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SOLVING TAXPATRIATION: “REALIZING” IT TAKES MORE THAN AMENDING THE ALTERNATIVE TAX

I. INTRODUCTION

Oliver Wendell Holmes once said, “[t]axes are what we pay for a civilized society”¹ As the U.S. Constitution states, tax revenue allows Congress to “pay the Debts and provide for the common Defence and the general Welfare of the United States.”² Taxes fund public goods such as police and fire departments, highway construction, public education and scientific research.³ Taxes also fund administrative activities such as the enforcement of laws to protect our natural resources and the environment.⁴ Without taxation, governments would have to resort to either the issuance of debt or the issuance of additional currency as the means to fund public programs and governmental activities.⁵ Despite the myriad benefits, some people are willing to travel great lengths to reduce or eliminate their taxes.

For some, the benefits of avoiding U.S. taxes are great enough that they are willing to renounce their U.S. citizenship to do so.⁶ How should our society react to expatriation to avoid taxation?⁷ The renunciation of

1. Sharon C. Nantell, *A Cultural Prospective on American Tax Policy*, 2 CHAP. L. REV. 33, 34 (1999), *citing* *Compania General de Tabacos de Filipinas v. Collector of Internal Revenue*, 275 U.S. 87, 100 (1927) (Holmes, J., dissenting).

2. U.S. CONST. art. 1, § 8.

3. U.S. Treasury Department Fact Sheet, <http://www.treas.gov/education/factsheets/taxes/economics.shtml> (last visited Jan. 24, 2006).

4. *Id.*

5. *Id.*

6. One example is Michael Dingman, chairman of a company which makes aerospace and industrial products. Mr. Dingman is now a citizen of the Bahamas which has a low tax rate. Mr. Dingman renounced his U.S. citizenship in June of 1994 because he had been living in the Bahamas in one form or another since 1964 and wanted a pleasant place to raise his three children. Mr. Dingman claims avoidance of U.S. taxes was not a factor in his decision to expatriate. However, his opinion is that if he is investing money in other countries, he should not have to pay U.S. taxes on money he invests because no other country taxes this way. Mr. Dingman also does not want his heirs to pay estate taxes on money he has already paid taxes on when he dies. Karen De Witt, *Some of Rich Find a Passport Lost is a Fortune Gained*, N.Y. TIMES, Apr. 12, 1995 (Late Edition), at A1.

7. For purposes of this Note, the terms “expatriation” will refer to the legal renunciation of one’s citizenship by an individual and “expatriate” will refer to one who has renounced his or her citizenship. Corporate expatriation, including corporate inversion, is beyond the scope of this Note.

U.S. citizenship to save taxes is like flag burning: it offends people.⁸ However, though offensive to patriotic Americans, flag burning is protected by the Constitution.⁹ What restrictions can or should be placed on the ability to expatriate?¹⁰

As discussed, taxes fund the cost of maintaining a civilized society.¹¹ Loss of tax dollars from expatriates means the loss of tax revenue to fund public and governmental programs.¹² But as Judge Learned Hand commented:

Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.¹³

However, moral sentiments and patriotic principles seem to be a driving force behind efforts to curb "taxpatriation."¹⁴ Recent congressional

8. Alice Abreu, *Taxing Exits*, 29 U.C. DAVIS L. REV. 1087, 1087 (1996).

9. See *Texas v. Johnson*, 491 U.S. 397 (1989) (protecting flag burning as a form of free speech under the First Amendment).

10. Expatriation is a right recognized under international law. Substantial restrictions placed on the right of expatriation would probably be a violation of human rights. Abreu, *supra* note 8, at 1127 n.150 (recognizing the right to leave one's own country (codified in International Convention on Civil and Political Rights art. 12, *opened for signature* Dec. 16, 1966, 999 U.N.T.S. 171, 6 I.L.M. 368; Universal Declaration of Human Rights, G.A. Res. 217A, art. 13, U.N. GAOR, 3d Sess., 1st plen. mtg., U.N. Doc A/810 (Dec. 12, 1948) (recognizing the right to leave and return to one's home country). *But see* Abreu, *supra* note 8, at 1127 n.150 (asserting that international law does not protect right to expatriate).

11. See *supra* note 1.

12. See *supra* notes 3-4 and accompanying text for examples of public and governmental programs funded by taxes. The loss of tax revenue from those most likely to expatriate to avoid taxes (i.e., individuals in the upper echelons of society with wealth estimated in the millions or billions of dollars) constitutes the largest base of taxable dollars. See *supra* note 6.

13. *Commissioner v. Newman*, 159 F.2d 848, 850-51 (2d Cir. 1947) (Hand, J., dissenting).

14. "Taxpatriation" refers to the act of renouncing one's citizenship to avoid taxes. The term "taxpatriation" comes from Robert Lenzner, *And Don't Come Back: U.S. Citizens Who Renounce Their Citizenship for Tax Purposes Face Obstacles*, FORBES, Nov. 18, 1996, at 44. Although loss of revenue is probably the greatest concern, the Congressional debate regarding taxpatriation seems fueled by anger over the ease former citizens have with severing allegiances and ties to their home country. While speaking on the floor of the House, Representative Neil Abercrombie passionately argued:

revisions to the Internal Revenue Code make avoiding U.S. taxes more difficult, but they still fall short of achieving the ultimate goal—stopping tax-motivated expatriation.¹⁵

This Note examines recent amendments the United States made to provisions dealing with expatriation to avoid taxes and their ineffectiveness in keeping capital within the United States. Part I examines the history of taxation as well as expatriation and the current system of taxation employed by the United States. Part II explores the potential tax benefits gained from expatriating and the procedure to formally renounce citizenship. This section also discusses previous efforts by Congress to curb expatriation. Lastly, this section will examine the American Jobs Creation Act of 2004 and its intended objectives to ease administration and increase enforcement of provisions dealing with expatriation to avoid taxation. Part III explores the weaknesses still present in the American Jobs Creation Act of 2004 amendments to Internal Revenue Code section

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

Abreu, *supra* note 8, at 1122–23, quoting 141 CONG. REC. H3845 (1995) (statement by Rep. Abercrombie) (omissions in original). In another instance, before the enactment of the Health Insurance Portability and Accountability Act of 1996, Representative Charles Rangel wanted to publish the names of taxpatriates as a form of punishment or as a deterrent to individuals who "care so little about [their U.S.] citizenship that they would flee in order to avoid taxes." 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, 889 (2004), quoting 141 CONG. REC. H3996 (1995) (statement by Rep. Rangel). Currently, section 6039G of the Internal Revenue Code of 1986 [hereinafter I.R.C.] provides that the names of people who have expatriated within the meaning of section 877(a) of the I.R.C. will be listed in the Federal Register. I.R.C. § 6039G(d) (West 2004). Since January 2000, 2874 people have expatriated. See discussion *infra* note 155.

15. See, e.g., American Jobs Creation Act of 2004, Pub. L. No. 108-357, §§ 804–806, 118 Stat. 1418 (2004). The American Jobs Creation Act of 2004 changes the subjective standards for determining whether expatriation is tax-motivated. See *infra* text accompanying notes 111, 116–18. However, the objective standards created by the American Jobs Creation Act of 2004 do not provide the best solution. See *infra* Part III.

877 and the alternative tax regime as a means for deterring tax-motivated expatriation. In furtherance of Congressional objectives and goals, this Note will propose a mark-to-market regime, which “realizes” accrued gains in property, as a better solution for eliminating purely tax-motivated expatriation while simultaneously upholding the inherent right of expatriation for those who truly want to renounce citizenship.

A. History of Taxation

In the 1800s, the federal government limited taxes to tariffs on imported goods.¹⁶ The bulk of taxes imposed by state and local governments were mainly on real property supplemented by excise taxes on items such as slaves, carriages, and personal property.¹⁷ As the United States shifted from an agrarian economy to an industrialized one, developments in the financial and social systems were reflected in contemporaneous changes to personal wealth. The composition of individual estates has evolved from being mainly real property to including commercial paper, stocks and other evidences of debt, to becoming primarily income.¹⁸ In short, the wealth of individual Americans came from sources untouched by the federal government’s import tax or the property tax imposed by state and local governments.¹⁹ In response to an economic crunch caused by financing the Civil War, the federal government turned towards taxing income.²⁰ This first tax on income evolved into our current tax system, which includes exemptions, deductions and the progressive rate structure.²¹ After many battles over the federal government’s ability to tax, the Sixteenth Amendment to the U.S. Constitution was passed in 1913 allowing Congress to establish a federal system of taxation on “income from whatever source derived.”²² Recently, individual income tax receipts equaled \$927.2 billion in 2005²³ (43 percent of

16. See Nantell, *supra* note 1, at 40–42.

17. *Id.* at 41–42, citing LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 185 (2d ed. 1985).

18. *Id.* at 42

19. *Id.*

20. *Id.*

21. Nantell credits the income tax law of 1862 with providing the basic structure for today’s current tax system. *Id.* at 43. The progressive rate structure means a system of taxation which imposes higher rates of tax at higher levels of income. See generally I.R.C. § 1.

22. Nantell, *supra* note 1, at 38; U.S. CONST. amend. XVI. See also I.R.C. § 22 (West 1913) (current version at I.R.C. § 61 (West 2006)).

23. Office of Management and Budget (OMB), Budget of the U.S. Government for 2007, Table S-11 (Receipts by Source—Summary), <http://www.whitehouse.gov/omb/>

receipts by source)²⁴ and are estimated to equal \$997.5 billion for 2006²⁵ (43.6 percent of receipts by source).²⁶

B. The Current United States System of Taxation

The United States is among the minority in its system of taxation.²⁷ It utilizes the “worldwide taxation” system, which taxes persons based on citizenship.²⁸ In contrast, most other nations around the world utilize a system of “territorial taxation,” which taxes persons based on residency.²⁹ U.S. citizens are subject to U.S. income tax on their worldwide income regardless of its source.³⁰ For an increasingly globalized society, this could have serious implications since the income tax rate for individuals can be as high as 35 percent.³¹ Additionally, nonresident citizens

budget/fy2007/pdf/budget/tables.pdf (last visited Feb. 13, 2006). The estate and gift tax receipts equaled \$24.8 billion in 2005 and are estimated to equal \$27.5 billion for 2006. *Id.*

24. Office of Management and Budget (OMB), Historical Tables for 2007, Table 22 (Percentage Composition of Receipts by Source: 1934-2011), <http://www.whitehouse.gov/omb/budget/fy2007/pdf/hist.pdf> (last visited Feb. 13, 2006). The total receipts for the federal government in 2005 equaled \$2,135.9 billion and is estimated to equal \$2,285.5 billion for 2006. *Id.* tbl. 2.1 (Receipts by Source: 1934–2011).

25. Office of Management and Budget, *supra* note 23, tbl. S-11.

26. Office of Management and Budget, *supra* note 24, tbl. 2.2.

27. Hale E. Sheppard, *Perpetuation of the Foreign Earned Income Exclusion: U.S. International Tax Policy, Political Reality, and the Necessity of Understanding How the Two Intertwine*, 37 VAND. J. TRANSNAT'L L. 727, 730 (2000).

28. See Antonio F. Perez, *The International Recognition of Judgments: The Debate Between Private and Public Law Solutions*, 19 BERKELEY J. INT'L L. 44, 79 (2000); Candace Carmichael, *Foreign Sales Corporations—Subsidies, Sanctions, and Trade Wars*, 35 VAND. J. TRANSNAT'L L. 151, 163–64 (2002) (noting that neither the United States nor countries utilizing the territorial taxation system employ a “pure” system of taxation. Most countries employ a combination of the two concepts to avoid double taxation of income).

29. Carmichael, *supra* note 28, at 163–64.

30. Kenneth D. Heath, *The Symmetries of Citizenship: Welfare, Expatriate Taxation, and Stakeholding*, 13 GEO. IMMIGR. L.J. 533, 545 (1999). See also Carmichael, *supra* note 28, at 164. See generally I.R.C. § 61 (defining “income”). Although outside the scope of this Note, it should be mentioned that the U.S. Estate Tax also applies to the worldwide estate of U.S. citizens regardless of its source. I.R.C. § 2001.

31. I.R.C. § 1, amended by Rev. Proc. 2005-70, 2005-47 I.R.B. 979. This tax rate is applicable to individuals whose taxable income exceeds \$336,550. Additionally, upon death, transfers of property will incur an additional estate tax with a ceiling of 46 percent in 2006 to decline to 45 percent for the years 2007 through 2009. *Id.* § 2001(c)(2). There will be no estate tax for the year 2010 and the maximum rate will return to 50 percent in 2011. *Id.* §§ 2001(c)(1).

may be subject to double taxation on income derived from their host country due to the conflict between the two systems of taxation.³²

In contrast, nonresident noncitizens³³ only pay U.S. taxes on U.S.-source income or income connected to the conduct of trade or business within the United States.³⁴ Nonresident noncitizens are taxed at a flat rate of 30 percent for income not connected with U.S. business³⁵ or at the same progressive rate structure applicable to U.S. citizens for income connected with a U.S. business.³⁶ Nonresident noncitizens are able to avoid many of the burdensome taxes imposed on U.S. persons.³⁷ Status

32. Renee S. Liu, Note, *The Expatriate Exclusion Clause: An Inappropriate Response to Relinquishing Citizenship for Tax Avoidance Purposes*, 12 GEO. IMMIGR. L.J. 689, 694 (1998). See Carmichael, *supra* note 28, at 165–66. A person's country of citizenship is referred to as their "home" country while the country where the person resides, derives income or owns property is referred to as the "host" country if different from their "home" country. The risk of double taxation also extends to a nonresident citizen's estate if the estate includes property situated within the host country. This double taxation may be abated or eliminated by income tax and estate tax treaties with other nations. As of April 30, 2004, the United States had fifty-four income tax treaties (one of which is the Commonwealth of Independent States which consists of the countries of Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan and Uzbekistan to bring the total number of countries the United States has income tax treaties with to sixty-two). See Department of Treasury Publication 901, U.S. Tax Treaties, at 48, tbl. 3 (List of Tax Treaties) (May 2004), available at <http://www.irs.gov/pub/irs-pdf/p901.pdf> (last visited Feb. 16, 2006). Treaties serve to lessen or maintain the tax burden, never to raise the tax burden. Ernest R. Larkins, *U.S. Income Tax Treaties in Research and Planning: A Primer*, 18 VA. TAX REV. 133, 189 (1998). However, some U.S. tax treaties contain "savings clauses" which reserves a country's right to tax its citizens or residents notwithstanding the existence of the treaty. *Id.* at 186. Moreover, tax burdens on U.S. citizens living abroad may decrease if they qualify for foreign income tax credits on foreign income taxes paid on income earned outside the United States. Heath, *supra* note 30, at 545 n.95. See I.R.C. §§ 901–07.

33. Expatriated Americans living abroad are considered nonresident noncitizens. See Heath, *supra* note 30, at 545.

34. I.R.C. § 871; Heath, *supra* note 30, at 545. The United States does not tax nonresident aliens on income derived from a source outside the United States. See generally I.R.C. § 871. Resident aliens are taxed comparably to U.S. individuals. See I.R.C. § 1; Heath, *supra* note 30, at 545.

35. I.R.C. § 871(a). Income not connected with U.S. business is basically income from U.S. sources. These sources include interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and the like, generated from within the United States. See generally *id.* § 871(a)(1)(A)–(D).

36. See *id.* § 871(b). This means conducting business within the United States. Moreover, the federal estate tax is not imposed on nonresident noncitizens except for assets within the United States. *Id.* § 2107.

37. See *infra* Table 1 for a comparison.

as a nonresident noncitizen allows an expatriate to avoid any U.S. tax liability on foreign source income and capital gains tax on appreciated U.S. securities by selling them and reinvesting outside the United States.³⁸ Consequently, the U.S. tax structure creates an incentive for many wealthy American individuals to expatriate for tax-avoidance purposes.³⁹

C. *The Battle Over Expatriation*

To trace the history of expatriation, one must turn to English common law. In recognizing the English doctrine of “perpetual allegiance,” U.S. common law disallowed renunciation of U.S. citizenship.⁴⁰ “Perpetual allegiance” espoused the principle that an individual had no legal right to renounce his or her sovereign.⁴¹ In the mid-nineteenth century, however, the United States, perhaps recognizing the inconsistency of admitting expatriates of other countries while disallowing expatriation of its own citizens,⁴² enacted the Expatriation Act of 1868.⁴³ Consequently, the United States formally acknowledged the freedom to renounce one’s citizenship as “a natural and inherent right of all people indispensable to the enjoyment of the rights of life, liberty and the pursuit of happiness.”⁴⁴ Since then, the roots of the right to expatriate have grown deep in American soil.⁴⁵ Only recently has Congress promulgated legislation to curb expatriation for tax-avoidance purposes.⁴⁶

38. Heath, *supra* note 30, at 545. Nonresident noncitizens are also not subject to the U.S. Estate Tax on their estates except on property situated within the United States. I.R.C. § 2101.

39. Heath, *supra* note 30, at 546.

40. Jerry R. Dagrella, *Wealthy Americans Planning to Renounce Their Citizenship to Save on Taxes Have a New Problem to Consider: This Time Congress Means Business*, 13 *TRANSNAT’L LAW.* 363, 364 (2000), *citing* Mackenzie v. Hare, 239 U.S. 299, 308 (1915) (recognizing the perpetual allegiance rule from England).

41. Dagrella, *supra* note 40, at 365.

42. Heath, *supra* note 30, at 543.

43. Expatriation Act of 1868, 15 Stat. 223 (1868).

44. Heath, *supra* note 30, at 543, *citing* Expatriation Act of 1868, 15 Stat. 223, pmb1. The U.S. Supreme Court also recognized that a citizen has a “constitutional right to remain a citizen in a free country unless he voluntarily relinquishes that citizenship.” Dagrella, *supra* note 40, at 368 n.40, *citing* Afroyim v. Rusk, 387 U.S. 253, 268 (1967).

45. This is evidenced by the consideration taken by Congress in fashioning a regime to tax individuals who wish to renounce citizenship by employing objective standards and to allow individuals to cut all ties with the United States and completely renounce citizenship if not done primarily for tax avoidance reasons. *See* STAFF OF JOINT COMM. ON TAXATION, 108TH CONG., 1ST SESS., *REVIEW OF THE PRESENT—LAW TAX AND IMMIGRATION TREATMENT OF RELINQUISHMENT OF CITIZENSHIP AND TERMINATION OF*

In the early 1990s, heavy media coverage familiarized Americans with tax-motivated expatriation.⁴⁷ Commentators and proponents of stronger expatriation laws appealed to people's sense of patriotism and loyalty to the United States by emotionally charging citizens who expatriate to avoid taxes as "financial draft evaders"⁴⁸ or "Billionaire Benedict Arnolds."⁴⁹ In 1996, Congress responded to the growing uneasiness over "taxpatriating"⁵⁰ by passing key provisions for dealing with the avoidance of income tax in two pieces of legislation. The first, the Health Insurance Portability and Accountability Act (HIPAA), amended provisions of Internal Revenue Code (I.R.C.) section 877 which governs tax-motivated expatriation.⁵¹ The amended provision taxes income of expatriates as if they were still U.S. citizens for ten years following the date

LONG-TERM RESIDENCY (Comm. Print 2003), available at <http://www.house.gov/jct/s-2-03.pdf> (last visited Jan. 8, 2006) [hereinafter 2003 JCT Report].

46. Congress first enacted the alternative tax regime in 1966 when it passed the Foreign Investors Tax Act. 2003 JCT Report, *supra* note 45, at 76, citing Pub. L. No. 89-809. The United States is also not alone in its taxation of expatriates. Eritrea, Finland, France, Germany, the Netherlands, Norway, the Philippines, Sweden and others all impose some form of taxation on former residents. Liu, *supra* note 32, at 700, citing STAFF OF JOINT COMM. ON TAXATION, 104TH CONG., 1ST SESS., ISSUES PRESENTED BY PROPOSALS TO MODIFY THE TAX TREATMENT OF EXPATRIATION, at B4-B7 (Comm. Print 1995). See also 2003 JCT Report, *supra* note 45, at 140-52 (Summary of Other Countries' Taxation of Citizenship Relinquishment, Residency Termination, and Immigration).

47. Several articles spurred the debate regarding taxpatriation. See generally Lenzner, *supra* note 14; James W. Michaels, Editorial, *You Can't Take It (All) With You*, FORBES, Mar. 13, 1995; Robert Lenzner & Philippe Mao, *The New Refugees: Americans Who Give Up Citizenship to Save on Taxes*, FORBES, Nov. 21, 1994, at 131; DeWitt, *supra* note 6; Brigid McMenamin, *Flight Capital: Avoiding U.S. Taxes By Renouncing Citizenship*, FORBES, Feb. 28, 1994, at 55.

48. Michael Kingsley, *Love It or Leave It*, TIME, Nov. 28, 1994, at 96.

49. During a House discussion regarding the Health Insurance Portability and Accountability Act of 1996, Representative Neil Abercrombie referred to billionaires who expatriated to avoid taxes as, "Benedict Arnolds who would sell out their citizenship, sell out their country in order to maintain their wealth. [J]et set[ters] who are able to . . . enjoy the full benefits of all the wealth that they have accumulated in the United States of America as citizens, and renounce." *Abercrombie Decries Recession of Expatriate Tax Provision from Health Deduction Bill*, TAX NOTES TODAY, Apr. 11, 1995, available at 95 TNT 70-27 (Lexis). See also Liu, *supra* note 32, at 690; Jeffrey M. Colon, *Changing U.S. Tax Jurisdiction: Expatriates, Immigrants, and the Need for a Coherent Tax Policy*, 34 SAN DIEGO L. REV. 1, 3 (1997); Kirsch, *supra* note 14, at 923.

50. Michelle Leigh Carter, Note, *Giving taxpatriates the Boot Permanently?: The Reed Amendment Unconstitutionally Infringes on the Fundamental Right to Expatriate*, 36 GA. L. REV. 835, 837 (2002), quoting Lenzner, *supra* note 14, at 44.

51. Health Insurance Portability and Accountability Act, Pub. L. 104-191, 511-513, 110 Stat. 1936 (1996).

of expatriation if they are found to have expatriated for tax-avoidance purposes.⁵² The second, the Illegal Immigration Reform and Immigrant Responsibility Act (IIRIRA),⁵³ amended and expanded part of the Immigration and Nationality Act (INA)⁵⁴ to deny expatriates re-entry into the United States if the U.S. Attorney General determines that the former citizen renounced U.S. citizenship for purposes of avoiding taxes.⁵⁵ Under the provisions of the IIRIRA, frequently referred to as the “Reed Amendment,”⁵⁶ the “taxpatriate” is deemed “inadmissible”⁵⁷ alongside

52. See generally I.R.C. § 877(a) (as amended by HIPAA). The I.R.C. also addresses expatriating to avoid estate taxes in section 2107 which imposes U.S. estate taxes for ten years following the date of death of the former citizen if it is established that the former citizen had a principal purpose of avoiding income taxes as determined under section 877(a)(2). I.R.C. § 2107(a).

53. Illegal Immigration Reform and Immigrant Responsibility Act, 8 U.S.C. §§ 1101, 1182, 1481, 1483 (1996).

54. Immigration and Nationality (McCarran) Act, 8 U.S.C. § 1182 (1996).

55. INA § 1182(a)(10)(E) (“Any alien who is a former citizen of the United States who officially renounces United States citizenship and who is determined by the Attorney General to have renounced United States citizenship for the purpose of avoiding taxation by the United States is inadmissible.”); Liu, *supra* note 32, at 690–91.

56. See generally Carter, *supra* note 50. The Reed Amendment is intended to impose a significant direct cost on a tax-motivated expatriate by foreclosing the former citizen’s ability to return to the United States. Kirsch, *supra* note 14, at 896. Representative Reed, in proposing the amendment, stated, “in an instrumental way, I would hope in the future if those very slick and smart tax lawyers advising their clients about how to avoid their taxes suggest expatriation they should also indicate very clearly that the consequences are you cannot return at will to the United States.” *Id.* (citing 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). According to Kirsch, Representative Reed introduced this amendment in response to a particular tax-motivated expatriate, Kenneth Dart, an owner of Dart Container Company, surrendered his citizenship to avoid U.S. taxes and became a citizen of Belize. Kirsch, *supra* note 14, at 892 n.133. Mr. Dart reportedly convinced the Belize government to appoint him as a consular official to the United States where he would have opened a consular office in Sarasota, Florida, Mr. Dart’s former hometown and city where his family still lived. *Id.* If Mr. Dart had been allowed to enter the United States as a diplomatic representative of Belize, he could have resided in there for the entire year without becoming a resident alien for U.S. income tax purposes. *Id.* (citing I.R.C. § 7701(b)(5)(A)(i), (5)(B) (West 2000), which exempts foreign diplomats and consular officials from the substantial presence test for income tax residence). After Representative Reed’s introduction of the Reed Amendment, but before it was enacted by HIPAA, Belize withdrew its request to appoint Mr. Dart as a consular official. *Id.* (citing State Dept. Briefing (Apr. 5, 1996), in Fed. News Serv., Apr. 5, 1996).

57. The terms “admission” and “admitted” in the IIRIRA supplanted the term “entry” in INA section 1101(a)(13) and effectively treated all aliens not “admitted” as applicants for admission even if the applicant possessed an immigrant visa issued by a consular officer in his or her home country. The visa only constitutes prima facie evidence of ad-

terrorists,⁵⁸ former-Nazis,⁵⁹ international child abductors⁶⁰ and government officials who severely violated religious freedom,⁶¹ to name a few.⁶²

More recently, Congress passed the American Jobs Creation Act of 2004 (2004 Jobs Act)⁶³ which revised the amendments made by HIPAA to ease administration and increase enforcement of the anti-taxpatriation provisions within the I.R.C.⁶⁴ The new provisions are also meant to further deter taxpatriating while allowing those who truly wish to sever ties with the United States to do so.⁶⁵

II. BACKGROUND

A. Income Tax Benefits of Expatriation

The combined effect of the United States' current tax structure (i.e., the "worldwide taxation" system), and the mechanisms employed by the federal government to curb taxpatriation, ensures that this problem will remain unless drastic changes occur.⁶⁶ Table 1 compares the tax treatment of U.S. resident and nonresident citizens versus nonresident non-citizens.⁶⁷ As Table 1 demonstrates, in a world surrounded by the territorial taxation system, the United States' worldwide taxation system rewards, rather than discourages taxpatriation.⁶⁸

missibility and does not preclude a "second look" by inspectors at the port-of-entry. 3 C.J.S. *Aliens* § 544 (West 2004).

58. See INA § 1182(a)(3)(B).

59. See *id.* § 1182(a)(3)(E).

60. See *id.* § 1182(a)(10)(C).

61. See *id.* § 1182(a)(2)(G).

62. See generally *id.* § 1182(a) for a complete list.

63. See *infra* note 108.

64. See 2003 JCT Report, *supra* note 45, at 204.

65. See *id.* at 204-07.

66. Provisions imposing an alternative tax on taxpatriates have existed since 1966. See *supra* note 46. Additionally, the stricter HIPAA provisions dealing with renunciation of citizenship for tax avoidance purposes has been in effect since 1996. See *supra* Part I.D. Since then, the problem of taxpatriating has not abated but continued to be a source of debate within Congress. See 2003 JCT Report, *supra* note 45. See also *infra* note 106. This is a partisan issue with many house Democrats calling for "punishments" of sorts to deal with taxpatriation and house Republicans calling for more "neutral" solutions. See generally De Witt, *supra* note 6; Lars-Erik Nelson, *The Happiest Billionaires—Abroad*, NEWSDAY, Apr. 2, 1995, at A34.

67. See *infra* Table 1.

68. The effects are even clearer when comparing income tax rates for U.S. corporations versus foreign corporations. For U.S. corporations, income originating in the United

Table 1

Income Source	United States Income Tax Imposed		
	<i>Resident Citizen</i>	<i>Nonresident Citizen</i>	<i>Nonresident Alien</i>
<i>United States</i>	Up to 35% ⁶⁹	Up to 35% ⁷⁰ plus applicable foreign income tax	30% ⁷¹
<i>Foreign Country</i>	Up to 35% ⁷²	Up to 35% ⁷³ plus applicable foreign income tax	0% ⁷⁴

States is taxed by the United States at a maximum rate of 35 percent. On the other hand, income of U.S. corporations originating in a foreign country is taxed by the United States at the maximum rate of 35 percent plus the applicable foreign tax rate. Foreign corporations, on the other hand, while taxed at the 30 percent tax rate for income originating in the United States, do not pay foreign taxes on that income. For income originating in a foreign country, they pay only the applicable foreign tax rate and no U.S. tax. *See generally* I.R.C. §§ 11, 881–882. Furthermore, when an individual factors in the effects of the U.S. estate taxes, the benefits become greater. The United States imposes estate tax on the worldwide estates of its citizens at a maximum rate of 46 percent in 2006. *See generally id.* at § 2001. Comparability of tax rates or even tax systems do not really provide a suitable benchmark. Unlike the United States, many developed nations do not impose capital gains tax. Michael G. Pfeifer & Joseph S. Henderson, *Expatriation: The Ultimate Estate Planning Tool?*, A.L.I.-A.B.A. COURSE OF STUDY, Course No. SJ027, Aug. 21–22, 2003, available at WL SJ027 ALI-ABA 575, 598 n.56. Others, although considered “high” tax jurisdictions may impose no estate or inheritance tax or impose taxes at rates far below applicable U.S. rates. *Id.*

69. I.R.C. § 1, amended by Rev. Proc. 2005-70, 2005-47 I.R.B. 979.

70. *Id.* Nonresident citizens may also be able to exclude foreign earned income up to \$80,000 and housing costs from their gross income. *Id.* § 911.

71. *Id.* § 871(a). This section only applies to income not connected to U.S. business. *See supra* note 35. Tax rates for effectively connected income from the conduct of trade or business within the United States are the same progressive tax rates as citizens in I.R.C. sections 1 and 55. I.R.C. § 871(b). *See supra* note 36. A discussion of effectively connected income is beyond the scope of this Note. Generally, gain on the sale of U.S. real property or income from regular, substantial and continuous profit-oriented activities will be considered connected to a trade or business. Eva Farkas-DiNardo, *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. 1, 10 n.11 (2005).

72. I.R.C. § 1. In addition, the taxable income may be subject to tax of the source country.

73. *Id.*

74. *See id.* § 871.

B. Renunciation of Citizenship by Individuals

The procedure for expatriation is governed by the INA.⁷⁵ Section 1481(a) of the INA outlines actions an individual must undertake to renounce U.S. citizenship.⁷⁶ An individual must either: naturalize in a foreign state,⁷⁷ formally declare allegiance by oath or affirmation to a foreign nation,⁷⁸ enlist in the military service of another country either as an officer or in a state that is engaged in hostilities against the United States,⁷⁹ commit treason,⁸⁰ renounce citizenship at a U.S. diplomatic or consular office,⁸¹ or provide renunciation in writing to the Attorney General when the United States is engaged in war.⁸² Pursuant to statute, a U.S. citizen can only renounce her citizenship on foreign territory.⁸³

C. Previous Efforts to Curb Tax-Motivated Expatriation

1. Health Insurance Portability and Accountability Act of 1996

As discussed above, HIPAA imposed an alternative tax regime on former citizens determined by the Attorney General to have expatriated for

75. See *supra* notes 54–56 and accompanying text.

76. See 8 U.S.C. § 1481(a).

77. *Id.* § 1481(a)(1) (“obtaining naturalization in a foreign state upon his own application or upon an application filed by a duly authorized agent, after having attained the age of eighteen years”).

78. *Id.* § 1481(a)(2) (“taking an oath or making an affirmation or other formal declaration of allegiance to a foreign state or a political subdivision thereof, after having attained the age of eighteen years”).

79. *Id.* § 1481(a)(3) (“entering, or serving in, the armed forces of a foreign state if (A) such armed forces are engaged in hostilities against the United States, or (B) such persons serve as a commissioned or noncommissioned officer”).

80. *Id.* § 1481(a)(7) (“committing any act of treason against, or attempting by force to overthrow, or bearing arms against, the United States”).

81. *Id.* § 1481(a)(5) (“making a formal renunciation of nationality before a diplomatic or consular officer of the United States in a foreign state, in such form as may be prescribed by the Secretary of State”).

82. *Id.* § 1481(a)(6) (“making in the United States a formal written renunciation of nationality in such form as may be prescribed by, and before such officer as may be designated by, the Attorney General, whenever the United States shall be in a state of war and the Attorney General shall approve such renunciation as not contrary to the interests of national defense”).

83. *Id.* § 1483(a) (except as provided under INA § 1481(a)(6)–(7) which provides that a former citizen renounces citizenship if he or she commits treason or provides writing to the Attorney General renouncing citizenship while the United States is at war). See also Liu, *supra* note 32, at 692.

tax-avoidance purposes.⁸⁴ The alternative tax effectively taxes the expatriate for ten years following the date of expatriation.⁸⁵ HIPAA sets a statutory presumption of expatriation for tax-avoidance purposes if the former citizen's "annual net income tax for the period of five taxable years ending before the date of the loss of United States citizenship is greater than \$100,000, or the net worth of the individual as of such date is \$500,000 or more."⁸⁶ Former citizens can contest the statutory presumption of tax-avoidance.⁸⁷ However, they bear the burden of showing that the expatriation was not tax-motivated.⁸⁸ I.R.C. section 877(c) (as amended by HIPAA) provides that the statutory presumption of tax-avoidance in section 877(a)(2) (as amended by HIPAA) does not apply if the expatriating individual: (1) has dual citizenship;⁸⁹ (2) is a long-term foreign resident; or (3) renounces citizenship before reaching the age of majority.⁹⁰ Additionally, within a year from the date of expatriation, the former citizen must appeal the presumption by submitting a ruling request for the Secretary's⁹¹ determination as to whether avoidance of U.S. taxes was one of the principal purposes for the renunciation of citizenship.⁹² If this procedure is followed, the former citizen is not presumed to have expatriated for tax avoidance purposes until the Secretary makes a ruling regarding the matter.⁹³

If the Secretary finds that an individual expatriated to avoid taxes within the meaning of section 877(a), the individual must file a statement pursuant to I.R.C. section 6039G, to either the Secretary or a competent court, with information regarding the expatriated individual's address of

84. I.R.C. § 877(b) (as amended by HIPAA).

85. *See id.* § 877(a)(1).

86. *Id.* § 877(a)(2)(A)–(B). For 2006, the annual net income tax is \$131,000 for the five taxable years before the date of renunciation. I.R.C. § 877(a)(2)(A), *amended by* Rev. Proc. 2005-70, 2005-47 I.R.B. 979. The net worth amount is currently \$2,000,000 or more. I.R.C. § 877(a)(2)(B). *See also infra* notes 120–21.

87. *See* I.R.C. § 877(c) (as amended by HIPAA).

88. *See id.* § 877.

89. The category of dual citizenship is broader than the traditional notion of holding citizenship in two countries simultaneously. Under I.R.C. § 877(c)(2)(A) (as amended by HIPAA), it includes an individual who became, at birth, a citizen of the United States and another country and continues to be a citizen of that country and an individual who becomes an citizen of his or her spouse's or either parents' country of birth.

90. *See id.* § 877(c)(2)(A)–(C). The age of majority is eighteen and a half years. *Id.* § 877(c)(2)(C).

91. "Secretary" in the I.R.C. refers to the Secretary of the Treasury or his or her delegate. *See id.* § 7701(a)(11)(B).

92. *See id.* § 877(c)(1)(B).

93. *See id.* § 877; Liu, *supra* note 32, at 697.

foreign residence, information detailing the assets and liabilities of such individual, the foreign country in which the individual is a citizen and the taxpayer's TIN,⁹⁴ among other requirements.⁹⁵ The Secretary is then required to publish the name of the expatriated individual in the Federal Register.⁹⁶

Another purpose for amending I.R.C. section 877 was "to equalize the United States tax burdens of expatriates with their United States tax liabilities had they not expatriated."⁹⁷ Though much legislation was written and many changes were made to stop "taxpatriation," the provision has largely been ineffective due to the scores of exceptions available to counter the presumption of tax-motivated expatriation.⁹⁸ With careful planning, even if a citizen considering expatriation does not qualify for an exception now, he or she may qualify at a later date.⁹⁹

2. Illegal Immigration Reform and Immigrant Responsibility Act of 1996

The IIRIRA's amendment to the INA (Reed Amendment) works in conjunction with HIPAA's amendment to the I.R.C.¹⁰⁰ The Reed Amendment, which denies admission to expatriates who renounced citizenship to avoid taxes, is only invoked after the Attorney General determines that the citizen expatriated for tax-avoidance reasons under I.R.C. section 877 (as amended by HIPAA).¹⁰¹ As discussed above, a section 877 determination of tax-motivated expatriation is rarely found.¹⁰² Additionally, as of February 2006, the Reed Amendment has never been enforced.¹⁰³

94. See I.R.C. § 7701(a)(41) (as amended by HIPAA) ("TIN" means the identifying number assigned to a person under § 6109).

95. *Id.* § 6039G(b).

96. *Id.* § 6039G(e)(3).

97. Colon, *supra* note 49, at 44–45. It may also have been in response to media coverage admonishing "taxpatriation." See *supra* notes 6, 14, 47–48.

98. Liu, *supra* note 32, at 698. See also 2003 JCT Report, *supra* note 45; *infra* Part III.A.

99. Liu, *supra* note 32, at 698. The same goes for avoiding the tax placed upon unrealized gains from assets which have appreciated. A patient expatriate who is able to wait the ten years before selling his or her assets can defer in part, and avoid in part, the capital gains tax. *Id.* at 699.

100. *Id.* at 698.

101. INA § 1182(a)(10)(E).

102. Carter, *supra* note 50, at 839. See also 2003 JCT Report, *supra* note 45, at 100.

103. See 2003 JCT Report, *supra* note 45, at 72. There is also an issue as to the constitutionality of such a provision. See generally Carter, *supra* note 50.

In response to the deficiencies and failures of HIPAA and the IIRIRA, Congress authorized the Joint Committee on Taxation to investigate their effectiveness.¹⁰⁴ In February 2003, the Joint Committee on Taxation published its findings.¹⁰⁵ As a result, Congress commenced another round of legislative drafting.¹⁰⁶ As a result of these efforts, many of the Joint Committee's recommendations to increase enforcement, ease the administration of I.R.C. section 877, and deter expatriation¹⁰⁷ are codified in the 2004 Jobs Act.¹⁰⁸

D. Current Efforts to Reduce Taxpatriation—The American Jobs Creation Act of 2004

As Congress's most recent attempt to curb tax-motivated expatriation, the 2004 Jobs Act amends the I.R.C. to remove its shortcomings.¹⁰⁹ It modifies the provisions enacted by HIPAA and section 877 to generally follow the recommendations made by the Joint Committee on Taxation in its 2003 report.¹¹⁰ 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 877.¹¹¹ Second, it provides a tax-based, instead of immigration-based, set of rules for de-

104. 2003 JCT Report, *supra* note 45, at 1.

105. *Id.*

106. *See generally* S. 260, 108th Cong. (2003) (Senator Thomas Harkins sponsored this bill which introduced a mark-to-market regime to "amend the Internal Revenue Code of 1986 to prevent the continued use of renouncing U.S. citizenship as a device for avoiding U.S. taxes"); S. 1054, 108th Cong. § 340 (2003) (Senator Charles Grassley sponsored this bill to reconcile the budget for fiscal year 2004 and included revised tax rules on expatriation and also called for a mark-to-market regime).

107. *See* 2003 JCT Report, *supra* note 45, at 75. Congress is trying to achieve the goals of: (1) expressing official disapproval of tax motivated expatriation; (2) deterring or punishing tax-motivated expatriation; (3) removing unintended tax incentives from expatriation; (4) taxing appreciation and asset value that accrues while a person is a U.S. citizen or resident; and (5) ensuring that individuals cannot enjoy tax benefits that may arise from expatriating while maintaining ties to the United States. *Id.* *See also infra* notes 152–53.

108. H.R. 4520, 108th Cong. (2004) (enacted).

109. *See generally* American Jobs Creation Act of 2004 (2004 Jobs Act), Pub. L. No. 108-357, §§ 801–06 (2004). *See also* 2003 JCT Report, *supra* note 45, at 72–74 (identifying impediments to effectively removing avoidance of taxes from a former citizen's decision to renounce citizenship).

110. For the Joint Committee recommendations, see generally 2003 JCT Report, *supra* note 45, at 204 (Part XI: Joint Committee Staff Recommendations).

111. *See* I.R.C. § 877(a)–(b) (as amended by the 2004 Jobs Act). *See also infra* Part III.B.1; 2003 JCT Report, *supra* note 45, at 205–08.

termining when an individual is no longer a U.S. citizen for federal tax purposes.¹¹² 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.¹¹³ Lastly, it provides that an annual information return¹¹⁴ be filed for each of the ten years following expatriation.¹¹⁵

1. Objective Rules for Determining Applicability of the Alternative Tax Regime

The Joint Committee recommended instituting an objective standard to determine whether a citizen has renounced U.S. citizenship to avoid taxes.¹¹⁶ The former provisions made administering the alternative tax regime difficult since it required the Internal Revenue Service (IRS) to determine the subjective intent of taxpayers who wished to expatriate.¹¹⁷ The 2004 Jobs Act replaces the subjective test established by the HIPAA amendments to section 877 by establishing a *presumption* of tax-avoidance.¹¹⁸

Similar to HIPAA, the 2004 Jobs Act subjects the taxpayer to the alternative tax regime for the ten years following renunciation of citizenship if the taxpayer meets certain requirements.¹¹⁹ If the individual's average annual net income tax for the five taxable years prior to the date of the loss of U.S. citizenship is greater than \$124,000,¹²⁰ the net worth of the individual is \$2,000,000 or more,¹²¹ or the individual either fails to make

112. See I.R.C. § 7701(n) (as added by the 2004 Jobs Act). See also *infra* Part III.B.2; 2003 JCT Report, *supra* note 45, at 208–10.

113. See I.R.C. § 877(g) (as added by the 2004 Jobs Act). See also *infra* Part III.B.3; 2003 JCT Report, *supra* note 45, at 210–12.

114. See *supra* note 94–95 and accompanying text for requirements for an information statement under I.R.C. § 6039G.

115. I.R.C. § 6039G (as amended by the 2004 Jobs Act). See *infra* Part III.B.4; see also 2003 JCT Report, *supra* note 45, at 213–15.

116. 2003 JCT Report, *supra* note 45, at 205–08.

117. *Id.*

118. See 2004 Jobs Act, Pub. L. No. 108-357, § 804(a)(1)–(2). The HIPAA amendments to section 877 only established tax-avoidance as a principle purpose of expatriation if certain factors were established by the IRS. The principal purpose of tax-avoidance could also be rebutted by numerous exceptions. See *supra* Part II.D.

119. I.R.C. § 877(a)(1) (as amended by the 2004 Jobs Act).

120. *Id.* § 877(a)(2)(A).

121. *Id.* § 877(a)(2)(B).

certain certifications¹²² or fails to submit evidence of compliance as the Secretary may require,¹²³ then the individual will be taxed under the alternative tax regime.¹²⁴ Unlike the HIPAA amendments, if the monetary thresholds described above are met, the 2004 Jobs Act applies the alternative tax regime of I.R.C. section 877 *unless* the former citizen meets certain exceptions.¹²⁵ The 2004 Jobs Act also lessens the number of exceptions available to avoid the alternative tax regime.¹²⁶ There are only two exceptions recognized which allow an expatriate to escape the monetary thresholds before imposition of the alternative tax regime.¹²⁷ The individual must either be a dual citizen or a “certain minor.”¹²⁸

Dual citizenship for purposes of the 2004 Jobs Act changed from the definition employed by HIPAA.¹²⁹ Dual citizenship, as defined by the 2004 Jobs Act, is any individual who became at birth a citizen of both the United States and another country, continues to be a citizen of such other country, and has had no substantial contacts with the United States.¹³⁰ An individual will be treated as having no substantial contacts with the United States only if the individual (i) was never a resident of the United States (as defined in section 7701(b)),¹³¹ (ii) has never held a

122. The individual must certify under penalty of perjury that he or she has met the requirements set out in the 2004 Jobs Act for the five preceding taxable years. *Id.* § 877(a)(2)(C).

123. *Id.*

124. I.R.C. § 877(a)(1)–(2).

125. 2003 JCT Report, *supra* note 45, at 9. *See also* 2004 Jobs Act, Pub. L. No. 108-357, § 804. HIPAA only established a rebuttable purpose of tax avoidance upon satisfaction of certain factors. *See supra* Part II.C.

126. *See generally* I.R.C. § 877(c) (as amended by the 2004 Jobs Act). The number of exceptions available in the past has been seen as a major point of inefficiency of I.R.C. § 877. 2003 JCT Report, *supra* note 45, at 204–10.

127. The two exceptions are dual citizenship and minority. I.R.C. § 877(c) (as amended by the 2004 Jobs Act).

128. *Id.*

129. *See supra* note 89 and accompanying text.

130. *See* I.R.C. § 877(c)(2)(A) (as amended by 2004 Jobs Act). In addition, an individual is considered a dual citizen under HIPAA when such individual becomes (not later than the close of a reasonable period after loss of U.S. citizenship) a citizen of the country in which: such individual was born; if such individual is married, such individual's spouse was born; or either of such individual's parents were born. I.R.C. § 877(c)(2)(A)(i)–(III) (as amended by HIPAA).

131. I.R.C. § 7701(b)(1) defines resident alien and nonresident alien. In general, a resident alien individual shall be treated as a resident of the United States with respect to any calendar year if (and only if) such individual: (i) is a lawful permanent resident of the United States at any time during such calendar year; (ii) meets the substantial presence test of paragraph (3); or (iii) makes the first year election. *Id.* § 7701(b)(1)(A). An indi-

U.S. passport, and (iii) was not present in the United States for more than thirty days during any calendar year for each of the ten calendar years preceding the individual's loss of U.S. citizenship.¹³²

The second exception allows "certain minors" to avoid the alternative tax regime.¹³³ An individual qualifies as a "certain minor" if he or she became at birth a citizen of the United States, neither parent of such individual was a citizen of the United States at the time of such birth, the individual's loss of U.S. citizenship occurs before such individual attains the age of eighteen and a half years, and the individual was not present in the United States for more than thirty days during any calendar year for each of the ten calendar years preceding the individual's loss of U.S. citizenship.¹³⁴

2. Tax-Based Rules For Determining Date of Expatriation

The 2004 Jobs Act amends the definitions set out in I.R.C. section 7701 by adding a new subsection. The new subsection (n) states that an individual who wishes to be treated as a nonresident noncitizen of the United States shall continue to be treated as a citizen or resident of the United States until the individual (1) gives notice of an expatriating act¹³⁵ or termination of residency to the Secretary of State or the Secretary of Homeland Security, and (2) provides an information statement in accordance with I.R.C. section 6039G.¹³⁶ The Joint Committee submitted this recommendation to Congress because a former citizen could previously

vidual is a nonresident alien if such individual is neither a citizenship of the United States nor a resident of the United States (within the meaning of subparagraph(A). *Id.* §7701(b)(1)(B). *See also id.* § 7701(b)(2) (codifying special rules for first and last year of residency).

132. *See id.* § 877(c)(2)(B) (as amended by 2004 Jobs Act).

133. *Id.* § 877(c)(3).

134. *See id.* § 877(c)(3)(A)–(D). To achieve uniformity, the 2004 Jobs Act also amends I.R.C. § 2107(a) which applies to estate taxes. *See* I.R.C. §§ 2001, 2101, 2107, 2501 for taxation of estates. The Joint Committee recommended changes to the estate tax provisions dealing with expatriates because of the difficulty of enforcement by the IRS. *See* 2003 JCT Report, *supra* note 45, at 104. This lack of enforcement is due to the lack of information the IRS had access to regarding former citizens. *Id.*

135. *See supra* Part II.B for the statutory requirements for giving notice of an expatriating act.

136. *See generally* I.R.C. § 7701(n) (as added by 2004 Jobs Act); *id.* § 6039G. *See also supra* note 95 and accompanying text relating to section 6039G of the Internal Revenue Code of 1986.

convert his or her federal tax status to that of a nonresident noncitizen without notifying the IRS.¹³⁷

3. Imposition of Full U.S. Taxation Liability

As recommended by the Joint Committee on Taxation, Congress added a new subsection to I.R.C. section 877 which defines “physical presence.”¹³⁸ The new subsection (g) generally subjects an expatriate to full U.S. taxation if the individual returns to the United States for more than thirty days during any taxable year in which the individual is subject to the alternative tax.¹³⁹ There is, of course, an exception.¹⁴⁰ An individual can disregard counting up to thirty days of “physical presence” within the United States in any calendar year if the individual is in the United States to perform services for their employer and the individual either has ties to another country or has minimal prior physical presence in the United States.¹⁴¹ The exception does not apply, however, if the individual is related to the employer or fails to meet requirements determined by the Secretary to prevent the avoidance of U.S. tax liability.¹⁴²

The purpose of this amendment is to deter an individual who wishes to expatriate to avoid U.S. taxes but wishes to retain significant ties to their interests in the United States.¹⁴³ By shortening the periods allowed before imposition of full U.S. taxation, the drafters of the amendment hoped to catch taxpatriates while not unduly interfering with individuals who truly wish to sever all ties with the United States.¹⁴⁴

4. Annual Information Return-Filing Requirement

The 2004 Jobs Act amends section 6039G of the I.R.C. to ease the administrative burden of enforcing the alternative tax by imposing stricter

137. Under previous law, the INA governed the determination of when a U.S. citizen was treated for U.S. federal tax purposes as having relinquished citizenship. INA § 1481. *See also* 2003 JCT Report, *supra* note 45, at 209 n.585. Additionally, the information form requirement under I.R.C. § 877 (as amended by HIPAA) did not require that the individual renouncing U.S. citizenship give the information to the IRS on the form itself. It only required information be given to the Department of State. As a consequence, the IRS has had many difficulties receiving timely information to help administer the alternative tax regime. *See* 2003 JCT Report, *supra* note 45, at 81, 209.

138. *See* 2004 Jobs Act, Pub. L. No. 108-357, § 804(c).

139. *See* I.R.C. § 877(g)(1) (as added by the 2004 Jobs Act).

140. *See id.* § 877(g)(2).

141. *Id.*

142. *Id.*

143. *See* 2003 JCT Report, *supra* note 45, at 210–12.

144. *See id.*

requirements and a higher frequency for filing information statements.¹⁴⁵ As amended by the 2004 Jobs Act, I.R.C. section 6039G now requires an annual information filing directly to the IRS,¹⁴⁶ as well as information regarding the annual income, assets and liabilities, and information regarding the number of days the former citizen was physically present in the United States for each taxable year.¹⁴⁷ Previously, section 6039G only required former citizens to file an information statement if they owed U.S. federal income tax.¹⁴⁸ The new amendments are meant to give the IRS more information regarding the relocation activities of former citizens, as well as more information regarding income generated by assets, and any dispositions of assets that would result in the imposition of U.S. taxes.¹⁴⁹

III. ANALYSIS

A. Weakness of the HIPAA Alternative Tax Regime

As previously discussed, the problem of taxpatriation can be attributed to the United States' system of worldwide taxation and its high tax rates.¹⁵⁰ The 2004 Jobs Act is designed to help abate tax-motivated expatriation.¹⁵¹ Congress identified five desirable purposes to guide revisions

145. See also *supra* Part II.C.1.

146. I.R.C. § 6039G(a) (as amended by the 2004 Jobs Act).

147. *Id.* §§ 6039G(b)(5)–(6). The amendment also removed the monetary threshold the former citizen had to reach before providing information regarding their assets and liabilities. See I.R.C. § 6039G(b) (as amended by HIPAA).

148. See 2003 JCT Report, *supra* note 45, at 213–14.

149. See *id.*

150. See Daniel J. Mitchell, *An OECD Proposal to Eliminate Tax Competition Would Mean Higher Taxes and Less Privacy*, HERITAGE FOUNDATION BACKGROUNDER, Sept. 18, 2000, at 1, available at <http://www.heritage.org/Research/Taxes/BG1395.cfm> (last visited Mar. 6, 2006). Although this article focuses on the impact of tax havens and the relocation of assets offshore, it can be likened to the problem of expatriation to avoid taxes. The same tax havens where offshore capital is sheltered and kept private are where former citizens attain new citizenship. See *id.* Although U.S. tax rates are considered high when compared to the tax rates of countries where former U.S. citizens have now attained citizenship, they are considered low compared to the other industrialized nations of the European Union. *Id.*

151. As previously discussed, 2004 Jobs Act amends HIPAA. HIPAA itself was enacted due to prior ineffective legislation such as the Foreign Investors Act of 1966, Pub. L. No. 89-809; the Deficit Reduction Act of 1984, Pub. L. No. 98-369; and the Tax Reform Act of 1986, Pub. L. No. 99-514 and was in response to the Joint Committee on Taxation's report in 1995 regarding its findings on the treatment of expatriates. 2003 JCT

of inadequate provisions prescribed by section 877.¹⁵² The five goals that the alternative tax regime seek to accomplish are: (1) to express official disapproval of tax-motivated expatriation; (2) to deter or punish tax-motivated expatriation; (3) to remove unintended tax incentives from expatriation; (4) to tax appreciation and asset value that accrue while a person is a U.S. citizen or resident; and (5) to ensure that individuals cannot enjoy any tax benefits that may arise from expatriating while maintaining significant ties to the United States.¹⁵³ Although intended to deter tax-motivated expatriation and remedy the shortcomings of section 877 (as amended by HIPAA),¹⁵⁴ Congress has yet to pass legislation to adequately address the problem of taxpatriation and offer a solution.¹⁵⁵ These amended provisions fall short of achieving the five Congressional goals¹⁵⁶ and, as with the HIPAA amendments, essentially represent a tiger with no teeth.¹⁵⁷

Report, *supra* note 45, 76–81. *See generally* 1995 Joint Committee Tax Report, *supra* note 46.

152. *See* 2003 JCT Report, *supra* note 45, at 75. These purposes were found by the Joint Committee on Taxation and also included a sixth purpose—to achieve a combination of and variations of the other five purposes. *Id.*

153. *Id.* These purposes are identified as important because Congress primarily intended the alternative tax regime to be “neutral.” *Id.* Neutrality of the alternative tax regime means that Congress wanted to eliminate the possible tax incentives in renouncing citizenship. *Id.*

154. *See* H.R. 4520, 108th Cong. pmb. (2d Sess. 2004) (proposing the bill “to amend the Internal Revenue Code of 1986 to remove impediments in such Code. . .”). *See also* 2003 JCT Report, *supra* note 45, at 103–39. Examples of shortcomings are loopholes caused by an abundance of exceptions available to remove a former citizen from the reach of the alternative tax regime, the inability of the IRS to establish a former citizen’s intent to avoid taxes, and the under-enforcement of the alternative tax regime. *Id.*

155. Although the future impact of the 2004 Jobs Act amendments have yet to play out, a look at the past serves as a prediction of its inadequacy. Like the HIPAA amendments to I.R.C. section 877, the amendments from the 2004 Jobs Act also have problems with enforceability and ease of administration. *See infra* Part III.B. *See also* Brigid McMenemy, *Home Free*, FORBES, July 26, 1999, at 110. *See generally* Liu, *supra* note 32; Kirsch, *supra* note 14; Richard A. Westin, *Expatriation and Return: An Examination of Taxdriven Expatriation by United States Citizens, and Reform Proposals*, 20 VA. TAX REV. 75 (2000).

156. For reasons discussed *infra* Part III.B, the amended provisions of the 2004 Jobs Act, although remedying some inadequacies of the HIPAA amendments, do not offer the best solution to deter tax-motivated expatriation. *See* 2003 JCT Report, *supra* note 45, at 75 (finding that the alternative tax regime would not be the most effective regime to reduce tax-motivated expatriation). *See also id.* app. 26.3 (Letter from Jonathan Talisman, Acting Assistant Secretary (Tax Policy), Department of the Treasury to Lindy Paull, Chief of Staff, Joint Committee on Taxation, dated May 5, 2000) stating that problems inherent in the current law cannot fully be addressed through the mere modification of the

In a letter to the Joint Committee on Taxation, the Treasury Department found that for the United States' worldwide system of taxation, a mark-to-market regime would more effectively deter taxpatriation, be a more appropriate and administrable method of taxing expatriates, and would eliminate many of the problems inherent under section 877.¹⁵⁸ The Treasury Department's recommended mark-to-market regime would

existing regime). *See also* McMenamin, *supra* note 155. The HIPAA provisions do not seem to have deterred tax-motivated expatriation. Under I.R.C. § 6039G(d), the Secretary is required to publish the names of individuals who have been determined to have expatriated to avoid taxes. The names of 2,735 former citizens were published in the Federal Register between 1995 to 1999. 2003 JCT Report, *supra* note 45, at 122.

So far, 346 names have been published for 2005. 70 Fed. Reg. 23295 (May 4, 2005); 70 Fed. Reg. 68511 (Nov. 10, 2005); 71 Fed. Reg. 6312 (Feb. 7, 2006). The names for the quarter ending June 30, 2005 have not yet been released as of the publication of this Note. For 2004, 631 names were published in the Federal Register. 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 (Feb. 2, 2005). For 2003, 471 names were published in the Federal Register. 68 Fed. Reg. 23180 (Apr. 30, 2003); 68 Fed. Reg. 44840-01 (July 30, 2003); 69 Fed. Reg. 61906-07 (Oct. 21, 2004); 69 Fed. Reg. 61910-11 (Oct. 21, 2004). In 2002, 504 names were published in the Federal Register. 67 Fed. Reg. 19621 (Apr. 22, 2002); 67 Fed. Reg. 47889-90 (July 22, 2002); 67 Fed. Reg. 66456 (Oct. 31, 2002); 68 Fed. Reg. 4549-51 (Jan. 29, 2003). In 2001, 491 names were published in the Federal Register. 66 Fed. Reg. 48915 (Sept. 25, 2001); 66 Fed. Reg. 48912 (Sept. 24, 2001); 67 Fed. Reg. 11375 (Mar. 13, 2002); 67 Fed. Reg. 11374 (Mar. 13, 2002). In 2000, 431 names were published in the Federal Register. 65 Fed. Reg. 3542326 (June 2, 2000); 65 Fed. Reg. 5005051 (Aug. 16, 2000); 66 Fed. Reg. 8049495 (Dec. 21, 2000); 66 Fed. Reg. 4891315 (Sept. 24, 2001). These numbers are only for the number of individuals with respect to whom the Secretary receives information about *and* determines to have renounced United States citizenship within the meaning of I.R.C. § 877 (as amended by HIPAA) which included numerous exceptions. I.R.C. § 877(c).

157. *See* McMenamin, *supra* note 155, at 110 (quoting tax and estate lawyer F. Bentley Mooney in describing the effectiveness of the HIPAA amendments). The weaknesses described regarding HIPAA also apply to the Reed Amendment which bars a former citizen from re-entering the United States since the IRS has never enforced this provision. *Id.* *See generally* Carter, *supra* note 50 (arguing that the Reed Amendment is unconstitutional). Additionally, many individuals do not even formally renounce citizenship, believing they can evade the bar on visiting the United States. McMenamin, *supra* note 155, at 110.

158. 2003 JCT Report, *supra* note 45, app. 26. Other bills before Congress included S. 260, 108th Cong. (2003), which introduced a mark-to-market regime and S. 1054, 108th Cong. § 340 (2003), which also introduced a mark-to-market regime. This is not the first time Congress has rejected realization. Even amid the Clinton Administration's support of a this type of system, the 104th Congress rejected proposals in both the Senate and House of Representatives that introduced mark-to-market regimes for taxing expatriates because it was seen as an "exit tax" like the one imposed by the former Soviet Union. *See* Liu, *supra* note 32, at 701.

have imposed tax liabilities at the time a wealthy expatriate leaves the U.S. tax jurisdiction.¹⁵⁹ The tax base for this “exit tax” would have included foreign assets and focused on unrealized gains accrued during citizenship.¹⁶⁰ While recognizing that a better tax system existed, the Treasury Department nonetheless made recommendations to improve the alternative tax regime if Congress chose to do so.¹⁶¹ Congress did choose to retain the alternative tax regime¹⁶² and followed most of the recommendations of the Joint Committee on Taxation when amending the alternative tax in an attempt to increase its effectiveness.¹⁶³ Congress made this decision despite the Treasury Department’s determination that “mere modifications” to the alternative tax system could not fully address inherent problems with the current law,¹⁶⁴ and that alternative avenues of taxation would be more effective in deterring tax-motivated expatriation.¹⁶⁵

159. 2003 JCT Report, *supra* note 45, apps. 26.3–26.4 (Letter from Jonathon Talisman).

160. *Id.* Gains accrued while a U.S. citizen represent unrealized gains. The United States only taxes gains which are “realized.” See I.R.C. § 61(a) (definition of income); Treas. Reg. § 1.61-1(a) (1960) (taxable income includes income realized in any form, whether in money, property, or services); *Eisner v. Macomber*, 252 U.S. 189 (1920) (holding that a taxpayer who received a stock-split was not subject to taxation on the additional shares of stock because the taxpayer’s proportion of the corporation remained the same and did not have a greater ability to pay the tax). See also I.R.C. §§ 7190 (items specifically included in income); *id.* §§ 101–40 (Items specifically excluded from income). The realization requirement is illustrated by the rules for calculating gains from property. For property, gain equals amount realized minus basis. Basis equals the cost of the property and the amount realized equals money received from the sale or disposition of property plus the fair market value of property (other than money) received. *Id.* § 61(a)(3) (gain from property equals income); *id.* § 1001(a) (definition of basis); *id.* § 1001(b) (definition of amount realized).

161. 2003 JCT Report, *supra* note 45, app. 26.4 (Letter from Jonathon Talisman).

162. See I.R.C. § 877(b) (as amended by the 2004 Jobs Act) (alternative tax).

163. Compare I.R.C. § 877 (as amended by the 2004 Jobs Act), with 2003 JCT Report, *supra* note 45, pt. XI.

164. 2003 JCT Report, *supra* note 45, app. 26.1 (Letter from John Talisman: Question 30).

165. Such other measures include either imposing a mark-to-market system or simplifying the tax code. *Id.* See also *supra* note 106; H.R. 269, 108th Cong. (2003) (proposing to simplify the current tax code). President George W. Bush has set reforming the tax code as one of his goals during his second term. Howard Gleckman, *Three Roads to Reform: A Bush Panel Homes in on Ways to Make Taxes Fairer and Simpler*, BUS. WEEK, Aug. 1, 2005, available at 2005 WLNR 11830849. President Bush appointed an advisory panel to provide recommendations for making the tax code simpler, fairer and more conducive for economic growth. *Id.* Among other things, the panel recommended the elimination of the alternative minimum tax. Edmund L. Andrews, *Your Taxes; Tax Reform*

B. Weaknesses and Strengths of the 2004 Jobs Act

1. Objective Rules for Determining Applicability of the Alternative Tax Regime

Passed in response to the Joint Committee's hearings and recommendations, the 2004 Jobs Act addressed some of the concerns regarding the difficulty in administering section 877 (as amended by HIPAA) due to its subjective nature and its numerous exceptions.¹⁶⁶ Primarily, the 2004 Jobs Act presumes a principal purpose of tax-avoidance when an individual expatriates, if the individual meets the objective monetary standards.¹⁶⁷ The 2004 Jobs Act amendments also reduced the number of exceptions that allow a former citizen to escape the alternative tax regime from four to two.¹⁶⁸ The increased chance of being placed in the alternative tax regime should act as a further deterrent from taxpatriating since there are fewer loopholes. However, though arguably less so, the prior weaknesses associated with the alternative tax regime are still present. Even if an individual is determined to have taxpatriated and is subjected to the alternative tax regime, the problems of enforcement and

Looking for a Passing Lane, N.Y. TIMES, Feb. 13, 2005, available at 2005 WLNR 2041238. Congress has only had a lukewarm reception to Bush's proposals and reforming the tax code seems a distance prospect. Mark E. Battersby, *Coming Soon: More Circular 230 Amendments*, INVESTMENT NEWS, Nov. 14, 2005, available at 2005 WLNR 18677586. Many conservative Republicans want to switch to a consumption based tax system. Edmund L. Andrews, *Economic View; Echoes of 1986? Not in Bush's Tax Panel*, N.Y. TIMES, Nov. 6, 2005, available at 2005 WLNR 17931938. Bush's proposals do, however, include an end to worldwide taxation for corporate profits. Jeffrey H. Birnbaum, *Commission Proposes Overhaul of Tax System*, WASH. POST, Nov. 2, 2005, available at 2005 WLNR 17661723.

166. See generally I.R.C. § 877 (as amended by HIPAA).

167. See *supra* text accompanying notes 120–24.

168. Compare HIPAA, Pub. L. No. 104-191, § 511(b), with 2004 Jobs Act, Pub. L. No. 108-357, § 804(a)(2). See also *supra* note 126 and accompanying text. Additionally, it is striking that these are the only exceptions available to long-term residents. These exceptions seem to only except "accidental" Americans from the alternative tax. Farkins-DiNardo *supra* note 71, at 33. In contrast, long-term residents seek to establish a close connection with the United States and therefore would not qualify for the exceptions. See *id.* An argument exists as to whether it is even fair to subject residents to the alternative tax let alone not provide exceptions comparable to those available to U.S. citizens since long-term residents in general choose not to gain U.S. citizenship and have not completely divested themselves of their former identity with another country. One could argue that the exceptions are only applicable to U.S. citizens who seemingly did not choose citizenship and have stayed away but on the other hand, long-term residents chose not to become citizens and did not avail themselves of the full benefits available to U.S. citizens. See also *id.* at 33–34, 36.

effectiveness remain. If a former citizen is patient or has foreign assets, which are outside the reach of section 877, he or she can escape much of the U.S. tax burden.¹⁶⁹ In short, while the new objective standards theoretically deter tax-motivated expatriation¹⁷⁰ and express official disapproval, they neither remove unintended tax incentives from expatriation nor tax appreciation and asset value accrued during citizenship or residency.¹⁷¹

2. Tax-Based Rules For Determining Date of Expatriation

The new subsection (n) of I.R.C. section 7701 (as added by the 2004 Jobs Act) establishes special rules for when an individual is no longer a U.S. citizen or long-term resident.¹⁷² It tries to ensure that former citizens will not be able to renounce citizenship and enjoy the tax benefits of non-resident noncitizens without informing the IRS.¹⁷³ However, new subsection (n) does not address the treatment of former citizens who simply leave *without* formally renouncing citizenship to avoid the alternative tax regime.¹⁷⁴ Subsection (n) does not put in place a procedure to catch those individuals who try to quietly slip away.¹⁷⁵ Although subsection (n) requires filing of an information statement, an individual can avoid imposi-

169. See Liu, *supra* note 32, at 699. See generally 2004 Jobs Act, Pub. L. No. 108-357, § 804 (amending only subsections (a) and (c) of I.R.C. § 877 (as amended by HIPAA) and not subsection (d) which lists the source rules of income and gain taxed by the alternative tax regime). See also 2003 JCT Report, *supra* note 45, at 204. It also taxes the resources of the IRS to monitor tax-motivated expatriates for a period as long as ten years.

170. Since these are new standards, we will have to wait to see if the new amendments to section 877 actually deter expatriation. But looking at past trends, it does not look likely.

171. The goal of ensuring that individuals cannot enjoy the tax benefits of expatriating while maintaining significant ties to the United States (goal number five discussed *supra* note 107 and accompanying text) is not applicable here since it does not regulate physical presence of a former citizen in the United States. See generally § 877(a), (c) (as amended by the 2004 Jobs Act).

172. See *supra* Part II.D.2.

173. 2003 JCT Report, *supra* note 45, at 209.

174. See Beckett G. Cantley, *Taxation Expatriation: Will the FAST Act Stop Wealthy Americans From Leaving the United States?*, 36 AKRON L. REV. 221, 238 n.95 (2003). Cantley states that "after the last attempt to legislatively deter tax expatriation, many tax expatriates deliberately lost their citizenship without formally renouncing it, believing that was a simple way to avoid the legislation." *Id.*

175. See generally I.R.C. § 7701(n) (as added by the 2004 Jobs Act).

tion of the alternative tax regime by failing to file.¹⁷⁶ Furthermore, the new tax-based rules for determining expatriation do not address the main concerns seen by the IRS and the Treasury Department.¹⁷⁷ Primarily, the unaddressed concerns include patient expatriates selling assets after the ten year alternative tax period, the non-taxation of foreign assets, and the labor intensive process of monitoring expatriates for ten years after a determination of tax avoidance.¹⁷⁸

3. Imposition of Full U.S. Taxation Liability

Not all changes made by the 2004 Jobs Act are ineffective. The addition of subsection (g) to I.R.C. section 877 furthers the Congressional goal of ensuring that individuals cannot enjoy any tax benefits that may arise from expatriating while maintaining significant ties to the United States. Subsection (g) subjects a former citizen to full U.S. taxation if he or she spends more than thirty days in any calendar year within the United States.¹⁷⁹ This way, only those who truly wish to expatriate, sever considerable ties with the United States, and re-establish or strengthen ties with another country will avoid getting caught in the net of section 877(g).¹⁸⁰

176. See Kirsch, *supra* note 14, at 905–06. When coupled with the effects of the Reed Amendment, discussed *supra* note 56, an individual, even if willing to pay the taxes imposed by I.R.C. section 877, may be motivated to avoid the alternative tax regime by not filing a tax return to decrease his or her chances of being denied entry because the individual was deemed to have expatriated for tax-motivated purposes.

177. See generally 2003 JCT Report, *supra* note 45, at 103–25 (Part VIII: Effectiveness of Present Law Treatment of Citizenship Relinquishment and Resident Termination).

178. 2003 JCT Report, *supra* note 45, app. 27 (Letter from Charles Rosotti, U.S. Department of Justice, to Lindy Paull, Chair of the Joint Committee on Taxation, dated May 5, 2000).

179. See *supra* note 107 and accompanying text (the fifth goal established by Congress). Subsection (g) defines “physical presence” and shortens the amount of time a nonresident noncitizen can be present in the United States without being subject to U.S. taxes. See *supra* note 141 and accompanying text regarding the exceptions to counting days of physical presence with the United States.

180. *But see* Farkins-DiNardo *supra* note 71, at 42 (arguing thirty days is not enough to establish a requisite connection for imposition of full U.S. tax liability). However, this fails to consider that the requirement is for former citizens who did not qualify for an exception due to their ties with the United States, and who still continue to maintain ties to the United States requiring presence within the United States for more than thirty days. See also *supra* Part II.D.3 for exceptions to the thirty day rule.

4. Annual Information Return-Filing Requirement

The amendment to section 6039G of the I.R.C. provides more information to the IRS by facilitating inter-agency exchange. The requirement of filing an annual return may alleviate one of the main problems of administering the alternative tax for ten years after the date of expatriation because it will ease the labor required to find information regarding transactions in which the former citizen is currently engaged.¹⁸¹

C. A Mark-to-Market Regime

Tax-motivated expatriation is born from the unequal treatment of non-resident noncitizens as compared to citizens and residents¹⁸² and the realization principle.¹⁸³ The combination of these two policy decisions creates the temptation for affluent citizens to discard their citizenship and exploit the differing tax treatment before they realize gains on property.¹⁸⁴ Ideally, a system to curb expatriation should effectively remedy these issues by removing the benefits. The principal benefits of taxpatriation are the non-taxation of unrealized gains¹⁸⁵ on foreign assets and the lower tax rate afforded to nonresident noncitizens of U.S. assets.¹⁸⁶ Therefore, if the United States treats assets of former citizens as being “realized,” and subject to U.S. taxation before expatriation becomes official, the benefits of taxpatriation are greatly reduced.

181. This is assuming that the former citizen will adhere to the rules established by I.R.C. § 6039G. If the former citizen does not file information statements with the IRS after expatriating, U.S. courts may not be able to establish personal jurisdiction over noncitizens outside the territorial borders of the United States if the former citizen no longer has “minimum contacts” with the United States. See *Int’l Shoe Co. v. Washington*, 326 U.S. 310 (1945) and progeny. See generally William S. Dodge, *Breaking the Public Law Taboo*, 43 HARV. INT’L L.J. 161 (2002) (stating foreign courts routinely refuse to enforce foreign public law).

182. See *supra* notes 30–36 and accompanying text.

183. See *Eisner v. Macomber*, 252 U.S. 189 (1920). See also *infra* notes 185, 187.

184. The differing tax treatment also includes differing estate tax treatment which is outside the scope of this Note.

185. An “unrealized gain” is a gain where there is still uncertainty as to whether there will be a definite gain or loss. See *Burnet v. Logan*, 283 U.S. 404 (1931) (where the taxpayer sold shares in an ore mine in exchange for a sum of money, less than their basis, plus the promise of future income based on the amount of ore produced. The court held the gain as “unrealized” and the transaction as still open due to the uncertainty of gain or loss). See also *infra* note 188 (discussion of basis).

186. I.R.C. § 871 The United States does not impose a capital gains tax on nonresident noncitizens. See *Abreu, supra* note 8, at 1106 (“[A]dvantages of expatriation are . . . the result of the operation of a tax system that combines the realization requirement with a virtual exemption from tax for appreciation in foreign capital.”).

To effectuate neutrality in the tax system, the United States should replace the alternative tax regime with a mark-to-market regime. This would deem a former citizen's accrued but unrealized gains on property as "realized" or marked to market, and therefore taxable, on the date the individual seeks to renounce citizenship.¹⁸⁷ While more effective than the alternative tax regime, this solution is not without controversy.¹⁸⁸ However, modifying a pure realization system to alleviate some of the harsh results from realizing unrealized gains could produce a more effective, as well as fairer, system.¹⁸⁹

Marking to market would require an individual to pay taxes on any unrealized gains above a certain threshold amount (i.e., \$1 million) before renunciation of citizenship becomes effective.¹⁹⁰ Only taxing unrealized gains above the threshold amount would allay the perceived unfairness of realizing these accrued gains.¹⁹¹ A reasonable threshold amount would

187. "Realizing gains" or marking property to market means treating the asset as if it were sold for its fair market value on the date the individual renounces citizenship and taxes the alleged gain on the property. See *supra* note 160 for a discussion of "realization."

188. See Abreu, *supra* note 8, at 1146–47 (arguing that realizing gains on assets poses a problem to taxpayers because it forces them to determine the basis of their assets). In spite of its difficulty, this places the burden on the individual taxpayer who desires to expatriate rather than on the IRS. Furthermore, conflicts which arise regarding the calculation of basis fall within the regular auditing duties of the IRS and do not require using special resources. See generally Lawrence Zelenak, *Taxing Gains at Death*, 46 VAND. L. REV. 361 (1993) (illustrating Canada's system of using a National Appraisal Date to determine the basis of property at death. Canadian officials reported only slight difficulty with calculating basis). "Basis" is needed to determine "Adjusted Basis" which determines the amount of gain or loss. See I.R.C. § 1001 (determination of amount and recognition of gain or loss), § 1011 (adjusted basis for determining gain or loss), § 1016 (adjustments to basis). "Basis" is generally the cost of the asset. I.R.C. § 1012. See also I.R.C. § 1014 (basis of property acquired by descent), § 1015 (basis of property acquired by gift and transfers in trust). Another issue which may arise from realizing unrealized gains is the dispute over valuation of an asset. See 2003 JCT Report, *supra* note 45, at 198–99. However, this also comes under the regular duties of the IRS and does not require additional resources.

189. *But see* Farkins-DiNardo, *supra* note 71, at 40 (arguing that taxing gains on the date of expatriation avoids the problem of double taxation). Even assuming this is true, applying a straight mark-to-market approach is harsh. The mark-to-market approach should be modified to provide a way to deal with illiquidity. See *infra* note 192 and accompanying text.

190. See *supra* Part II.B for a discussion on the procedure to renounce U.S. citizenship.

191. One of the reasons for requiring a tax only on gains that are realized is that the gains are tangible. Without realization, there is uncertainty as to whether the asset will produce a gain at all. *Burnet*, 283 U.S. at 413.

also be more likely to catch wealthy Americans with an incentive to tax-patriate, while allowing average Americans with less of a tax-motivated incentive to escape the tax. The individual would be taxed on those accrued gains above a threshold amount and subject to the same progressive rates as during citizenship.

Another issue raised by implementing a realization regime is the taxpayer's liquidity.¹⁹² If most of the taxpatriate's wealth is derived from those unrealized gains, then the taxpayer may have difficulty paying the tax assessed. One way to alleviate this problem is to allow, at the option of the taxpayer, installment or deferred payments.¹⁹³ In either situation, the IRS will most likely also need to receive a security interest in collateral located in the United States to assure payment of the tax.

As stated, the realization regime would further many Congressional purposes as well as eliminate many problems stemming from the alternative tax regime.¹⁹⁴ For instance, one of the primary defects in the alternative tax regime is the difficulty in administration. Requiring the IRS to monitor former citizens determined to have expatriated to avoid taxes for ten years after the date of expatriation is a substantial task.¹⁹⁵ The proposed realization regime would eliminate the need to monitor former citizens because the taxable gain on property will have been paid. This furthers the Congressional goal of administrative ease by creating a one time tax event for the IRS to administer instead of ten annual ones as required by the alternative tax.¹⁹⁶ Taxing gains before an individual expatriates also solves the lack of information dilemma for the IRS since the individual will still be present in the United States to provide it.

192. 2003 JCT Report, *supra* note 45, at 199. The term liquidity refers to the taxpayer's ability to pay the tax using cash or cash equivalents.

193. With interest accruing on unpaid taxes.

194. Canada and Australia impose an "exit tax" on former residents. Australia subjects individuals to a capital gains tax (CGT) upon the happening of a CGT Event. A CGT Event includes when an individual "stop[s] being an Australian resident." Australian Taxation Office, Introduction to Capital Gains Tax for Individuals, <http://www.ato.gov.au/individuals/content.asp?doc=/content/20427.htm> (last visited Feb. 16, 2006). Canada taxes individuals who leave Canada to settle in another country and sever their residential ties. Canada Revenue Agency, International and Non-Resident Individuals—Leaving Canada, <http://www.cra-arc.gc.ca/tax/nonresidents/individuals/leaving-e.html> (last visited Feb. 16, 2006).

195. See 2003 JCT Report, *supra* note 45, at 122–25.

196. Another benefit is that the IRS does not have to deal with information statements required by I.R.C. § 6039G and the calculation of days of physical presence under I.R.C. § 877(g).

The realization regime furthers the Congressional goal of taxing appreciation and asset value of property while an individual is a citizen. Since property is deemed "realized" for individuals who wish to expatriate, any gain in value will be taxed.¹⁹⁷ Additionally, the realization tax removes any unintended incentives to expatriation caused by the U.S. tax code and promotes tax neutrality for expatriation by realizing gains upon expatriation. This way, it is more likely that only those with pure desires to expatriate will do so. Lastly, the realization regime would also accomplish Congress's goals of expressing official disapproval and deterring tax-motivated expatriation.¹⁹⁸

IV. CONCLUSION

Taxation is a complex machine with many interrelated parts. One component will undoubtedly affect the performance of another. On occasion, the interaction of our system of taxation and the rules used by our society to accomplish certain policy objectives creates undesirable loopholes. Expatriation, when used as a tool to avoid taxation, is one such example. It offers an escape from taxation on gains accrued during a citizen's lifetime because of a combination of the realization principle and the different treatment afforded foreigners.

In the quest for a solution, Congress developed the alternative tax. The alternative tax regime in existence prior to the 2004 Jobs Act fell short of deterring tax-motivated expatriation. It was ineffective in many ways. First, the regime was difficult to administer and placed the burden of proving subjective intent to avoid taxes on the IRS. Additionally, there were many exceptions which negated the statutory presumption of tax-motivated expatriation. Third, information regarding whether or not a citizen expatriated, and thus left the U.S. taxing jurisdiction, rarely reached the IRS. Finally, a patient expatriate could wait ten years and leave the alternative tax regime before realizing gains.

By passing the 2004 Jobs Act, Congress tried to remedy these deficiencies. Although solving a few inadequacies, many remained. For example, a patient expatriate can still wait ten years before realizing gains.

197. If above the threshold amount suggested *supra* text accompanying notes 190–91. Taxing appreciation and asset value of property while an individual is a citizen is Congress's fourth goal. See *supra* note 107 and accompanying text for a discussion of Congressional goals.

198. See *supra* note 107. The accomplishment of these two goals is quite clear. The whole purpose in having a law subjecting an expatriate to a separate taxation regime is to deter the expatriation and act as a symbol of disapproval by the regulating body (i.e., Congress).

Also, although less difficult, the alternative tax is still administratively burdensome on the IRS. Furthermore, although more narrow, exceptions still remain to take an expatriate out of the alternative tax regime.

With all the complexities and nuances the I.R.C. contains, the simplest and most effective technique for remedying a disapproved course of action is to recognize the benefits of that action and promulgate legislation to directly counter it. To eradicate the benefits from taxpatriating, there should be a realization event which occurs at the time a former citizen attempts to renounce citizenship. Realizing these accrued gains eliminates the desire to taxpatriate, yet does not interfere with those who truly wish to renounce their U.S. citizenship for that of another country. This mark-to-market system would also further many Congressional goals, such as deterrence, disapproval and administrative ease. To mitigate some of the harshness of a pure mark-to-market system, Congress should impose threshold amounts of gain before the tax is imposed. Moreover, Congress should allow deferred or installment payments to ease the taxpayer's potential lack of liquidity. Additionally, a mark-to-market system would combat one of the toughest inadequacies to remedy—a patient expatriate. Until a time when tax-motivated expatriation ceases to enrage the citizenry as unfairly benefiting the wealthy, the realistic option would be to change a flawed system.

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