the expatriate has certain ties to a country other than the United States.[284] To qualify for the latter exception, an expatriate must, within a reasonable period, become a citizen or resident of the foreign country in which the expatriate was born or in which the expatriate's spouse or parents were born, and become fully liable for income tax in that country.[285]

B. Estate and Gift Tax Provisions

Generally, the gross estates of a U.S. citizen and resident are subject to U.S. estate tax on property, whether the property is real or personal, tangible or intangible, and regardless of its location.[286]

[279] *See* § 804(c), 118 Stat. at 1570–71 (adding I.R.C. § 877(g)); *see also* Tang, *supra* note 51, at 640 (suggesting that § 877(g) was one of the few added provisions that proved effective, because its stringent requirements prevented expatriates from enjoying significant ties to the U.S. if they hoped to avoid the alternative tax regime).

[280] § 804(c), 118 Stat. at 1570–71 (adding I.R.C. § 877(g)); I.R.S. Notice 05-36, 2005-19 C.B. 1007, 1007. In determining whether an individual has more than a minimal physical presence in the United States, the Gulf Opportunity Zone Act of 2005 clarified that, as originally intended, days spent in the United States by an individual with a medical condition that arose while in the United States and by exempt individuals, such as teachers, trainees, students, some professional athletes, and foreign government-related individuals, are excluded. Gulf Opportunity Zone Act of 2005, Pub L. No. 109-135, 119 Stat. 2577, 2628 (codified as amended at I.R.C. § 877(g)(2)(C)).

[281] § 804(c), 118 Stat. at 1570–71 (adding I.R.C. § 877(g)); I.R.C. § 7701(b)(7)(A) (defining "present"); I.R.S. Notice 05-36, 2005-19 C.B. 1007, 1007.

[282] *See* § 804(c), 118 Stat. at 1571 (adding I.R.C. § 877(g)(2)).

[283] *Id.* (adding I.R.C. § 877(g)(2)(A)). The exception does not apply if the employer is related to the individual within the meaning of I.R.C. § 267(b) or fails to meet any anti-avoidance regulation promulgated by the Secretary. *Id.*

[284] *Id.* (adding I.R.C. § 877(g)(2)(B)).

[285] *Id.*

[286] I.R.C. § 2001 (imposing such a tax and explaining its calculation); *Id.* § 2031 (defining "gross estate"); *see also id.* §§ 2033–2046 (requiring the inclusion into the gross

The gross estate of a nonresident alien is subject to the U.S. estate tax only to the extent of U.S.-situs property, including real estate and tangible property located in the United States, stock in U.S. corporations, and debt obligations of U.S. persons or government entities.[287] If an expatriate is subject to the alternative tax regime on the date of death, the definition of U.S.-situs property is expanded to include the expatriate's proportionate share of the U.S-situs property held by any foreign corporation in which the expatriate owns, directly or indirectly, "10 percent or more of the total combined voting power of all classes of stock entitled to vote" and, directly, indirectly, or constructively, "more than 50 percent of ... (A) the total combined voting power of all classes of stock entitled to vote ... or (B) the total value of the stock of such [foreign] corporation."[288]

However, as with the alternative tax regime, the JOBS Act added the restriction that, if the expatriate is present in the United States for a period of thirty days or more during any calendar year within the ten-year period following expatriation, and dies within that same calendar year, the decedent is treated as a resident of the United States for U.S. estate tax purposes.[289] Thus, all of the property of the decedent is included in the decedent's gross estate, wherever located, including foreign assets.[290]

The U.S. gift tax applies to all transfers of property made by gift during any calendar year by a U.S. citizen or resident, regardless of whether the gift was made directly or indirectly, in outright or in trust, and regardless of whether the property was real or personal, tangible or intangible.[291] The gratuitous transfers by a nonresident alien of tangible property, real and personal, situated in the United States are subject to the U.S. gift tax.[292] Transfers of U.S.-situs intangible property by nonresident aliens are

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estate of certain property interests). A credit against the federal estate tax is allowed for the amount of foreign death taxes paid on property included in the decedent's gross estate. *Id.* § 2014.

[287] *Id.* § 2101 (imposing such a tax on the transfer of property for "every decedent nonresident not a citizen of the United States"); *Id.* § 2103 (defining "gross estate"); I.R.C. § 2104 (defining "property within the United States").

[288] *Id.* § 2107(b). A limited credit was permitted for foreign estate, legacy, inheritance, or succession taxes actually paid for property included in the gross estate of an individual solely by reason of the alternative tax. *Id.* § 2107(c)(2).

[289] American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 804(a)(3), 118 Stat. 1418, 1570 (codified as amended at I.R.C. § 2107(a)).

[290] *Id.*

[291] *See* I.R.C. §§ 2501(a)(1), 2511(a).

[292] *See id.* §§ 2501(a)(1)–(2), 2511(a). The estate of a nonresident alien receives a unified credit of only $13,000 against U.S. estate tax, unless otherwise specified in an estate and gift tax treaty. *Id.* § 2102(b)(1).

generally not subject to U.S. gift tax.[293] If the nonresident alien is an expatriate subject to the alternative tax regime under I.R.C. section 877, the stock of U.S. corporations and debt obligations of U.S. persons and government entities are treated as property situated within the United States.[294] Again, if the expatriate is present in the United States for a period of thirty days or more in any calendar year that ends during the ten-year period following expatriation, the expatriate is treated as a resident of the United States for U.S. gift tax purposes.[295] Thus, all gratuitous transfers, regardless of where the property is situated, made by the expatriate in that calendar year are subject to federal gift tax.[296]

The JOBS Act addressed gifts of stock for certain closely-held foreign corporations made by an expatriate who is subject to the alternative tax regime.[297] If the gift is made during the ten-year period following expatriation, the transfer is subject to the U.S. gift tax.[298] The stock of a foreign corporation is subject to U.S. gift tax if, at the time of the transfer, the donor is subject to the alternative tax regime and the expatriate owns, directly or indirectly, "10 percent or more of the total combined voting power of all classes of stock entitled to vote" and, directly, indirectly, or constructively, "more than 50 percent of ... (I) the total combined voting power of all classes of stock entitled to vote ... or (II) the total value of stock of such [foreign] corporation."[299] The value of the stock for gift tax purposes is the expatriate's proportionate share of the U.S. asset value of the stock at the time of transfer.[300] Thus, the same inclusion rule applies to the stock of a closely-held foreign corporation for both U.S. estate tax and U.S. gift tax purposes.

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[293] *Id.* § 2501(a)(2). No unified credit is allowed for gifts made during the lifetime of a nonresident alien, unless otherwise specified in an estate and gift tax treaty; however, nonresident aliens do receive the benefit of the gift tax annual exclusion. *Id.* § 2503(b)(1).

[294] § 804(d), 118 Stat. at 1571–72 (codified as amended at I.R.C. § 2501(a)). A credit is permitted for any foreign gift tax actually paid with respect to a gift subject to tax solely by reason of the alternative tax. § 804(d)(1), 118 Stat. at 1571–72 (codified as amended at I.R.C. § 2501(a)(3)(B)).

[295] § 804(c), 118 Stat. at 1570–71 (adding I.R.C. § 877(g)).

[296] *See* § 804(d), 118 Stat. at 1571–72 (codified as amended at I.R.C. § 2501(a)).

[297] *See id.*

[298] *Id.* (codified as amended at I.R.C. § 2501(a) and adding I.R.C. § 2501(a)(5)).

[299] *Id.* (codified as amended at I.R.C. § 2501(a) and adding I.R.C. § 2501(a)(5)(B)).

[300] *Id.* (codified as amended at I.R.C. § 2501(a) and adding I.R.C. § 2501(a)(5)(C)).

C. Criticisms of the Alternative Tax Regime

Since its inception, I.R.C. section 877 contained inherent problems that made administration and enforcement difficult, and provided a motivated expatriate the opportunity for tax avoidance.[301] Although the aim of Congress with each revision of I.R.C. section 877 was to eliminate these weaknesses and to strengthen the authority and consequences of the section, Congress was only moderately successful, and failed to deal with some of the more fundamental problems underlying the alternative tax regime.[302]

As discussed above, to ease the administration of the alternative tax regime,[303] the JOBS Act imposed a purely objective standard,[304] and limited the exceptions of the alternative tax regime to only dual citizenship and certain minors.[305] Further, I.R.C. section 877 no longer required an individual to seek, and the Secretary to issue, a ruling as to the tax motives of the individual in order for the individual to fall within one of the exceptions to its application.[306] Changes were also made to the reporting requirements in an effort to provide the Service with the information necessary to better administer the alternative tax regime and to monitor the compliance of expatriates.[307] Importantly, if the expatriate fails to comply with the reporting requirement, the Secretary can continue to tax the expatriate as a U.S. citizen or resident on worldwide income.[308] Further, every expatriate subject to the alternative tax regime is required to report annually for ten years.[309] Finally, the JOBS Act forced an individual who relinquished citizenship or terminated residency for tax reasons to sever their ties with the United States.[310] If such an individual is present in the

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[301] Agnew, *supra* note 186, at 76–77 (explaining three major loopholes in the original § 877); Kirsch, *supra* note 42, at 881–83 (describing the shortcomings of I.R.C. § 877 as enacted, including problems with administrability and substantive operation of the provisions).

[302] *See* Tang, *supra* note 51, at 634–35 (explaining Congress's five goals guiding the revisions for § 877 in the JOBS Act, and concluding that the amended provisions have failed to adequately achieve Congress's plan).

[303] H.R. REP. NO. 108-548, pt. 1, at 62–63 (2004) (providing the objective requirements meeting the standards for the new tax regime).

[304] § 804(a)(1), 118 Stat. at 1569 (codified as amended at I.R.C. § 877(a)).

[305] *Id.* at 1569–70 (codified as amended at I.R.C. § 877(c)).

[306] § 804(a)(2), 118 Stat. at 1569 (codified as amended at I.R.C. § 877(c)).

[307] H.R. REP. NO. 108-548, at 275–76.

[308] § 804(b), 118 Stat. at 1570 (adding new I.R.C. § 7701(n)); § 804(e)(2), 118 Stat. at 1572–73 (codified as amended at I.R.C. § 6039G(b)).

[309] § 804(e), 118 Stat. at 1572–73 (codified as amended at I.R.C. § 6039G).

[310] § 804(b), 118 Stat. at 1570 (codified as amended at I.R.C. § 7701).

United States for more than thirty days in a calendar year, the former citizen or long-term resident will be subject to U.S. taxation on worldwide income.[311]

Nevertheless, a continuing shortcoming of the alternative tax regime is the difficulty of enforcing I.R.C. section 877 against individuals living abroad with limited connection to the United States.[312] The JOBS Act did little to enforce the alternative tax against individuals who choose to leave the country without officially expatriating and choose not to comply with the U.S. tax laws.[313] Thus, any individual who simply moves away and stops paying taxes has effectively expatriated but, in doing so, remains outside of the Service's reach, as the individual and the individual's assets are outside of the United States.[314]

Another major problem with the alternative tax regime is that an expatriate can avoid the alternate tax by simply exercising patience.[315] Since its inception, I.R.C. section 877 has applied to expatriates only for a ten-year period following the date of expatriation.[316] As a result, an expatriate can merely wait ten years before realizing any income or gain from property reached by the alternative tax. One scholar referred to the expatriate who can wait for the ten-year period to lapse as a "patient expatriate."[317] Under the current version of I.R.C. section 877, patient expatriates can still wait for the ten-year period to lapse to avoid the alternative tax.[318]

Congress's reason for limiting the temporal scope of I.R.C. section 877 was, in part, because it believed that the tax revenue received for a ten-year period was sufficient remuneration for the benefits conferred on the expatriate while a citizen or long-term resident of the United States.[319] However, the effect of this time period is to create tax inequity among the expatriates subject to the alternative tax regime. First, wealthy individuals,

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[311] § 804(c), 118 Stat. at 1570–71 (adding I.R.C. § 877(g)); H.R. REP. NO. 108-548, at 253.

[312] Tang, *supra* note 51, at 638–39.

[313] *Id.*; Walker, *supra* note 14, at 591.

[314] Tang, *supra* note 51, at 638–39.

[315] *Id.* at 628.

[316] Kirsch, *supra* note 42, at 882.

[317] Agnew, *supra* note 186, at 77.

[318] Richard A. Westin, *Expatriation and Return: An Examination of Tax-Driven Expatriation by the United States Citizens, and Reform Proposals*, 20 VA. TAX REV. 75, 151 (2000).

[319] Lee, *supra* note 13, at 1079 (stating that the purpose of the legislation is to prevent expatriates from avoiding taxes on the appreciation in the value of assets during the time "they enjoyed the privileges and protections of the U.S. citizenship" (internal quotation omitted)).

and those with diversified portfolios, can wait for the ten-year period to lapse; however, individuals with fewer resources and less diversified portfolios cannot. This comparative treatment of individuals creates an unfair result, in which wealthier expatriates are able to avoid the alternative tax while less wealthy individuals, who cannot afford to be patient, are subjected to the alternative tax.[320] Further, expatriates with valuable assets can also avoid the alternative tax by borrowing against assets subject to I.R.C. section 877, in lieu of disposing of such assets during the ten-year period.[321]

Pursuant to the HEART Act, the alternative tax regime of I.R.C. section 877 will not apply to citizens relinquishing citizenship or long-term residents terminating residency after June 17, 2008.[322] Nevertheless, the alternative tax regime will continue to apply to individuals who relinquished citizenship or terminated long-term residency prior to such date for the balance of the ten-year period from relinquishment or termination.[323]

VI. HEROES EARNINGS ASSISTANCE AND RELIEF TAX ACT OF 2008

A. The History of the Mark-to-Market Regime

A renewed interest in the taxation of expatriates began with the Clinton administration proposing an exit tax in February 1995.[324] The debate launched by the Clinton administration ultimately resulted in substantial amendments to the expatriation tax, but not the enactment of an exit tax.[325]

The Clinton administration proposed an exit tax that would have applied to U.S. citizens who relinquished their citizenship and long-term residents who terminated their residency.[326] Under this proposal, former citizens and long-term residents would have been treated as having sold all

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[320] Westin, *supra* note 318, at 151.

[321] Kirsch, *supra* note 42, at 887.

[322] Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110-245, § 301(a), 122 Stat. 1624, 1643 (2008).

[323] § 301(d), 122 Stat. at 1646 (adding I.R.C. § 877(h)).

[324] Lee, *supra* note 13, at 1078.

[325] This proposal was introduced in the House as H.R. 981, 104th Cong. (1995) and in the Senate as S. 453, 104th Cong. (1995). The Clinton administration proposal was rejected in favor of Representative Archer's less drastic proposal passed by the Congress in the form of the Health Insurance Portability and Accountability Act in 1996. *See supra* text accompanying notes 140–46 (discussing the passage of the Health Insurance Portability and Accountability Act).

[326] Lee, *supra* note 13, at 1078.

of their property at fair market value on the day immediately preceding their loss of citizenship or long-term residency.[327] Any gains from this deemed sale in excess of $600,000 would have been subject to U.S. income tax.[328] Except for interests in certain qualifying retirement plans, the exit tax would have applied to all property interests that would have been included in the individual's estate under the U.S. estate tax provisions, had the individual died the day before expatriation.[329]

The Senate Finance Committee largely adopted the mark-to-market approach put forth in the Clinton administration proposal.[330] A key difference between the Clinton administration proposal and the Senate Finance Committee proposal was the Senate's decision to limit the application of the exit tax to former citizens.[331] The Senate Finance Committee proposal would not have applied to former long-term residents who terminated residency.[332]

Senator Moynihan proposed legislation similar to the Clinton administration proposal.[333] However, the Senator Moynihan proposal contained additional exceptions that would have excluded individuals who spent less than five years in the United States and expatriated prior to reaching eighteen and one-half years of age from the exit tax.[334] Although former long-term residents would have been subject to the exit tax under the Senator Moynihan proposal, former residents who had lived in the United States for fewer than eight of the fifteen years preceding the termination of their residency would have been excepted from the exit tax.[335]

During the period between the passage by Congress of HIPAA and the JOBS Act, many proposals were submitted, and, with each proposal, the exit tax became increasingly refined.[336] The version of the exit tax included in the HEART Act is largely similar to H.R. 3997, which the House

[327] *Id.*
[328] *Id.*
[329] *Id.* at 1079.
[330] The Senate Finance Committee's Proposal came in the form of H.R. 831, 104th Cong. § 6 (1995); *see* Lee, *supra* note 13, at 1080 (indicating that the Senate Finance Committee's proposal was dropped during the House-Senate Conference and replaced with a directive that the Joint Committee on Taxation complete a report on the taxation of expatriates).
[331] Lee, *supra* note 13, at 1080.
[332] *Id.*
[333] S. 700, 104th Cong. § 1 (1995).
[334] *Id.*; Lee, *supra* note 13, at 1081.
[335] S. 700, 104th Cong. § 2; Lee, *supra* note 13, at 1081.
[336] *See generally* 2003 JCT REPORT, *supra* note 220, at 177–86 (describing the proposals made by the Clinton administration, the House of Representatives, and the Senate).

and Senate considered several times in December 2007 without settling on a final version, and H.R. 3056, the Tax Collection Responsibility Act of 2007.[337] The HEART Act enacted a mark-to-market regime that was generally based on a 1995 proposal by the Clinton Administration.[338]

B. Mark-to-Market Regime

I.R.C. section 877A imposes a mark-to-market tax on U.S. citizens who relinquish their citizenship, and on U.S. long-term residents who terminate their residency on or after June 17, 2008.[339] These individuals are subject to a one-time exit tax on the net unrealized gain in their property as if the property had been sold for its fair market value on the day before citizenship relinquishment or residency termination.[340] Generally, the gain and loss is taken into account at the time of the deemed sale, unless the individual elects to defer payment of the tax by providing security and waiving any treaty rights that would have prevented assessment or collection of the deferred tax.[341] The gain included in gross income by reason of the deemed sale is reduced by the exemption amount of \$600,000.[342] Thus, the mark-to-market tax allows the U.S. government to collect tax that would have been due had the former U.S. citizen or resident sold their assets, rather than moving their assets outside the reach of the U.S. government.[343] In 2009, the Treasury Department released and

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[337] *See* Defenders of Freedom Tax Relief Act of 2007, H.R. 3997, 110th Cong.; Tax Collection Responsibility Act of 2007, H.R. 3056, 110th Cong.

[338] Steven J. Arsenault, *Surviving a HEART Attack: Expatriation and the Tax Policy Implications of the New Exit Tax*, 24 AKRON TAX J. 37, 38 (2009); Michael G. Pfeifer, *The Current State of Expatriation*, *in* EST. PLAN. & ADMIN., at 249, 253 & n.6 (PLI Tax L. & Est. Plan. Course Handbook Ser., 2008).

[339] Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110-245, 122 Stat. 1624, 1624; STAFF OF J. COMM. ON TAX'N, 110TH CONG., TECHNICAL EXPLANATION OF H.R. 6081, THE "HEROES EARNINGS ASSISTANCE AND RELIEF TAX ACT OF 2008," AS SCHEDULED FOR CONSIDERATION BY THE HOUSE OF REPRESENTATIVES ON MAY 20, 2008, at 45–46 (2008) [hereinafter 2008 JCT EXPLANATION] (providing that § 877A is effective for any individual whose expatriation date is on or after the date of enactment of the HEART Act).

[340] I.R.C. § 877A(a)(1); 2008 JCT EXPLANATION, *supra* note 339, at 39; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 1.

[341] I.R.C. § 877A(a)(2), (b); 2008 JCT EXPLANATION, *supra* note 339, at 39–42; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 1.

[342] I.R.C. § 877A(a)(3); 2008 JCT EXPLANATION, *supra* note 339, at 39; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 1.

[343] *See* Arsenault, *supra* note 338, at 52.

published Notice 2009-85, providing guidance to individuals who are subject to I.R.C. section 877A.[344]

The amount of tax revenue that will be generated from a mark-to-market regime will depend on the number of individuals expatriating, and the net worth of those individuals. According to the Joint Committee, the mark-to-market regime, implemented by the HEART Act, is projected to generate $411 million over a ten-year period.[345]

1. Covered Expatriates

Pursuant to I.R.C. section 877A, the term "expatriate" refers to a U.S. citizen who relinquishes citizenship or a long-term resident who ceases to be a lawful permanent resident of the United States.[346] The term "expatriation date" refers to the date on which an individual relinquishes U.S. citizenship or the date on which an individual ceases to be a lawful permanent resident of the United States.[347] Under the HEART Act, a U.S citizen continues to be treated as a U.S. citizen for tax purposes until citizenship is relinquished.[348] Relinquishment of citizenship is deemed to have occurred on the earliest of four possible dates: (1) "the date the individual renounces ... [U.S.] nationality before a diplomatic or consular officer of the United States pursuant to [a specified provision] of the Immigration and Nationality Act,"[349] provided the voluntary relinquishment is later approved by the issuance of a certificate of loss of nationality by the State Department; (2) "the date the individual furnishes to the ... Department of State a signed statement of voluntary relinquishment of [U.S.] nationality confirming the performance of an act of expatriation specified in ... the Immigration and Nationality Act,"[350] provided the voluntary relinquishment is later approved by the issuance of a certificate of loss of nationality

[344] I.R.S. Notice 09-85, 2009-45 I.R.B. 598.

[345] 2008 JCT EXPLANATION, *supra* note 339 (predicting annual revenue over a ten-year period: $10 million in 2008; $56 million in 2009; $52 million in 2010; $48 million in 2011; $44 million in 2012; $39 million in 2013; $34 million in 2014; $29 million in 2015; $31 million in 2016; 33 million in 2017; $35 million in 2018).

[346] I.R.C. § 877A(g)(2).

[347] *Id.* § 877A(g)(3).

[348] Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110-245, § 301(c), 122 Stat. 1624, 1646.

[349] I.R.C. § 877A(g)(4)(A) (referring to § 349(a), para. (5) of the Immigration and Nationality Act as codified at 8 U.S.C. § 1481(a)(5)).

[350] *Id.* § 877A(g)(4)(B) (referring to specifications outlined in § 349(a), paras. (1), (2), (3), and (4) of the Immigration and Nationality Act as codified at 8 U.S.C. § 1481(a)(1)–(4)).

by the State Department;[351] (3) "the date the ... Department of State issues ... a certificate of loss of nationality;"[352] or (4) "the date a [U.S.] court ... cancels a naturalized citizen's certificate of naturalization."[353] An expatriate subject to the mark-to-market regime continues to be treated as a U.S. citizen or long-term resident for federal tax purposes until any statement required by I.R.C. section 6039G is provided, and the U.S. citizen gives notice of an expatriating act to the Secretary of State or the U.S. long-term resident gives notice of termination of residency to the Secretary of Homeland Security.[354]

The term "long-term resident" has the same meaning as under the alternative tax regime.[355] A long-term resident is an individual who has been a lawful permanent resident of the United States in at least eight of the previous fifteen taxable years, ending with the taxable year that includes the expatriation date.[356] Under the HEART Act, a U.S. long-term resident continues to be treated as a long-term resident for tax purposes until "the individual ceases to be a lawful permanent resident of the United States within the meaning of [I.R.C.] section 7701(b)(6),"[357] which occurs when the individual "loses his or her green card status through revocation or has been administratively or judicially determined to have abandoned such status."[358] Under I.R.C. section 7701(b)(6), as amended by the HEART Act, a U.S. long-term resident also ceases to be a lawful resident of the United States if the individual, under the provisions of a tax treaty, begins

[351] *Id.* § 877A(g)(4).

[352] *Id.*

[353] *Id.*; 2008 JCT EXPLANATION, *supra* note 339, at 41; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 2(A).

[354] Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110-245, § 301(c)(2)(C), 122 Stat. 1624, 1646 (striking I.R.C. § 7701(n)); *see also supra* text accompanying notes 274–78 (describing the information reporting and notification requirements of I.R.C. §§ 6039G and 7711(n)).

[355] 2008 JCT EXPLANATION, *supra* note 339, at 40.

[356] I.R.C. § 877A(g)(5) (citing I.R.C. § 877(e)(2)); 2008 JCT EXPLANATION, *supra* note 339, at 37; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 2(A).

[357] I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 2(A); *see also* I.R.C. § 877A(g)(3)(B); 2008 JCT EXPLANATION, *supra* note 339, at 38, 41.

[358] 2008 JCT EXPLANATION, *supra* note 339 at 40. "Holding a green card for any one day [of the] taxable year is sufficient for that year to count towards the eight-year [residency requirement]." Alexis M. Petas & Brian Wainwright, *Significant Changes to U.S. Taxation of Expatriating Citizens and Long-Term Residents*, PILLSBURY WINTHROP INT'L TAX BULL. (July 2008), *available at* http://pmstax.com/intl/expat0807.shtml. Nevertheless, if an individual is a U.S. resident during the taxable year but does not hold a green card on any day during the taxable year, that year will not count towards the eight-year residency requirement. *Id.*

to be treated as a resident of the treaty partner, does not waive the benefits of the tax treaty, and notifies the Secretary of such treatment.[359]

The term "covered expatriate" under the HEART Act imposes the same thresholds as those established under the alternative tax regime.[360] A covered expatriate includes an expatriate who has an average annual net income tax liability greater than $124,000 for the five previous years ending before the expatriation date,[361] has a net worth of $2 million or more on the date of expatriation, or fails to certify under penalty of perjury that all U.S. income tax obligations for the five preceding years have been met or to submit evidence of compliance as required by the Secretary.[362] Thus, an expatriate who does not satisfy the tax liability test or the net worth test may still be classified as a covered expatriate if that expatriate fails to comply with the certification test.[363]

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[359] *See* § 301(c)(2)(B), 122 Stat. at 1646 (adding I.R.C. § 7701(b)(6) flush language); 2008 JCT EXPLANATION, *supra* note 339, at 40; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 2(A). A U.S. long-term resident who ceases to be a lawful resident of the United States under the provisions of a tax treaty between the United States and a foreign country and who does not waive the benefits of the tax treaty must notify the Secretary of such treatment on Forms 8833 and 8854. I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 4, ex. 8. The date of termination of lawful permanent residency by a long-term resident, under the "tie breaker" provisions of a tax treaty, occurs when the individual's foreign residence commences for tax treaty purposes and not the date that notice of such commencement is provided to the Service. *Id.*

[360] I.R.C. § 877A(g)(1)(A) (defining covered expatriates by reference to I.R.C. § 877(a)(2)(A)–(C)). For guidance as to whether an individual is a covered expatriate by reason of the tax liability test or the net worth test, reference should be made to I.R.S. Notice 97-19, 1997-1 C.B. 394, § III; *see also* I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 2(B). If the covered expatriate is a U.S. citizen or long-term resident for only part of the taxable year, the covered expatriate must file a dual-status return, which requires the covered expatriate to file a Form 1040 NR, with a Form 1040 attached as a schedule. I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 8(B). For subsequent years, a covered expatriate must file Form 1040 NR, unless the covered expatriate is fully withheld at source and does not have income effectively connected with the conduct of a trade or business in the United States. *Id.*

[361] I.R.C. § 877(a)(2)(A). The amount adjusted for inflation is $139,000 for 2008 (Rev. Proc. 07-66, 2007-45 I.R.B. 970, § 3.29), and $145,000 for 2009 (Rev. Proc. 08-66, 2008-45 I.R.B. 1107, § 3.26) and 2010 (Rev. Proc. 09-50, 2009-45 I.R.B. 617, § 3.26).

[362] I.R.C. § 877A(g)(1)(A) (referencing I.R.C. § 877(a)(2)); 2008 JCT EXPLANATION, *supra* note 339, at 40; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 2(A). To satisfy the "certificate test," the covered expatriate must file a Form 8854 in order to certify, under penalty of perjury, that he or she has complied with all federal tax laws during the five years preceding the year of expatriation. I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 8(C).

[363] Kevin E. Packman & Summer A. LePree, *IRS Provides Some Guidance on the New Expatriation Exit Tax*, 112 J. TAX'N 145, 145 (2010).

Nevertheless, the HEART Act did modify the prior law exceptions to the tax liability test and net worth test for certain dual citizens and individuals relinquishing U.S. citizenship before the age of eighteen and one-half.[364] Under the HEART Act, an individual satisfying either the tax liability test or the net worth test will not be treated as a covered expatriate if: (1) the expatriate is born with citizenship in both the United States and another country, and, as of the expatriation date, continues to be a citizen of the other country and is taxed as a resident of the other country, and has been a resident of the United States[365] for no longer than ten taxable years during the fifteen-year span, which ends with the taxable year of the expatriation; and (2) the expatriate relinquishes U.S. citizenship before he or she is eighteen and one-half years, and has not been a resident of the United States, as determined under the substantial presence test,[366] for more than ten years prior to the expatriation date.[367]

2. Exit Tax

Under I.R.C. section 877A, a mark-to-market tax is imposed on all property owned by a covered expatriate as if the property had been sold for its fair market value on the day before the expatriation date.[368] Any gain from the deemed sale is taken into account at that time without regard to other provisions of the I.R.C.,[369] but any loss from the deemed sale is taken into account at that time only to the extent otherwise provided in the I.R.C.[370] Thus, as to gains, exclusions and nonrecognition provisions gen-

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[364] I.R.C. § 877(c).

[365] The term "residency" is defined using the substantial presence test set forth in I.R.C. § 7701(b)(1)(A)(ii). *Id.* § 877A(g)(1)(B)(i) (citing I.R.C. § 7701(b)(1)(A)(ii)); 2008 JCT EXPLANATION, *supra* note 339, at 40; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 2(A); *see also supra* note 20 (defining the term "substantial presence" under I.R.C. § 7701(b)(1)(A)(ii)).

[366] I.R.C. §§ 877A(g)(1)(B), 7701(b)(1)(A)(ii).

[367] *Id.* § 877A(g)(1)(B); 2008 JCT EXPLANATION, *supra* note 339, at 40; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 2(A).

[368] I.R.C. § 877A(a)(1).

[369] *Id.* § 877A(a)(2)(A); 2008 JCT EXPLANATION, *supra* note 339, at 39; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 1. Notwithstanding any other provision of the I.R.C., "any time period for acquiring property [that] would result in the reduction [of recognized gain] ... with respect to [the disposition of property] terminate[s] on the day before the expatriation date and ... any extension of time for the payment of tax [ceases]." I.R.C. § 877A(h)(1). Examples of such provisions include like-kind exchanges and involuntary conversions. I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 4.

[370] I.R.C. § 877A(a)(2)(B); 2008 JCT EXPLANATION, *supra* note 339, at 39; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 1. However, the wash sales rules of I.R.C. § 1091 do

erally are ignored, and, as to losses, disallowance and nonrecognition provisions generally prevent losses from being taken into account.[371] The net gain on the deemed sale is reduced by $600,000, with annual inflation adjustments after 2008.[372] To determine the tax imposed by I.R.C. section 877A(a), the basis of property held by a long-term resident is treated as not less than the fair market value of the property on the date that the individual first became a United States resident.[373]

Generally, unless the property is excluded property under I.R.C. section 877A(c),[374] a covered expatriate is considered to own any interest in property that would have been taxable as part of the covered expatriate's gross estate for U.S. estate tax purposes, without consideration of any credits against tax under I.R.C. sections 2010 through 2016.[375] A covered expatriate is also deemed to own any beneficial interests in trusts that might not otherwise have been included as part of the covered expatriate's

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not apply. I.R.C. § 877A(a)(2)(B); *see also id.* § 1091 (disallowing a loss from the wash sales of stock or securities).

[371] GUSTAFSON ET AL., *supra* note 24, at 54. The amount of any gains or losses later realized by a former U.S. citizen or long-term resident is adjusted for gain or loss taken into account upon expatriation without regard to the amount excluded. I.R.C. § 877A(a)(2); 2008 JCT EXPLANATION, *supra* note 339, at 39; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 1.

[372] I.R.C. § 877A(a)(3); 2008 JCT EXPLANATION, *supra* note 339, at 39; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 1. The exclusion amount for tax years beginning in 2009 is $626,000. Rev. Proc. 08-66, 2008-45 I.R.B. 1107, § 3.27. The exclusion amount for tax years beginning in 2010 is $627,000. Rev. Proc. 2009-50, 2009-45 I.R.B. 617, § 3.27.

[373] I.R.C. § 877A(h)(2); 2008 JCT EXPLANATION, *supra* note 339, at 44; I.R.S. Notice 2009-85, 2009-45 I.R.B. 598, § 3(D). A former U.S. resident may make an irrevocable election, on a property-by-property basis, not to apply the step-up-in-basis rule. I.R.C. § 877A(h)(2); 2008 JCT EXPLANATION, *supra* note 339, at 41; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(D). The date on which a nonresident alien first becomes a resident of the United States is determined pursuant to I.R.C. § 7701(b). I.R.C. § 877A(h)(2); I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(D). The election must be made on Form 8854. I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(D). The Service and the Treasury Department intend to exclude U.S. real property interests from the step-up-in-basis rule, within the meaning of I.R.C. § 897(c), and property used in the conduct of a trade or business within the United States. *Id.* Nevertheless, if "prior to becoming a [U.S. resident], the nonresident alien was a resident of a country with which the United States had an income tax treaty ... [and] held property used ... [in a] trade or business ... not carried on through a permanent establishment in the United States, ... [the] property [will not be excluded from the step-up-in-basis rule]." *Id.*

[374] Generally, I.R.C. § 877A(c) excepts from the mark-to-market regime any deferred compensation item as defined in I.R.C. § 877A(d)(4), any specified tax deferred account as defined in I.R.C. § 877A(e)(2), and any interest in a nongrantor trust as defined in I.R.C. § 877A(f)(3).

[375] I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(A).

gross estate.[376] The fair market value of each interest in property is to be determined "as of the day before the expatriation date in accordance with the valuation principles applicable for purposes of the Federal estate tax."[377] The fair market value of each beneficial interest in a trust that would not have been included in the gross estate is determined by U.S. gift tax valuation principles.[378] An interest in a life insurance policy is valued "as if the covered expatriate had made a gift of the policy on the day before the expatriation date."[379]

Deferred compensation items, specified tax deferral accounts, and interests in a nongrantor trust are excepted from the mark-to-market regime and are subject to treatment under special rules.[380] A "deferred compensation item" means any interest in a qualified plan or other arrangement described in I.R.C. section 219(g)(5),[381] "any interest in a foreign pension

[376] *Id.* "If the covered expatriate is deemed to be the owner of a trust under the grantor trust rules, all of the assets held by the trust (which the covered expatriate is deemed to own) also are subject to the mark-to-market tax." Packman & LePree, *supra* note 363, at 146. Property considered owned through a nongrantor trust is included for the purposes of the net worth test for covered expatriate status. *See* I.R.S. Notice 97-19, 1997-1 C.B. 394, § III (establishing special rules for determining beneficial interests in trusts for the purposes of the net worth test). Such property is not considered owned for the purposes of the deemed sale "because beneficial interests in non-grantor trusts, as well as deferred compensation items and specified tax deferred accounts, are expressly excepted from the operation of the mark-to-market tax." Pfeifer, *supra* note 14, at 609.

[377] I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(A).

[378] *Id.*

[379] *Id.*

[380] I.R.C. § 77A(c).

[381] 2008 JCT EXPLANATION, *supra* note 339, at 42.

> (1) *Deferred compensation item* means:
>
> a. Any interest in a plan or arrangement described in [I.R.C.] section 219(g)(5), which means:
>
> i. a plan described in [I.R.C.] section 401(a) that includes a trust exempt from tax under [I.R.C.] section 501(a),
>
> ii. an annuity plan described in [I.R.C.] section 403(a),
>
> iii. a plan established for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing, but excluding an eligible deferred compensation plan (within the meaning of [I.R.C.] section 457(b)),
>
> iv. an annuity contract described in [I.R.C.] section 403(b),
>
> v. a simplified employee pension (within the meaning of [I.R.C.] section 408(k)),
>
> vi. a simplified retirement account (within the meaning of [I.R.C.] section 408(p)), or
>
> vii. a trust described in [I.R.C.] section 501(c)(18).

I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 5(B).

plan or similar retirement arrangement or program,"[382] "any item of deferred compensation,"[383] and "any property, or right to property, which the individual is entitled to receive in connection with the performance of services to the extent not previously taken into account under [I.R.C.] section 83."[384] Although an eligible deferred compensation item is not subject to the mark-to-market regime,[385] the payor must deduct and withhold a tax equal to thirty percent of any taxable payment[386] that is made to a covered expatriate.[387] The term "eligible deferred compensation item" refers to any deferred compensation item with respect to which the payor is either a U.S. person or a non-U.S. person who "elects to be treated as a [U.S.] person for the purposes of [withholding]"[388] and who meets the requirements prescribed by the Secretary to ensure compliance with the withholding requirements, "notifies the payor of his status as a covered expatriate," and irrevocably waives any claim of withholding reduction under any tax treaty with the United States.[389] If the deferred compensation item is not an eligible deferred compensation item, the "covered expatriate generally is treated as having received an amount equal to the present value of the covered expatriate's accrued benefit on the day before the expatriation date."[390] These rules do not apply to any deferred compensation item that is "attributable to services performed outside the United States [by the covered expatriate] while the ... expatriate was not a citizen or resident of the United States."[391]

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[382] I.R.C. § 877A(d)(4)(B).

[383] *Id.* § 877A(d)(4)(C).

[384] *Id.* § 877A(d)(4)(D). Generally, I.R.C. § 83 requires the inclusion of the fair market value of property received for the performance of services, less any amount paid for such property, to be included in gross income of the service provider in the first taxable year in which such property is transferable or not subject to substantial risk of forfeiture. *Id.* § 83(a). The person who performed the services may elect inclusion in gross income in the taxable year in which the property was transferred. *Id.* § 83(b).

[385] *Id.* § 877A(c)(1), (d) (Supp. III 2010).

[386] The term "taxable payment" means any payment that would have been "includ[ed] in the gross income ... if [the covered] expatriate continued to be subject to tax as a citizen or resident of the United States." I.R.C. § 877A(f)(2).

[387] *Id.* § 877A(d)(1)(A).

[388] *Id.* § 877A(d)(3).

[389] *Id.*

[390] I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 1; *see also* I.R.C. § 877A(d)(2); 2008 JCT EXPLANATION, *supra* note 339, at 42. No early distribution tax is assessed and appropriate adjustments will be made to subsequent distributions. I.R.C. § 877A(d)(2).

[391] I.R.C. § 877A(d)(5); 2008 JCT EXPLANATION, *supra* note 339, at 43; *see also* I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 5 (detailing the treatment of deferred compensation items).

"Specified tax deferred accounts" are also exempted from the mark-to-market regime and are subject to special rules.[392] If a covered expatriate holds any interest in an individual retirement account and certain education and health savings accounts,[393] the "covered expatriate is treated as having received a distribution of the ... entire interest in such account on the day before the expatriation date."[394] No early distribution tax is assessed and appropriate adjustments will be made to subsequent distributions.[395]

Finally, the mark-to-market regime does not apply to a nongrantor trust.[396] A trust is a "nongrantor trust" if the covered expatriate is not treated as the beneficial owner of any portion of the trust under the grantor trust provisions of the I.R.C. immediately before the expatriation date.[397] In the case of any direct or indirect distribution from a nongrantor trust to a covered expatriate, the trustee must "deduct and withhold from such distribution an amount equal to thirty percent of the taxable portion[398] of the distribution."[399] "If the fair market value of ... property [distributed] exceeds its adjusted basis," gain is "recognized to the trust as if [the] property were sold" by the trust and the proceeds distributed to the covered expatriate.[400] "The covered expatriate is treated as having waived any right

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392 I.R.C. § 877A(c)(2), (e). "A covered expatriate who has a deferred compensation item, a specified tax deferral account, or an interest in a nongrantor trust must file form W–8CE with the relevant payor." I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 8(D).

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> [T]he term "specified tax deferral account" means [(1)] an individual retirement plan (as defined in [I.R.C.] section 7701(a)(37)), ... [(2)] a qualified tuition program (as defined in [I.R.C.] section 529), [(3)] a Coverdell education savings account (as defined in [I.R.C.] section 530), [(4)] a health savings account (as defined in [I.R.C.] section 223), and [(5)] an Archer MSA (as defined in [I.R.C.] section 220).

I.R.C. § 877A(e)(2); *see also id.* §§ 220, 223, 529, 530, 7701(37).

394 I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 1; *see also* I.R.C. § 877A(e)(1); 2008 JCT EXPLANATION, *supra* note 339, at 43; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 6 (detailing the treatment of specified tax deferral accounts).

395 I.R.C. § 877A(e)(1).

396 *Id.* § 877A(c)(3), (f).

397 *Id.* § 877A(f)(3); 2008 JCT EXPLANATION, *supra* note 339, at 43–44; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 1; *see also* I.R.C. §§ 671–679 (establishing the retained interest that will result in the grantor of a trust being treated as the owner of the corpus for federal income tax purposes).

398 The term "taxable portion" refers to that portion of the distribution that would have been included in gross income if the covered expatriate "continued to be subject to tax as a citizen or resident of the United States." I.R.C. § 877A(f)(2).

399 *Id.* § 877A(f)(1)(A) (footnote added).

400 *Id.* § 877A(f)(1)(B). If the covered expatriate is treated as the beneficial owner of any portion of the trust under the grantor trust provisions, the assets held by that portion

to claim any reduction in withholding under any [tax] treaty with the United States."[401]

If "a covered expatriate becomes subject to tax as a [U.S.] citizen or resident ... for any period ... after the expatriation date," the mark-to-market regime does not apply to the "covered expatriate during that period for the purposes of applying the withholding rules relating to deferred compensation items, the rules relating to interests in nongrantor trusts, and the rules relating to gifts and bequests from covered expatriates."[402] Nevertheless, the mark-to-market tax and other provisions are "retriggered" with a new expatriation date.[403]

3. Allocation of Exclusion Amount and Adjustment to Basis

The mark-to-market regime subjects a covered expatriate to federal income tax on unrealized gain by treating all the property of the covered expatriate as sold for its fair market value on the day before the expatriation date.[404] However, the amount taken into gross income from the deemed sale is reduced by $600,000, annually adjusted for inflation after 2008.[405] The basis for property subject to the mark-to-market tax is adjusted by the amount of gain or loss taken into account under the mark-to-market regime without regard to the exclusion amount attributable to the property.[406]

The exclusion amount "must be allocated among all built-in gain property that is subject to the mark-to-market [tax] ... regardless of whether the covered expatriate makes an election to defer tax with respect to any such property."[407] "Specifically, the exclusion amount [is] allocated pro-rata to each ... 'gain asset' by multiplying the exclusion amount by the ratio of built-in gain with respect to each gain asset over the total built-in gain of

of the trust are subject to the mark-to-market regime. *Id.* §§ 671–679; 2008 JCT EXPLANATION, *supra* note 339, at 43–44; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 1.

401 2008 JCT EXPLANATION, *supra* note 339, at 44; *see also* I.R.C. § 877A(f)(4)(B); I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 7(A) (detailing the treatment of interests in nongrantor trusts).

402 2008 JCT EXPLANATION, *supra* note 339, at 41.

403 Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110-245, § 301(g), 122 Stat. 1624, 1647; 2008 JCT EXPLANATION, *supra* note 339, at 41.

404 I.R.C. § 877A(a)(1); JCT EXPLANATION, *supra* note 339, at 39; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 1.

405 I.R.C. § 877A(a)(3); 2008 JCT EXPLANATION, *supra* note 339, at 39; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 1.

406 I.R.C. § 877A(a); 2008 JCT EXPLANATION, *supra* note 339, at 39; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(C).

407 I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(B).

all gain assets."[408] The exclusion amount allocated to each gain asset cannot "exceed the amount of that asset's built-in gain," and, if the aggregate built-in gain is "less than the exclusion amount, then the exclusion amount that can be allocated to all gain assets [is] limited to the [aggregate built-in gain]."[409]

Furthermore, an individual is limited to only one lifetime exclusion amount.[410] If a covered expatriate again becomes a U.S. citizen or long-term resident, and again relinquishes citizenship or ceases to be a lawful resident, "the exclusion amount with respect to the ... second expatriation is limited to the unused portion of ... [the] exclusion amount remaining (if any) after the first expatriation."[411] For example, if the covered expatriate uses one-third of the exclusion amount for the first expatriation, two-thirds of the exclusion amount, adjusted for inflation, is available in the event of a second expatriation.[412]

Notice 2009-85 provides examples relating to the allocation of the exclusion amount and the adjustment to the basis of property subject to the mark-to-market regime.[413] The first three examples are summarized as follows:

> **Example 1:** In 2009, *A*, a covered expatriate, owned three assets that had the following built-in gains and losses on the day before *A*'s expatriation date: Asset *X* with a built-in gain of $1,800,000, Asset *Y* with a built-in gain of $200,000, and Asset *Z* with a built-in loss of $300,000. The 2009 exclusion amount of $626,000 is prorated between the two gain assets by the ratio of the built-in gain on each gain asset over the total built-in gain on all gain assets subject to I.R.C. section 877A(a). Thus, the amount included in gross income by *A* with respect to Asset *X* is $1,236,600 ($1,800,000 built-in gain minus the ratable portion of the exclusion amount of $563,400 (($1,800,000 ∗ $626,000) / $2,000,000)) and with respect to Asset *Y* is $137,400 ($200,000 built-in gain minus the ratable portion of the exclusion amount of $62,600 (($200,000 ∗ $626,000)/$2,000,000)).[414]

[408] *Id.*
[409] *Id.*
[410] *Id.*
[411] *Id.*
[412] *Id.*
[413] *See* I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(B), (C) (providing guidance for expatriates under I.R.C. § 877A, including the "allocation of the exclusion amount" and the "adjustment to basis of property subject to the mark-to-market regime").
[414] *Id.* § 3, ex. 1.

Example 2: The facts are the same as Example 1, except Asset *X* had a built-in gain of only $300,000. The total built-in gain of $500,00 (Asset *X* built-in gain of $300,000 plus Asset *Y* built-in gain of $200,000) is less than the exclusion amount of $626,000; therefore, *A* does not recognize any gain as a result of I.R.C. section 877A(a). Assuming the built-in loss of $300,000 on Asset *Z* is a capital loss, *A*'s use of the capital loss will be limited by the loss limitation provisions of the I.R.C., including I.R.C. section 1211(b).[415]

Example 3: The facts are the same as in Example 1, with the added assumption that Asset *X* with a built-in gain of $1,800,000 and Asset *Z* with a built-in loss of $300,000 are U.S. real property interests within the meaning of I.R.C. section 897(c).[416] In 2013, *A*, now a nonresident alien, sells Asset *X* for $3,000,000 and Asset *Z* for $700,000. For U.S. tax purposes, *A* recognizes $1,000,000 gain on the sale of Asset *X* ($3,000,000 amount realized minus $2,000,000 adjusted basis ($200,000 original basis plus $1,800,000 built-in gain deemed recognized under I.R.C. section 877A(a))) and $200,000 gain on the sale of Asset *Z* ($700,000 amount realized minus $500,000 adjusted basis ($800,000 original basis minus $300,000 built-in loss deemed recognized under I.R.C. section 877A(a))). On the disposition of Asset *X*, *A*'s basis is adjusted by the entire built-in gain of $1,800,000, without regard to the $563,400 exclusion amount allocated to Asset *X*.[417]

Thus, a portion of the exclusion amount is prorated to its relative built-in gain, with the basis of the gain asset increased by the entire built-in gain, thereby making the exclusion permanent.

4. Election to Defer Tax

A covered expatriate may make a "deferral election" with respect to any tax imposed on the deemed sale of property under the mark-to-market regime.[418] The deferral election is irrevocable[419] and made on an asset-by-

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[415] *Id.* § 3, ex. 2. Generally, under I.R.C. § 1211(b), capital losses are allowed only to the extent of capital gains, plus, if capital losses exceed capital gains, the lower of $3,000 or the excess of capital losses over capital gains. I.R.C. § 1211(b).

[416] Generally, under I.R.C. § 897, foreign persons will recognize gain or loss on the disposition of real property located in the United States. I.R.C. § 897.

[417] I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3, ex. 3.

[418] I.R.C. § 877A(b); 2008 JCT EXPLANATION, *supra* note 339, at 41; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(E). A covered expatriate who makes a deferral election must enter into a tax deferral agreement with the Service. I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(E). A template of a tax deferral agreement is provided in Appendix A of Notice 2009-45. *Id.* at app. A.

[419] I.R.C. § 877A(b)(6); 2008 JCT EXPLANATION, *supra* note 339, at 44; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(E).

asset basis.[420] If a deferral election is made, the individual is allowed to defer payment of the additional tax that would otherwise be imposed on the deemed sale of the deferral asset.[421] Under the election, payment of the additional tax is deferred until the earliest of two dates: either the due date of the return for the taxable year in which the property is disposed of by sale, nonrecognition transaction, gift, or other disposition; or the taxable year that includes the death of the covered expatriate.[422] The "additional tax" imposed on a particular property is determined by multiplying the total mark-to-market tax by the ratio of the gain on the deemed sale of said property over the total gain taken into account with respect to all property deemed sold.[423] Interest is charged during the deferment period at the rate normally applied to individual underpayments of tax as set forth in I.R.C. section 6601.[424]

To make the election with respect to a particular property, the covered expatriate must irrevocably waive any rights under a U.S. tax treaty that would preclude the assessment or collection of the tax imposed by reason of I.R.C. section 877A.[425] In addition, the covered expatriate must provide adequate security.[426] The term "adequate security" is defined as a bond furnished to and accepted by the Secretary, conditioned on the payment of the tax and interest, which meets the requirements of I.R.C. section 6325,[427] or any other form of security that meets the requirements of the Secretary, such as letters of credit.[428] "If the [Service] subsequently determines that the security provided for the deferred tax no longer qualifies as adequate security, the deferred tax and interest become immediately

[420] I.R.C. § 877A(b)(2); 2008 JCT EXPLANATION, *supra* note 339, at 41; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(E).

[421] I.R.C. § 877A(b)(1).

[422] *Id.* § 877A(b)(1), (3); 2008 JCT EXPLANATION, *supra* note 339, at 41; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(E).

[423] I.R.C. § 877A(b)(2); I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(E).

[424] I.R.C. § 877A(b)(7); 2008 JCT EXPLANATION, *supra* note 339, at 41; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(E).

[425] I.R.C. § 877A(b)(5); 2008 JCT EXPLANATION, *supra* note 339, at 42; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(E). The covered expatriate must make the waiver on Form 8854. I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(E).

[426] I.R.C. § 877A(b)(4)(A); 2008 JCT EXPLANATION, *supra* note 339, at 42; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(E).

[427] *See* I.R.C. § 6325 (requiring the Service to issue a certificate of release for a notice of federal tax lien within thirty days after the date on which the tax liability has been fully satisfied or has become legally enforceable, or receipt of a bond that is conditioned upon payment of the tax liability).

[428] *Id.* § 877A(b)(4)(B); 2008 JCT EXPLANATION, *supra* note 339, at 42; I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(E).

due."[429] Finally, the covered expatriate must appoint a U.S. person to act as the covered expatriate's limited agent for the purpose of accepting any communication from the Service related to the tax deferral agreement on the covered expatriate's behalf.[430] The question of adequate security or collateral may be the largest practical issue for a covered expatriate electing to defer, as insufficient liquid assets may often be the reason for a deferral election.[431]

C. Estate and Gift Tax Provisions

The HEART Act dramatically changed the U.S. taxation of gifts and bequests made by expatriates on or after June 17, 2008, with the enactment of I.R.C. section 2801.[432] If, during any calendar year, a citizen or resident of the United States receives a covered gift or bequest from a covered expatriate,[433] the recipient must pay a "succession tax" equal to the value of the property received multiplied by the highest estate tax rate or, if greater, the highest gift tax rate.[434] The term "covered gift or bequest" includes "any property acquired by gift directly or indirectly from an individual who, at the time of such acquisition, is a covered expatriate ... [or] by reason of the death of an individual who, immediately before such death, was a covered expatriate."[435] The term does not include property that is a taxable gift by a covered expatriate shown on a timely filed gift tax return, or that is included in the gross estate of a covered expatriate

[429] I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 3(E). The covered expatriate has thirty days after the Service mails notification to correct the inadequacy. *Id.*

[430] *Id.* A template of the binding agreement between the covered expatriate that must be submitted with the deferral agreement is provided in Appendix B of Notice 2009-45. *Id.*

[431] Packman & LePree, *supra* note 363, at 148.

[432] Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110-245, § 301(b)(1), 122 Stat. 1624, 1644–46 (adding I.R.C. § 2801 (Supp. III 2010)); 2008 JCT EXPLANATION, *supra* note 339, at 45. I.R.C. § 2801 is effective for covered gifts and bequests received on or after the enactment of the HEART Act. I.R.C. § 2801; *see also supra* text accompanying notes 286–300 (describing the federal estate and gift tax treatment of U.S. citizens and resident and nonresident aliens subject to the alternative tax regime).

[433] For the purposes of I.R.C. § 2801, the term "covered expatriate" carries the same definition as is provided in I.R.C. § 877A(g)(1). *Compare* I.R.C. § 2801(f), *with id.* § 877A(g)(1).

[434] *Id.* § 2801(a), (b); § 301(b)(1), 122 Stat. at 1644–46 (adding I.R.C. § 2801); 2008 JCT EXPLANATION, *supra* note 339, at 45.

[435] I.R.C. § 2801(e)(1); § 301(b)(1), 122 Stat. at 1644–46 (adding I.R.C. § 2801); 2008 JCT EXPLANATION, *supra* note 339, at 45.

shown on a timely filed estate tax return.[436] The term also does not include property eligible for a gift or estate tax charitable or marital deduction if the donor or decedent was a U.S. person.[437]

The succession tax regime is imposed on the recipient of a covered gift or bequest to the extent the total value of the covered gifts and bequests received exceed the annual exclusion amount set forth in I.R.C. section 2503(b).[438] The tax is "reduced by the amount of any gift or estate tax paid to a foreign country with respect to [the] covered gift or bequest."[439] A covered gift or bequest made to a domestic trust is subject to tax in the same manner as a U.S. citizen; as the recipient, the trust is required to pay the tax imposed.[440] A covered gift or bequest made to a foreign trust is also subject to tax at the time a distribution attributable to the covered gift or bequest is made to a U.S. citizen or resident.[441]

Under I.R.C. section 2801, the succession tax may arise years after the expatriation date of the covered expatriate, and may include wealth generated in the United States or in the country of residence after the expatriation date.[442] The succession tax also "appears to be in addition to the existing estate and gift tax provisions applicable to nonresident aliens."[443] As a nonresident alien, a covered expatriate is "subject to estate and gift taxes on transfers of property located within the [United States], and, in addition, on transfers of property located ... outside the [United States as] ...

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[436] I.R.C. § 2801(e)(2); § 301(b)(1), 122 Stat. at 1644–46 (adding I.R.C. § 2801); 2008 JCT EXPLANATION, *supra* note 339, at 45.

[437] I.R.C. § 2801(e)(3); § 301(b)(1), 122 Stat. at 1644–46 (adding I.R.C. § 2801); 2008 JCT EXPLANATION, *supra* note 339, at 45.

[438] I.R.C. § 2801(c); § 301(b)(1), 122 Stat. at 1644–46 (adding I.R.C. § 2801); 2008 JCT EXPLANATION, *supra* note 339, at 45. The amount that a donor can exclude annually from taxable gifts made to each donee is $10,000, adjusted for inflation after 1998. The inflation-adjusted annual exclusion amount for 2009, 2010, and 2011 is $13,000. Rev. Proc. 08-66, 2008-45 I.R.B. § 2.30; Rev. Proc. 09-50, 2009-45 I.R.B. § 2.30; Rev. Proc. 10-40, 2010-46 I.R.B. § 2.21(1).

[439] I.R.C. § 2801(d); 2008 JCT EXPLANATION, *supra* note 339, at 45.

[440] I.R.C. § 2801(e)(4)(A); 2008 JCT EXPLANATION, *supra* note 339, at 45.

[441] I.R.C. § 2801(e)(4)(B)(i); 2008 JCT EXPLANATION, *supra* note 339, at 45. A deduction is allowed under I.R.C. § 164 in the amount of the succession tax paid by the U.S. citizen or resident by reason of a distribution from a foreign trust, but only to the extent the tax "is imposed on the portion of the distribution which is included in the [recipient's] gross income." I.R.C. § 2801(e)(4)(B)(ii); *see also id.* § 164(a)(3); 2008 JCT EXPLANATION, *supra* note 339, at 45. Solely for the purposes of I.R.C. § 2801, the foreign trust may elect to be treated as a domestic trust. I.R.C. § 2801(e)(4)(B)(iii); 2008 JCT EXPLANATION, *supra* note 339, at 45.

[442] Yu Hang Sunny Kwong, *Catch Me If You Can: Relinquishing Citizenship for Taxation Purposes After the 2008 HEART Act*, 9 HOUS. BUS. & TAX L.J. 411, 434–35 (2009).

[443] Arsenault, *supra* note 338, at 57.

covered gifts or bequests received by [U.S. citizens and residents]."[444] A scholar noted, "[t]his provision therefore represents a very real expansion of U.S. estate and gift taxes to reach previously untaxed assets."[445]

D. Effective Date of the Mark-to-Market Regime

Former U.S. citizens and long-term residents with expatriation dates prior to June 17, 2008 continue to be subject to the alternative tax regime under I.R.C. section 877 for the balance of their ten-year term and subject to the reporting and notification requirements of I.R.C. sections 6039G and 7701(n).[446] As a consequence, an individual subject to the alternative tax regime continues to be subject to the restriction on the number of days the individual can be present in the United States during a calendar year.[447] If an individual subject to the alternative tax regime is present in the United States on more than thirty days in any single calendar year, the alternative tax regime no longer applies, and the individual is subject to U.S. taxation on worldwide income as a U.S. resident for the tax year.[448]

The mark-to-market regime under I.R.C. section 877A applies to individuals whose expatriation date is on or after June 17, 2008.[449] The HEART Act made the reporting requirements of I.R.C. section 6039G applicable to covered expatriates for any taxable year in which I.R.C. section 877A applies.[450] Nevertheless, the thirty-day physical presence

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[444] *Id.*

[445] *Id.*

[446] I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 4. The ten-year period commences on the date the U.S. resident complies with I.R.C. § 7701(n). *Id.* Thus, if a U.S. citizen relinquishes U.S. citizenship on June 10, 2008, but does not file Form 8854 until December 12, 2009, the former U.S. citizen is subject to the rules of I.R.C. § 877 and the reporting and notification requirements of I.R.C. § 6039G and § 7701(n), as in effect prior to June 17, 2008, commencing December 12, 2009. *Id.* § 4, ex. 7. If a former U.S. long-term resident qualifies as a resident of a foreign country pursuant to a tax treaty between the United States and the foreign country on or after January 1, 2008, the former U.S. long-term resident is subject to the rules of I.R.C. § 877 and the reporting and notification requirements of I.R.C. §§ 6039G and 7701(n), as in effect prior to June 17, 2008, commencing January 1, 2008. *Id.* § 4, ex. 8.

[447] I.R.C. § 877(g)(1).

[448] *Id.* § 877(g); *see also supra* text accompanying notes 280–85 (describing the limitation on physical presence in the United States under I.R.C. § 877(g)).

[449] I.R.C. § 877(h) (Supp. III 2010); I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 4; *see also* 2008 JCT EXPLANATION, *supra* note 339, at 46.

[450] Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110-245, § 301(e)(1), (2), 122 Stat. 1624, 1646 (codified as amended at I.R.C. § 6039G(a), (d)); I.R.S. Notice 09-85, 2009-45 I.R.B. 598, § 8(A). The notice requirement of I.R.C.

restriction does not apply to covered expatriates who are subject to the mark-to-market regime; thus, covered expatriates are free to return to the United States for extended periods of time.[451]

VII. THE CONTINUING PROBLEMS

A. The Constitutionality of I.R.C. Sections 877 and 877A

Despite the partial success achieved by Congress with strengthening the administration and enforcement of I.R.C. section 877, the JOBS Act provided expatriates with a stronger basis on which to argue that the alternative tax regime is unconstitutional. Specifically, the JOBS Act imposed an objective standard for determining whether the alternative tax regime applied, an annual information return-filing requirement for a ten-year period, and U.S. taxation on worldwide income if the expatriate returned to the United States for more than thirty days in a calendar year during the ten-year period following expatriation.[452]

Some scholars have suggested "that the [U.S.] Constitution may limit the ability of the United States to impose a special tax on expatriates."[453] Although broad legislative support exists for the position that expatriation is a fundamental right,[454] the right to expatriate is not specifically recognized in the U.S. Constitution.[455] If the Supreme Court has not previously recognized a right as fundamental, "the doctrine of judicial self-restraint requires [the court] to exercise the utmost care whenever [it is] asked to break new ground in this field."[456] However, this language is not necessarily dispositive, as the Supreme Court has recognized that not all of the fundamental rights are listed in the U.S. Constitution.[457] The Supreme Court has developed numerous tests to determine whether a right is "fun-

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§ 7701(n) does not apply to covered expatriates subject to I.R.C. § 877A. § 301(c)(2)(C), 122 Stat. at 1646 (striking I.R.C. § 7701(n) (Supp. III 2010)).

[451] I.R.C. § 877(g)(2).

[452] *See supra* text accompanying notes 262–85 (describing amendments to I.R.C. § 877 by the JOBS Act).

[453] Walker, *supra* note 14, at 576.

[454] *Id.*; *see also* Carter, *supra* note 228, at 859–60 (arguing that expatriation is a fundamental right protected by the U.S. Constitution).

[455] Walker, *supra* note 14, at 576–77 (taking the position that expatriation is not a fundamental right because it is not found in the U.S. Constitution).

[456] Reno v. Flores, 507 U.S. 292, 302 (1993) (internal citations omitted).

[457] Marbury v. Madison, 5 U.S. (1 Cranch) 137, 178 (1803) (establishing implied right of judicial review); Carter, *supra* note 228, at 844–45 & n.93 (citing to the U.S. CONST., amend. IX) ("The enumeration in the Constitution of certain rights, shall not be construed to deny or disparage others retained by the people.").

damental," and one such test is "whether the right has been traditionally recognized as fundamental in American society."[458]

Congress recognized the right of expatriation when it enacted the Expatriation Act of 1868.[459] Before the enactment of the Expatriation Act, the United States followed the English doctrine of perpetual allegiance, which disallowed expatriation.[460] However, many Americans objected to this doctrine because they believed that the doctrine disregarded the U.S. Constitution and the fundamental principles of the United States.[461] The Expatriation Act begins by stating that:

> [T]he right of expatriation is a natural and inherent right of all people, indispensable to the enjoyment of the rights of life, liberty, and pursuit of happiness; ... [thus,] any declaration, instruction, opinion, order, or decision of any officers of this Government which denies, restricts, impairs or questions the right of expatriation, is hereby declared inconsistent with the fundamental principles of this government.[462]

Notwithstanding the Expatriation Act of 1868, one scholar states that, "tax imposed in connection with expatriation should not, as a general matter, violate the Constitution even if it significantly burdens expatriation, because it is very doubtful that the right to expatriate itself enjoys any specific constitutional protection."[463] A distinction is made between the right to expatriate (that is, relinquish U.S. citizenship) and the right to travel internationally (that is, physically leave the United States). The latter right is arguably more fundamental to personal liberty and may logically encompass a right to emigrate (that is, terminate physical residency). A concurrent tax by the United States and the foreign country of residence may constitute a confiscatory tax on emigration.[464] Nevertheless, a foreign tax credit for foreign residence-based taxes imposed on the expatriate or

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[458] Carter, *supra* note 228, at 848 (quoting Russell W. Galloway, Jr., *Basic Substantive Due Process Analysis*, 26 U.S.F. L. REV. 625, 634 (1992)).

[459] Expatriation Act of 1868, 15 Stat. 223; Carter, *supra* note 228, at 842 (quoting the Expatriation Act).

[460] Carter, *supra* note 228, at 840 (arguing that opposition to the English doctrine led to the right to expatriate).

[461] *Id.*

[462] Expatriation Act of 1868, 15 Stat. 223, 223–24.

[463] Walker, *supra* note 14, at 577; *see also* Arsenault, *supra* note 338, at 61 (assuming Walker is correct that a special tax on expatriates does not violate the U.S. Constitution). *But see* Carter, *supra* note 228, at 841 (discussing expatriation as a natural right).

[464] Walker, *supra* note 14, at 577.

emigrant protects the alternative tax regime from this constitutional objection.[465]

A challenge to the alternative tax regime may rest on the general constitutional power to tax.[466] The limits of the power to tax at the federal level are few. The due process clause of "the Fifth Amendment protects against deprivation of property without due process of law."[467] However, a taxing provision "must likely be so arbitrary as to amount to a confiscation of property," to constitute a violation of substantive due process.[468] Generally, the federal government enjoys great latitude as to whether a taxing provision is arbitrary or confiscatory.[469] A tax on a former U.S. citizen or long-term resident that only preserves the power to tax income that accrued economically during the period of citizenship or residency would survive constitutional scrutiny.[470] Thus, the alternative tax regime that, for a limited period of ten years, taxes only U.S-source income and allows a foreign tax credit for any foreign taxes paid on such income would "be viewed as a revenue-raising regime which merely denies excessive tax benefits to expatriates and does not unduly burden the right of emigration."[471] Arguably, the mark-to-market regime "burdens emigration ... because it taxes, on an accelerated basis, income or gain,"[472] that may be taxed in the foreign jurisdiction of residence and does not assure a foreign tax credit.[473] Nevertheless, the intent of Congress appears to have been to protect the federal revenue; therefore, the mark-to-market regime is likely to survive a challenge on due process grounds.[474]

Perhaps a better contention is that imposing a special tax on expatriates violates international law.[475] Under Article 12 of the International Convention on Civil and Political Rights, the right to emigrate is recognized as a basic human right,[476] and, under Articles 13(2) and 15(2) of the

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[465] *Id.*

[466] *Id.* at 578 (arguing that the government's broad power to tax would allow the tax on expatriation to survive constitutional scrutiny).

[467] *Id.*

[468] *Id.* (arguing that the government's broad power to tax would allow the tax on expatriation to survive constitutional scrutiny).

[469] *Id.*

[470] Walker, *supra* note 14, at 578.

[471] *Id.*

[472] *Id.*

[473] *Id.*

[474] *Id.* (arguing that it "is constitutionally permissible [under the Due Process Clause] if it is reasonably calculated to prevent tax avoidance").

[475] Arsenault, *supra* note 338, at 61.

[476] International Covenant on Civil and Political Rights, *opened for signature* Dec. 19, 1966, 999 U.N.T.S. 171, art. 12 (entered into force Mar. 23, 1976).

Universal Declaration of Human Rights as adopted by the United Nations General Assembly on December 10, 1948, both the right to emigrate and to expatriate are protected.[477] The United States officially recognizes both the right to emigrate and the right to expatriate.[478] Although "[t]he rights to emigrate and expatriate are not ... unlimited or unqualified,"[479] the protection extends to arbitrary or unreasonable infringements that prohibit their exercise, or to conditions that are so burdensome that they amount to de facto denial of these rights.[480] Both the alternative tax regime and mark-to-market regime are not unduly burdensome as to prohibit the exercise of the right to emigrate and expatriate.[481] The Joint Committee on Taxation noted that while some U.S. citizens and long-term residents might be deterred, the exit tax is not actually required as a condition to exercising the right to relinquish citizenship or terminate long-term residency.[482]

Thus, the final question is whether the mark-to-market regime constitutes an arbitrary infringement upon the rights to emigrate or expatriate.[483] Although the standard for "determining whether a burden on such rights is arbitrary under international law is not clear[, t]o avoid being arbitrary, the restriction 'must pursue a legitimate governmental [purpose] and be narrowly tailored to be proportional to that [purpose].'"[484]

> The U.S. State Department, in assessing the 1995 proposed exit tax, took the position that the proposed tax did not constitute an arbitrary infringement on these rights under international law because they fairly addressed the governmental aim of equalizing the overall tax burdens between those who remain U.S. citizens or residents and those who do not.[485]

Other countries, including Australia, Canada, and Denmark, impose similar taxation regimes that deem assets disposed of upon exiting the taxing

[477] Universal Declaration of Human Rights, G.A. Res. 217A, U.N. GAOR, 3d Sess., 1st plen. mtg., U.N. Doc. A/810 (Dec. 12, 1948).

[478] 1995 JCT Report, *supra* note 131, at 89–91 (arguing the right to emigrate is fundamental); Arsenault, *supra* note 338, at 61 n.198 (citing Detlev F. Vagts, *The Proposed Expatriation Tax—Human Rights Violation?*, 89 AM. J. INT'L L. 578, 578–79 (1995)).

[479] Arsenault, *supra* note 338, at 62.

[480] 1995 JCT Report, *supra* note 131, at 91 (discussing whether the expatriation tax is inconsistent with principles of avoiding unduly burdening emigration).

[481] Arsenault, *supra* note 338, at 62.

[482] *Id.* at 62 & n.203 (citing 1995 JCT Report, *supra* note 131, at 93).

[483] *See id.* at 62.

[484] *Id.*

[485] *Id.* (citing 1995 JCT Report, *supra* note 131, at 94).

jurisdiction.[486] "The [Joint Committee]'s conclusion that the 1995 proposed exit tax does not constitute an arbitrary infringement on the right to expatriate is likely correctly applied to the HEART Act's exit tax as well."[487]

In *Di Portanova v. United States*,[488] the expatriate "argued that the application of [the alternative tax regime] to him was unconstitutional on the grounds that it represented an invalid exercise of personal jurisdiction, and that it was a denial of due process."[489] The court held that the alternative tax regime was not a jurisdiction-based tax but a source-based tax, and that the expatriate's claim of discriminatory treatment did not convert source jurisdiction to personal jurisdiction.[490] Quoting an early Supreme Court case, the court stated: "The power of Congress in levying taxes is very wide, and where a classification is made of taxpayers that is reasonable, and not merely arbitrary and capricious, the Fifth Amendment can not apply."[491] The expatriate also argued that the alternative tax regime denied him due process, as the tax was unnecessary and inappropriate to the proposed end, and unreasonably harsh or oppressive when viewed in light of the expected benefit and the guarantee of due process.[492] The court responded: "Congress has wide discretion in deciding whom to tax and how much. This court has said the test is one of minimum rationality. There is a strong policy against invalidating tax statutes, and any rational basis for a taxing statute will justify it."[493] In addressing the argument that I.R.C. section 877 did not cover all instances of tax-motivated expatriation, the court deferred to Congress:

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[486] *Id.* at 63.
[487] *Id.*
[488] Di Portanova v. United States, 690 F.2d 169 (Ct. Cl. 1982).
[489] GUSTAFSON ET AL., *supra* note 24, at 52; *see also id.* at 52–53 (outlining the expatriate's arguments and the court's rejection of those arguments).
[490] *Di Portanova*, 690 F.2d at 180.
[491] *Id.* (citing Barclay & Co. v. Edwards, 267 U.S. 442, 449–50 (1924), which held that foreign corporations may be treated by Congress as a separate class).
[492] *Id.*
[493] *Id.* (citations omitted).

> The possibility that Congress might draft a better or a more comprehensive statute is not a reason for invalidating the present one. Congress certainly had a reasonable basis for concluding that United States citizens who expatriate themselves with a principal purpose of avoiding taxes should not be given the favorable tax treatment that nonresident aliens generally receive.[494]

As expressed in *Di Portanova*, the authority that Congress may exercise in the creation and development of the income tax system is extremely broad, especially with respect to income that can reasonably be regarded as U.S.-source income.[495] As to whether the mark-to-market regime is constitutional and whether it is consistent with the principles of international law, "most commentators have answered both of these questions in the affirmative."[496]

Finally, the JOBS Act and the HEART Act did not address the Reed Amendment.[497] Enacted shortly after HIPAA, the Reed Amendment bars a former citizen from reentry into the United States if the U.S. Attorney General determines that the former citizen renounced U.S. citizenship for tax avoidance purposes.[498] The Reed Amendment has never been implemented or enforced.[499] Scholars have strongly argued that expatriation is a fundamental right and that the Reed Amendment violates this fundamental right and, therefore, is unconstitutional:

> The Reed Amendment to the INA [Immigration and Nationality Act], which includes taxpatriates in a class of inadmissible aliens, should be struck down as a violation of a constitutionally protected fundamental right. Probably enacted as a reaction to media frenzy, the legislation infringes on the exercise of a right that has been historically recognized since the birth of this nation. The Reed Amendment violates both the Due Process Clause and Equal Protection clause because it is not narrowly tailored to serve a compelling state interest. Thus, Congress should repeal the legislation or amend it to make it more narrow in its application; otherwise, the Court should strike down this legislation as unconstitutional.[500]

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[494] *Id.*; *see also* GUSTAFSON ET AL., *supra* note 24, at 49–56 (discussing I.R.C. §§ 877 and 877A).

[495] GUSTAFSON ET AL., *supra* note 24, at 52.

[496] *Id.* at 17.

[497] *See supra* text accompanying notes 212–34 (discussing the enactment and consequences of the Reed Amendment).

[498] *See supra* text accompanying notes 212–34 (discussing the enactment and consequences of the Reed Amendment).

[499] Pfeifer, *supra* note 14, at 41.

[500] Carter, *supra* note 228, at 860–61.

The 2003 Joint Committee Report recommended changing the provision to bar reentry into the United States only of former citizens who were not fully in compliance with their expatriation tax obligations, but neither the JOBS Act nor the HEART Act incorporated the recommended change.[501]

B. Conflicts with Existing Tax Treaties

The fundamental purpose of bilateral income tax treaties is "to prevent taxes from interfering with the free flow of international trade and investment."[502] The potential for double taxation arises often in conjunction with international activities, as the United States taxes U.S. citizens and residents on worldwide income, while most foreign countries tax only residents on worldwide income.[503] Generally, tax treaties mitigate the potential for double taxation "by limiting the jurisdiction that each treaty country may exercise to tax income from domestic sources realized by residents of the other country."[504] Income tax treaties also provide clarification in the application of the tax laws of the two countries to the extent ambiguous or unpredictable, and encourage cooperation between taxing agencies of the two countries in matters of tax administration.[505] To mitigate or eliminate international double taxation, "U.S. tax treaties typically contain a commitment by the United States to allow its residents and citizens a foreign tax credit, in accordance with the provisions of U.S. law, for taxes paid to the foreign country."[506] As of November 2010, the United States has bilateral income tax treaties with fifty-seven countries.[507]

Under the U.S. Constitution, U.S. treaties and federal statutes have equal status as the "supreme law of the land"[508] and, as such, are given equal authoritative weight with statutes enacted by Congress.[509] As a result of this equal status, problems arise when a subsequently enacted treaty or statute conflicts with an existing statute or treaty. U.S. courts have created a general rule of interpretation for resolving conflicts between treaty provisions and federal tax law in the absence of an expressed congression-

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[501] Pfeifer, *supra* note 14, at 41.
[502] GUSTAFSON ET AL., *supra* note 24, at 63.
[503] *Id.*
[504] *Id.*
[505] *Id.*
[506] *Id.* at 67.
[507] *Id.* at 62.
[508] U.S. CONST. art. VI, cl. 2.
[509] JOEL D. KUNTZ & ROBERT J. PERONI, U.S. INTERNATIONAL TAXATION ¶ C4.03 (2005).

al direction.[510] When no conflict exists, U.S. courts will construe the language of the subsequently enacted legislation or treaty to give effect to both.[511] If a conflict exists, generally the legislation or treaty adopted last in time prevails.[512] As a consequence, if a tax provision is enacted or amended, the last-in-time rule will result in the benefits of the tax treaty not being available.[513] Nevertheless, because the "unilateral abrogation of an international treaty obligation may violate international legal principles, federal courts will not interpret a federal statutory provision as modifying or abrogating a pre-existing treaty obligation unless Congress has clearly expressed its intent to do so."[514]

The majority of U.S. tax treaties contain saving clauses that provide that the benefits of a U.S. tax treaty are not accorded to U.S. citizens and residents.[515] The saving clause reserves the right of the United States to tax its citizens and residents, regardless of the terms of the tax treaty.[516] "Thus, a U.S. tax treaty generally does not reduce U.S. taxes on the income of U.S. citizens [and] resident[s]."[517] When I.R.C. section 877 was originally enacted, an expatriate residing in a treaty country arguably could escape the alternative tax regime. Therefore, the United States began including in its U.S. model income and estate tax treaties language authorizing either country to tax its citizens and former citizens for a ten-year period if loss of citizenship had as one of its principal purposes the avoidance of tax. [518] In 1979, the Service determined that "the income tax treaty

[510] *Id.*

[511] *Id.* I.R.C. § 894(a)(1) states: "The provisions of this title shall be applied to any taxpayer with due regard to any treaty obligation of the United States which applies to such taxpayer." I.R.C. § 894(a)(1).

[512] KUNTZ & PERONI, *supra* note 509, ¶ C4.03. I.R.C. § 7852(d)(1) states: "[N]either the treaty nor the law shall have preferential status by reason of its being a treaty or law." I.R.C. § 7852(d)(1).

[513] KUNTZ & PERONI, *supra* note 509, ¶ C4.03; *see also* Rev. Rul. 79-199, 1979-1 C.B. 246, 247 (stating the relationship between the I.R.C. and tax treaties).

[514] KUNTZ & PERONI, *supra* note 509, ¶ C4.03.

[515] GUSTAFSON ET AL., *supra* note 24, at 68; *see also* U.S. MODEL TREATY, *supra* note 26, art. 1(4) ("[T]his Convention shall not affect the taxation by a Contracting State of its residents ... and its citizens.").

[516] Agnew, *supra* note 186, at 83. Agnew highlights three types of saving clauses: (1) those that apply to current citizens but do not mention former citizens; (2) those that apply to current and former citizens for ten years if they have a tax-motivated reason for expatriating; and (3) those that apply to all citizens, current and former, regardless of the reason for loss of citizenship. *Id.* at 84.

[517] GUSTAFSON ET AL., *supra* note 24, at 68.

[518] DENIS A. KLEINFIELD & EDWARD J. SMITH, LANGER ON PRAC. INT'L TAX PLAN. § 26:3.4 (Practising Law Institute 2005).

does not exempt from United States taxation [a] taxpayer's capital gain on the liquidation proceeds because by virtue of section 877 the taxpayer remains subject to tax as a United States citizen within the meaning of the treaty saving clause."[519] The Service concluded this was "in agreement with the legislative intent of section 877 of the code which '... was enacted to forestall tax-motivated expatriation.'"[520]

In *Crow v. Commissioner*, the United States Tax Court disagreed.[521] The petitioner, a former U.S. citizen who expatriated to Canada, filed for summary judgment on the issue of whether the tax treaty between the United States and Canada precluded the United States from taxing petitioner under I.R.C. section 877.[522] The Tax Court found that the term "citizen," as used in the saving clause of the Convention Between the United States of America and Canada with Respect to Taxes on Income and Capital (Canada-U.S. Tax Treaty), did not include former citizens, because neither party to the tax treaty contemplated such an interpretation by the Commissioner.[523] Neither could the Tax Court reasonably construe the term "nonresident alien" used in I.R.C. section 877 within the interpretation of the term "citizen" as used in the Canada-U.S. Tax Treaty.[524] Further, despite legislative intent to prevent tax-motivated expatriation, the Tax Court found that FITA expressly provided that no part of the act was intended to override any treaty provisions.[525] In dicta, the Tax Court implied that I.R.C. section 877 was likely at odds with most tax treaties and probably would not override tax treaty provisions.[526]

In the legislative history of HIPAA, Congress indicated that the amendments to I.R.C. section 877 should temporarily override conflicting tax treaties.[527] Specifically, Congress stated that the amendments should prevail over any tax treaty provision for a period of ten years, except those tax treaties containing saving clauses that did not refer to former citizens.[528] At the same time, Congress instructed the Treasury Department to review all tax treaties and negotiate changes.[529] In enacting HIPAA, Con-

[519] Rev. Rul. 79-152, 1979-1 C.B. 237 (internal quotations omitted).
[520] *Id.*
[521] Crow v. Comm'r, 85 T.C. 376, 388–89 (1985).
[522] *Id.* at 377–78.
[523] *Id.* at 392–93; Agnew, *supra* note 186, at 85 ("Because the treaty contained a Class I saving clause, the United States did not retain the right to tax its former citizen").
[524] *Crow*, 85 T.C. at 384.
[525] *Id.* at 383–84.
[526] *Id.* at 387–88.
[527] H.R. REP. NO. 104-736, at 329 (1996) (Conf. Rep.).
[528] *Id.*
[529] *Id.*

gress believed that the expatriation tax provisions were generally consistent with the underlying principles of U.S. tax treaties, as HIPAA provided a foreign tax credit for foreign taxes paid; nevertheless, "it is intended that the purpose of the expatriation tax provisions, as amended, not be defeated by any treaty provision."[530] Thus, the expatriation tax provisions, as amended, "were intended to override inconsistent provisions of preexisting income and estate and gift tax treaties for a ten-year period following enactment, or until August 21, 2006."[531] Since the enactment of the HIPAA amendments, the Treasury Department has added language to the savings clause of new or renegotiated treaties and protocols reserving the right of the United States to tax former U.S. citizens and long-term residents.[532] The saving clause of the 2006 United States Model Tax Convention (U.S. Model Treaty), from which U.S. tax treaties are generally drawn, states as follows:

> Except to the extent provided in paragraph 5, this Convention shall not affect the taxation by a Contracting State of its residents (as determined under Article 4 (Resident)) and its citizens. Notwithstanding the other provisions of this Convention, a former citizen or former long-term resident of a Contracting State may, for the period of ten years following the loss of such status, be taxed in accordance with the law of that Contracting State.[533]

As to U.S. citizens and long-term residents who lost citizenship or residency before June 17, 2008, and are still within the ten-year post-expatriation period, the issues unresolved under the alternative tax regime are still relevant. A lingering issue is whether and when the tax treaty override of the HIPAA amendments ceases to apply.[534] Since the legislative history of the JOBS Act makes no reference to the treaty override, and the JOBS Act did not materially amend or reenact the alternative tax regime, arguably, the treaty override provision of HIPAA lapsed on August 21, 2006.[535] "Although the likelihood of this issue being raised by the IRS becomes ever more remote with the passage of time, a number of im-

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[530] *Id.*
[531] Pfeifer, *supra* note 120, at 883.
[532] *Id.*
[533] U.S. MODEL TREATY, *supra* note 26, art. 1(4).
[534] Pfeifer, *supra* note 120, at 883 (arguing that the treaty override lasts "10 years following enactment, or until August 21, 2006").
[535] *Id.*

portant pre-HIPAA treaties remain without a saving clause that includes former long-term residents as well as former citizens."[536]

Congress was also silent as to whether the provisions of the HEART Act override existing U.S. tax treaties.[537] As the deemed taxable event occurs prior to expatriation, seemingly, I.R.C. section 877A will not be interpreted to override the provisions of existing tax treaties.[538] Nevertheless, "many of the current U.S. ... tax treaties may have to be renegotiated to prevent double taxation stemming from [the mark-to-market regime]."[539] The Fifth Protocol amending the Canada-U.S. Tax Treaty, which was signed in September 2007 and entered into force in December 2008, reflects the exit taxes now employed by both countries.[540] The Fifth Protocol contains amendments to the Canada-U.S. Tax Treaty designed to prevent double taxation of pre-emigration gains accrued by an expatriate prior to relinquishing citizenship or terminating long-term residency.[541] As amended, paragraph 7 of Article XIII (Gains) of the Canada-U.S. Tax Treaty states as follows:

> Where at any time an individual is treated for the purposes of taxation by a Contracting State as having alienated a property and is taxed in that State by reason thereof, the individual may elect to be treated for the purposes of taxation in the other Contracting State, in the year that includes that time and all subsequent years, as if the individual had, immediately before that time, sold and repurchased the property for an amount equal to its fair market value at that time.[542]

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[536] *Id.* at 887–88. Treaties that do not include a savings clause for former citizens and former long-term residents include the current income tax treaties with Italy (1984) and France (1994). *Id.* at n.42.

[537] *Id.* at 890.

[538] Pfeifer, *supra* note 338, at 266.

[539] Ellen Seiler Brody & Jason K. Binder, *New Expatriation Rules Under Sections 877A and 2801*, 56 CANADIAN TAX J. 559, 563 (2008).

[540] Convention Between the United States of America and Canada with Respect to Taxes on Income and Capital, U.S.-Can., Sept. 26,1980, 1980 Can. T.S. No. 15, T.I.A.S. No. 11087 [hereinafter Canada-U.S. Tax Treaty] (the current version of the Canada-U.S. Tax Treaty has been subject to five protocols; the Fifth, and latest, Protocol was signed September 21, 2007 and entered into force on December 15, 2008).

[541] Protocol Amending the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital Done at Washington on September 26, 1980, as Amended by the Protocols Done on June 14, 1983, March 28, 1984, March 17, 1995, and July 29, 1997, U.S.-Can., Sept. 21, 2007, S. Treaty Doc. No. 110-15 (ratified Sept. 23, 2008) (paragraph 3 of Article 8 replaces paragraph 7 of Article XIII of the Canada-U.S. Tax Treaty).

[542] *Id.* at 11.

The purpose of paragraph 7 of Article XIII of the Canada-U.S. Tax Treaty "is to provide a rule to coordinate the taxation of gains by Canada and the United States in the case of a timing mismatch."[543] Mismatching "may occur, for example, where a Canadian resident is deemed, for Canadian tax purposes, to recognize capital gain upon emigrating from Canada to the United States, ... [while] the United States defers taxation [by] assigning the [pre-tax basis to the property]."[544] If the individual is a U.S. citizen, the individual can resolve the timing mismatch by electing to be liable to tax in the United States as if the property had been "sold and repurchased ... for an amount equal to its fair market value at a time immediately prior to the deemed [disposition]."[545] The U.S. citizen or an individual otherwise subject to U.S. tax, is allowed by the election "to accelerate the tax ... and allow [a foreign] tax credit[] to be used to avoid double taxation."[546] If the Canadian resident is not a U.S. citizen or otherwise subject to U.S. tax, under the new paragraph 7 of Article XIII,

> the effect of the election [is] to give the individual an adjusted basis [in the property] for U.S. tax purposes equal to the fair market value of the property as of the date of the deemed [disposition] ... with the result that only post-emigration gain will be subject to U.S. tax [upon actual disposition].[547]

Thus, unless a U.S. tax treaty contains a provision similar to paragraph 7 of Article XIII of the Canada-U.S. Tax Treaty, a covered expatriate will likely be subject to taxation in the foreign country of residence when the assets subject to the exit tax are actually sold or otherwise disposed after expatriation. Similarly, the foreign country where the asset is located may

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[543] U.S. DEP'T OF THE TREASURY, TECHNICAL EXPLANATION OF THE PROTOCOL DONE AT CHELSEA ON SEPTEMBER 21, 2007 AMENDING THE CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND CANADA WITH RESPECT TO TAXES ON INCOME AND ON CAPITAL DONE AT WASHINGTON ON SEPTEMBER 26, 1980, AS AMENDED BY THE PROTOCOLS DONE ON JUNE 14, 1983, MARCH 17, 1995, AND JULY 29, 1997 25 (2008) [hereinafter TECHNICAL EXPLANATION OF THE PROTOCOL DONE AT CHELSEA], *available at* http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/tecanada08.pdf.

[544] *Id.*

[545] *Id.*

[546] *Id.*; *see also* I.R.C. §§ 901–908 (providing a credit against U.S. tax liability for foreign taxes paid).

[547] TECHNICAL EXPLANATION OF THE PROTOCOL DONE AT CHELSEA, *supra* note 543, at 25. A September 18, 2000 press release announced an agreement by the U.S. Treasury and the Canadian Department of Finance extending the election to individuals not citizens, or otherwise not taxable, in the country of emigration; thus, the replaced paragraph 7 is generally effective for alienations of property that occur after September 17, 2000. *Id.*

exercise its jurisdiction to tax upon the disposition of the asset.[548] As stated by one scholar:

> While the HEART Act adjusts the expatriate's basis in the asset for U.S. tax purposes, thus avoiding double taxation by the U.S. in the event the taxpayer returns to U.S. taxing jurisdiction, no such adjustment is guaranteed for foreign tax purposes. While these potential double tax issues are not technically of concern to the U.S. government, they are a concern from a policy standpoint in examining the implementation of the HEART Act.[549]

C. I.R.C. Sections 877 and 877A at Odds with Tax Policies

In evaluating tax systems, the tax objectives traditionally employed are equity, efficiency, and simplicity.[550] The concept of tax equity embodies the notions of horizontal equity and vertical equity.[551] Horizontal equity is the "principle that persons similarly situated should pay equal amounts of tax."[552] Vertical equity is the principle that individuals with more taxable income should bear more of a tax burden than individuals with less taxable income.[553] "Efficiency [can] refer to the market economy's allocation of resources to their most productive use."[554] Included in the several aspects of simplicity are the ease with which taxpayers can apply the system of tax, the extent to which taxpayers are compelled to take tax consequences into account in structuring transactions, and the ease of administration of the tax system.[555]

In enacting and amending I.R.C. section 877, Congress was concerned about the revenue loss that resulted from tax-motivated expatriations.[556] Congress was also outraged by reports of U.S. citizens renouncing their U.S. citizenship merely to save tax dollars.[557] As stated by one scholar, "[t]he desire for retribution and deterrence complicates the analysis of proposals to change the taxation of expatriation because retribution and

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548 Arsenault, *supra* note 338, at 67.

549 *Id.*

550 PAUL R. MCDANIEL, MARTIN J. MCMAHON, JR., DANIEL L. SIMMON & GREGG D. POLSK, FEDERAL INCOME TAXATION: CASES AND MATERIALS 2 (6th ed. 2008).

551 *Id.*

552 *Id.*

553 *Id.*

554 *Id.* at 3. Efficiency also can refer to the extent to which the intended beneficiaries actually receive the tax subsidies. *Id.*

555 MCDANIEL ET AL., *supra* note 550, at 3–4.

556 Agnew, *supra* note 186, at 72 (arguing that revenue loss and media attention brought expatriation to the center of the political discourse).

557 Abreu, *supra* note 138, at 1090.

deterrence are traditional aims of punishment, not of taxation."[558] Given the unique purpose of I.R.C. section 877, it is not surprising that the alternative tax regime cannot satisfy the traditional tax policy objectives.[559]

The alternative tax regime has been at odds with the principles of horizontal equity and vertical equity from its inception in 1966. I.R.C. section 877 does not comport with the notion of horizontal equity as only U.S.-source income is subject to the alternative tax.[560] Expatriates with diversified portfolios and substantial foreign assets escape paying the same U.S. taxes as expatriates who did not have the forethought to diversify their investments before expatriation.[561] "Although HIPAA revised the source rules to reach some foreign-source income, the provision is still limited, and allows the more sophisticated and diversified expatriates to avoid U.S. taxes under [the alternative tax regime]."[562] Vertical equity is also violated by the alternative tax regime. Typically, wealthier expatriates can avoid or reduce the applicability of I.R.C. section 877, as wealthier expatriates have the means to plan financially for their departure.[563] Wealthier expatriates are also more likely to avoid the alternative tax regime altogether, as the wealthier expatriates can patiently wait out the ten-year period during which I.R.C. section 877 applies.[564] Therefore, contrary to the principles of vertical equity, a wealthy expatriate is more likely to avoid the alternative tax.[565]

Another tax principle by which the alternative tax regime can be analyzed is tax neutrality.[566] "Under the neutrality principle, the Code would provide neither an incentive nor a disincentive with respect to individuals who expatriate."[567] The issue with I.R.C. section 877 is not the disincentive to expatriate but the *incentive* to expatriate. I.R.C. section 877 does not diminish the incentive to expatriate for tax avoidance purposes. The primary reason Congress will never lessen or eliminate the tax incentive to expatriate is its unwillingness to deal with the fundamental basis for the incentive; namely, the disparate treatment between U.S. citizens and non-

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[558] *Id.*

[559] William L. Dentino, *Expatriating to Avoid Taxes: Does I.R.C. Section 877 Curb the Abuse?*, 45 TAX NOTES INT'L 991, 1002 (2007) (arguing that "Section 877 is at odds with the general tax policies of horizontal and vertical equity and tax neutrality").

[560] *Id.*

[561] Agnew, *supra* note 186, at 81.

[562] Dentino, *supra* note 559, at 1002.

[563] *Id.*

[564] *Id.*

[565] *Id.* (arguing that no tax code solution enables tax neutrality for every expatriate).

[566] *See* Kirsch, *supra* note 42, at 933.

[567] *Id.* at 933 n.304.

resident aliens.[568] However, Congress is unlikely to forgo taxing U.S. citizens on their worldwide income.[569]

The mark-to-market regime is also at odds with tax equity, as similarly situated individuals are treated differently and wealthier individuals have a tax planning advantage. Under I.R.C. section 877A, covered expatriates are subject to an immediate tax on the deemed sale of assets held worldwide on the day before expatriation.[570] "For individuals who hold most of their assets in cash and unappreciated property, and have no heirs who [are, or] will be, U.S. residents or citizens, ... the [mark-to-market] regime [and the succession tax regime] permit expatriation with little immediate [U.S. income] tax and no ... future [U.S.] gift[] and [estate taxes]."[571] Those individuals will be able to reenter, and remain in, the United States without the annual thirty-day restriction, and will not have the potential of income tax or gift and estate tax liability for the ten-year period after the date of expatriation.[572] However, if the assets held by the individual have appreciated in value and family members are U.S. citizens or residents, the cost is significantly higher.[573] Again, wealthier covered expatriates have the means and flexibility to plan their portfolio prior to expatriation.

Legislation that treats expatriation as realization cannot be entirely tax neutral. The mark-to-market regime taxes income on an accelerated basis, which violates the principle of realization.[574] The realization requirement results in tax deferral, which is a valuable tax preference as it reduces current tax liability, while acceleration of gain penalizes the expatriate by increasing current tax liability.[575] The issue of liquidity also arises as a result of this immediate realization upon expatriation, and, although Congress has included a tax deferral election, the expatriate must provide

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568 *Id.* at 933.

569 *Id.* at 934.

> The only way in which full neutrality could be achieved with respect to expatriation is by eliminating the differences between the income and transfer taxation of citizens and nonresident aliens. As a practical matter, such a change could only be achieved by eliminating the worldwide taxation of United States citizens, which has been a long-standing feature of our tax system.

Id.

570 *See supra* text accompanying notes 339–431 (describing the U.S. taxation of expatriates under the mark-to-market regime).

571 Brody & Binder, *supra* note 539, at 570.

572 *Id.*

573 *Id.*

574 Walker, *supra* note 14, at 584.

575 *Id.* Since tax may be avoided entirely upon death under I.R.C. § 1014, acceleration can be more than a timing disparity. *Id.*

adequate security and pay interest on the deferral.[576] Thus, tax equity is violated if the majority of assets held by the covered expatriate are illiquid assets.[577] Nevertheless, since these provisions tax only with respect to economic appreciation during the period of U.S. citizenship or long-term residency, this approach can be viewed as non-punitive.[578]

The mark-to-market regime may also create a tax incentive to time expatriation. If the assets held by the individual are likely to appreciate in the future, the individual has an incentive to expatriate before appreciation.[579] In the current economic climate, the assets of an individual may have decreased in value, therefore making expatriation in the near future less costly.[580] The alternative tax regime did not create an incentive to accelerate expatriation because the income would remain subject to U.S. tax during the ten-year period after the expatriation date.[581] An individual who inherits property with a basis stepped-up to the fair market value at the date of the decedent's death[582] also has an incentive to expatriate before appreciation.[583] Nevertheless, the succession tax exacted under the HEART Act may mitigate some of the timing concerns. If the family of the covered expatriate remains U.S. citizens or residents, the transfer of assets by gift or death will be subject to U.S. gift and estate tax at the highest rates applicable.[584] In this situation, "the estate and gift tax provisions may be a disincentive to expatriat[ion]."[585]

Earlier versions of mark-to-market and succession tax regimes were commented on by various legal and accounting groups, which offered helpful advice on how to make the final legislation more effective.[586] It was suggested that an exemption be created for U.S. real property interests

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[576] Arsenault, *supra* note 338, at 64–65.

[577] *Id.*

[578] Kirsch, *supra* note 8, at 495.

[579] Arsenault, *supra* note 338, at 66.

[580] Alexander M.G. Gelardi, *The Expatriation Rules of the Heroes Earnings Assistance and Relief Tax Act of 2008*, INT'L TAX J., May–June 2009, at 83, 88.

[581] Arsenault, *supra* note 338, at 66.

[582] *See* I.R.C. § 1014 (providing a fair market value at date of death basis for property acquired from a decedent).

[583] Arsenault, *supra* note 338, at 66.

[584] *Id.*

[585] *Id.*

[586] *See* Letter from Jeffrey R. Hoops, Chair, Tax Exec. Comm., Am. Inst. of Certified Pub. Acct. (AICPA), to John Buckley, Chief Tax Couns., House Ways & Means Comm., and Allen Littman, Legis. Couns., J. Comm. on Tax'n, (Jan. 16, 2008), *available at* http://www.aicpa.org/InterestAreas/Tax/Resources/International/Pages/AICPA%20Comments%20on%20Proposed%20Expat%20Legislation.aspx [hereinafter Letter from Jeffrey R. Hoops].

because these interests[587] are currently subject to tax when owned by nonresident aliens.[588] Because this suggestion was not adopted, covered expatriates must pay tax on the deemed sale of real property located within the United States even though they will be subject to tax on any future appreciation upon actual disposition.[589] "Other countries, including Canada, exempt from their exit taxes assets that will otherwise be taxable upon their ultimate disposition."[590] It was also advised that the $600,000 exclusion amount be coordinated with the estate tax exemption amount under I.R.C. section 2010(c).[591] The Senate Report accompanying the HEART Act states that, "to the extent possible, an individual's decision to relinquish citizenship or terminate residency should be tax-neutral."[592] If individuals are taxed more harshly when they expatriate rather than remain U.S. citizens or long-term residents, the goal of tax neutrality is not met.[593]

D. Administration and Enforcement

The administration and enforcement of the alternative tax regime became easier with the inclusion in HIPAA of an objective standard to be used in determining whether the expatriate had tax avoidance as a principal motive, and the inclusion in the JOBS Act of an entirely objective standard to be used in determining whether the individual was subject to the alternative tax regime.[594] Also, amendments to the reporting requirements shifted the burden of administration slightly, but not entirely, to the expatriate, thereby relieving the Secretary of some enforcement costs.[595] Importantly, if the expatriate fails to comply with the reporting requirements upon expatriation or for the next ten years, the expatriate is taxed as a U.S. citizen or resident on worldwide income.[596] Furthermore, if an

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[587] *See* I.R.C.§ 897 (taxing nonresident aliens and foreign corporations on the disposition of investments in U.S. real property).

[588] Letter from Jeffrey R. Hoops, *supra* note 586.

[589] *Id.* at 6–7.

[590] Brody & Binder, *supra* note 539, at 564.

[591] The estate tax allocable exclusion amount for decedents dying after 2009 and before 2013 is $5,000,000. I.R.C. § 2010(c)(2)(A) (as amended by the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, § 302(a)(1), Pub. L. No. 111-312, 124 Stat. 3296).

[592] S. REP. NO. 110-1, at 43 (2007).

[593] Letter from Jeffrey R. Hoops, *supra* note 586.

[594] *See supra* text accompanying notes 262–65 (discussing the final evolution of the necessity of a tax-avoidance motive).

[595] *See supra* text accompanying notes 274–78 (discussing the reporting requirements of the alternative tax regime).

[596] *See supra* text accompanying note 277.

expatriate is present in the United States for more than thirty days in any calendar year during the ten-year period following expatriation, the expatriate will be taxed on worldwide income as a citizen or resident of the United States.[597]

Nevertheless, serious administrative and enforcement problems continued under the alternative tax regime because of the expatriate's limited contacts with the United States.[598] The longstanding international practice that the courts of a country will not enforce the tax judgments of another country—which is followed by the United States—severely restricts the ability of the United States to reach expatriates once they have left.[599] As a result, if an expatriate has little or no contact with the United States during the ten-year period following the date of expatriation, the expatriate probably can avoid the alternative tax regime to the extent his or her property is not situated within the United States. Only a small number of U.S. tax treaties provide general assistance in collecting tax judgments.[600]

The mark-to-market regime is seen as an answer to the enforcement problems that plagued the alternative tax regime. The new regime is simpler. Because the tax serves as an exit tax and the amount of tax due is determined the day before expatriation, it seems that the United States has little need to continue to monitor covered expatriates.[601] In essence, the relationship between a covered expatriate and the United States ends the moment that the covered expatriate pays the mark-to-market tax.[602] Nevertheless, administration and enforcement problems persist in instances where individuals simply leave the country without informing the government of their intention to relinquish their citizenship or terminate their long-term residency.[603] The illusion of enhanced enforceability is premised on the assumption that an individual is more likely to be found within the United States at the time of expatriation, rather than at some later point in time.[604] However, the mark-to-market regime has the same enforcement challenges presented by those individuals who choose to leave the country

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[597] *See supra* text accompanying notes 280–85 (describing the limitation on physical presence in the United States under I.R.C. § 877(g)).

[598] Cynthia Blum & Paula N. Singer, *A Coherent Policy Proposal for U.S. Residence-Based Taxation of Individuals*, 41 VAND. J. TRANSNAT'L L. 705, 733 (2008).

[599] Walker, *supra* note 14, at 588–90.

[600] *Id.* at 590.

[601] *See* Arsenault, *supra* note 338, at 63; *supra* text accompanying note 368.

[602] Arsenault, *supra* note 338, at 63 (suggesting that a benefit of the mark-to-market regime is the lack of a "need to maintain contact with the expatriate for a lengthy period after expatriation").

[603] *Id.*

[604] Walker, *supra* note 14, at 591.

without officially expatriating as those individuals who choose not to voluntarily comply with other U.S. tax laws.[605] The United States has "little leverage" for enforcing the mark-to-market regime against individuals who are essentially "foreigner[s] living in a foreign country."[606] At least under the alternative tax regime, the U.S. tax is generally imposed upon the income and assets that the United States can often reach without personal jurisdiction over the expatriate.[607]

Administratively, the United States must again rely on covered expatriates to honestly report their worldwide assets for the determination of the tax under I.R.C. section 877A. It is impractical, if not impossible, for the Treasury Department to locate the worldwide assets of a covered expatriate, especially if the individual hides assets prior to expatriating.[608] Additionally, the mark-to-market regime requires readily determinable valuation of the assets.[609] Under the mark-to-market regime, a deemed sale takes place the day before expatriation occurs and, therefore, the value of all illiquid assets must be determined as of that date.[610] "Significant administrative resources are ... likely to be consumed" in disputes between the Service and the covered expatriate over valuation issues.[611] Finally, as the succession tax is imposed upon the U.S donees or beneficiaries of a covered expatriate, less any foreign succession taxes paid, the Treasury Department must cross-reference each recipient with the covered expatriate donor or decedent and "keep track of the taxes due and the proper [foreign] tax credit[]."[612] As one scholar stated, "this oversight burden can be even more onerous than tracking the expatriate's movements under the [alternative tax] regime."[613]

As the mark-to-market tax ends the relationship between covered expatriates and the United States, covered expatriates are not limited as to the amount of time that they can spend in the United States.[614] Under the alternative tax regime, the amount of time that former U.S. citizens or residents may spend in the United States is limited to thirty days per

[605] *Id.*
[606] Kwong, *supra* note 442, at 439.
[607] Walker, *supra* note 14, at 590.
[608] Kwong, *supra* note 442, at 439.
[609] Walker, *supra* note 14, at 589.
[610] *See id.*
[611] *Id.*
[612] Kwong, *supra* note 442, at 440.
[613] *Id.*
[614] *See supra* text accompanying notes 280–85 (describing the limitation on physical presence in the United States under I.R.C. § 877(g)).

year.[615] If an expatriate exceeds the limit, the expatriate is treated as a U.S. citizen or resident for the taxable year and taxed on worldwide income.[616] Under the mark-to-market regime this restriction does not apply; instead, the substantial presence test[617] is relied on to render the individual a U.S. resident for tax purposes.[618] Thus, the mark-to-market regime eliminates the need to continually monitor the annual presence of former U.S. citizens and long-term residents in the United States.

CONCLUSION

The exit tax is a move in the right direction. The mark-to-market and succession tax regimes lessen the emotional impact on individuals that decide, for whatever reason, to relinquish U.S. citizenship or terminate long-term residency. The elimination of the requirement to report annually for a ten-year period and the ability to reenter the United States for extended periods of time allow such individuals to freely participate in a global society and economy while maintaining ties with the United States. Arguably, the goal of these regimes is not to punish, as was the case with the alternative tax regime, but merely to provide a practical vehicle for ensuring the collection of U.S. tax on wealth accrued during the period of citizenship or residency. Scholars will continue to debate whether the burdens and benefits of citizenship or residency justify the taxation by the United States of its citizens and residents on worldwide income.[619] Perhaps the exit tax is the first step by the United States towards abandoning citizenship as a jurisdictional basis for taxation, thereby removing the underlying tax incentive for expatriation.

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[615] *See supra* text accompanying note 448.

[616] *See supra* text accompanying note 448.

[617] *See supra* note 20 (defining the term "substantial presence" under I.R.C. § 7701(b)(1)(A)(ii)).

[618] Brody & Binder, *supra* note 539, at 560.

[619] *See* Arsenault, *supra* note 338, at 38, 67 (discussing justifications for and significant issues with the expatriation tax); Avi-Yonah, *supra* note 18, at 389 (arguing that the U.S. should not continue to tax citizens who live permanently abroad); Blum & Singer, *supra* note 598, at 705 (questioning citizenship as a jurisdictional basis for taxation); *see also* Kirsch, *supra* note 8, at 443 (supporting citizenship as a jurisdictional basis for taxation); Edward A. Zelinsky, *Citizenship and Worldwide Taxation: Citizenship as an Administrable Proxy for Domicile*, 96 IOWA L. REV. 1289 (2011).