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REVISITING THE TAX TREATMENT OF CITIZENS
ABROAD: RECONCILING PRINCIPLE AND
PRACTICE

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REVISITING THE TAX TREATMENT OF CITIZENS ABROAD:
RECONCILING PRINCIPLE AND PRACTICE

*Michael S. Kirsch**

In an increasingly mobile world, the taxation of citizens living abroad has taken on increased importance. Recent international administrative developments—most notably, the weakening of foreign bank secrecy and expansion of global information sharing norms—have further raised the profile of this issue. While U.S. law traditionally has taxed U.S. citizens living abroad in the same general manner as citizens living in the United States, a number of scholars have proposed abandoning the use of citizenship as a jurisdictional basis to tax. In its place, they would apply residence-based principles—i.e., exercising full taxing rights over U.S. citizens only if the citizens reside in the United States. Citizens residing outside the United States would be taxed in the same limited manner as non-citizens residing outside the United States.

This Article examines the impact of the recent international administrative developments on proposals to eliminate citizenship-based taxation and replace it with residence-based taxation. It also discusses a number of substantive concerns with the residence-based taxation proposals. While the Article concludes that the United States should retain its citizenship-based taxation regime, it acknowledges that a number of practical steps could be taken to ameliorate unnecessary burdens faced by overseas citizens.

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INTRODUCTION

In general, citizenship status in a country not only entitles the holder to certain rights, but also imposes upon the holder certain obligations. As far back as the Civil War, and continuing throughout the one hundred-year history of the modern income tax,¹ one such obligation imposed on U.S. citizens is the requirement to pay income taxes.² The United States uses a person's citizenship status as a jurisdictional basis upon which to impose tax. Thus, subject to some significant exceptions, a U.S. citizen is subject to U.S. income tax liability even if she resides outside the United States, and even if all of her income arises outside the United States. The United States also uses residence as a jurisdiction to tax, so that noncitizens who reside in the United States generally are subject to tax on all of their income, even if it arises outside the United States.³ In contrast to the United States' use of either citizenship or residence, almost all other countries⁴ use only residence (although sometimes broadly defined) as a basis to assert full taxing jurisdiction over an individual.⁵

As a practical matter, many nonresident citizens will not actually owe any U.S. income tax on income arising abroad. The foreign earned income exclusion permits qualifying individuals to exclude up to \$97,600 of foreign earned income, along with up to \$13,664 (and possibly more in certain high-cost foreign areas)

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¹ Congress enacted the first "modern" income tax law in 1913, shortly after the ratification of the Sixteenth Amendment. See Act of Oct. 3, 1913, ch. 16, § II(A)(1), 38 Stat. 114, 166. Even under the temporary Civil War-era income tax that expired in 1872, and the 1894 income tax that was declared unconstitutional and never enforced, income tax obligations were imposed based on U.S. citizenship status, even if the citizen resided outside of the United States. See Michael S. Kirsch, *Taxing Citizens in a Global Economy*, 82 N.Y.U. L. REV. 443, 449-456 (2007) (providing detailed explanation and analysis of citizenship as a jurisdictional basis to tax under the Civil War-era and 1894 income taxes)

² The extent to which a citizen is actually liable for any income tax depends on a myriad of factors, including the amount of her gross income and the extent to which she qualifies for various deductions and credits.

³ The United States as well as other countries also exercise source-based jurisdiction over income that arises within their jurisdiction, even if earned by a foreign person. See, e.g., I.R.C. § 871(a). This source-based jurisdiction is not directly relevant to the residence/citizenship-based jurisdiction that is the focus of this Article.

⁴ Eritrea, North Korea, and Vietnam are the other countries that are sometimes cited as attempting to assert citizenship-based taxing rights. See Kirsch, *supra* note 1, at 445-46 n.5 (citing sources). The Philippines imposed citizenship-based taxation prior to 1997 on its citizens abroad, as did Mexico prior to 1981. See *id.*

⁵ See *infra* notes 392-394 and accompanying text. The United States and other countries also exercise "source"-based jurisdiction to tax certain income that is viewed as arising within that country, even if the taxpayer has no citizenship or residence ties to the country. See, e.g., I.R.C. § 871(a) & (b) (taxing nonresident alien individuals on certain U.S. source investment income and income connected to a U.S. business).

attributable to housing expenses.⁶ In order to claim these benefits, nonresident citizens must comply with various reporting requirements.⁷ Nonresident citizens may further reduce their U.S. tax liability with the foreign tax credit to the extent they paid foreign income taxes on foreign source income that is otherwise subject to U.S. tax.⁸

A citizen residing abroad is also subject to U.S. transfer tax liability in the same manner as an individual (whether a citizen or not) residing in the United States. Accordingly, all lifetime gifts, as well as the entire estate, are subject to U.S. transfer tax, regardless of where in the world the assets are located.⁹ Like a citizen residing in the United States, an overseas citizen generally is exempt from tax on the first \$5,250,000 (indexed for inflation) of aggregate lifetime gifts and taxable estate.

In contrast, nonresident non-citizens are subject to the U.S. estate or gift tax only with respect to assets situated in the United States.¹⁰ Lifetime transfers of intangible assets (including stock in a domestic corporation) by a nonresident non-citizen are not subject to the gift tax (although stock in a domestic corporation held by a nonresident non-citizen decedent is subject to the estate tax).¹¹ A nonresident non-citizen's estate is allowed a \$60,000 exemption for purposes of the estate tax imposed on U.S. situs assets.¹²

Special rules apply in the case of a U.S. citizen who renounces or otherwise loses her U.S. citizenship if, at the time of the renunciation, her net worth or average income tax liability exceeds specified thresholds.¹³ Such a

⁶ See I.R.C. § 911(a) (providing exclusion); Rev. Proc. 2012-41 § 3.17, 2012-45 I.R.B. 539, 541 (providing foreign earned income exclusion amount for 2013); IRS Notice 2013-31, 2013-21 I.R.B. 1099 (providing housing cost amounts for 2013).

⁷ See generally IRS Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad* (containing summaries of the special tax provisions applicable to overseas citizens, including the various filing requirements). In general, citizens abroad are subject to the same Form 1040 tax return filing requirements as citizens residing in the United States. In order to elect the foreign earned income exclusion and housing exclusion, a taxpayer must file a Form 2555 with his tax return, no later than the time specified in regulations. See Treas. Reg. § 1.911-7(a)(2) (as amended in 2008). For overseas citizens whose total foreign earned income does not exceed the excludible amount, are not claiming the foreign housing exclusion, and who meet certain other requirements, a simplified Form 2555-EZ is available. Once an election is made, it generally remains in effect for subsequent taxable years unless it is revoked. See Treas. Reg. § 1.911-7(a)(1) (as amended in 2008).

⁸ See I.R.C. § 901.

⁹ In addition, the donee/beneficiary is not subject to income tax upon receiving the gift or bequest. See I.R.C. § 102(a). But see I.R.C. § 2801 (imposing tax on U.S. recipients of gifts or bequests from certain former citizens who are "covered expatriates").

¹⁰ See I.R.C. §§ 2103 (estate tax); 2511(a) (gift tax).

¹¹ Compare I.R.C. § 2501(a)(2) (exclusion of intangibles from gift tax), with I.R.C. § 2104(a) (treating stock in a domestic corporation as U.S. situs asset if held by nonresident alien decedent).

¹² See I.R.C. § 2102(b)(1) (\$13,000 credit corresponds to \$60,000 exemption under I.R.C. § 2001(c) rate schedule). This exclusion does not apply to a nonresident alien's lifetime gifts.

¹³ In 2013, these thresholds are \$155,000 average income tax liability for the prior five years, or \$2 million net worth. See § 877A(g)(1)(A); I.R.C. § 877(a)(2); Rev. Proc. 2012-41 § 3.16, 2012-45 I.R.B. 539, 541 (inflation adjustment for average income tax liability). These rules also generally apply to long-term (*i.e.*, 8 of the prior 15 years) lawful permanent residents who lose resident status. See I.R.C. §§ 877A(g)(2)(B); 877A(g)(2)(E); 877(e)(2). If the former citizen or long-term lawful permanent resident lost such status prior

person is treated as having sold all of her assets (subject to some exceptions) on the date of citizenship loss, and must recognize this deemed gain to the extent it exceeds \$668,000.¹⁴ In addition, if the former citizen subsequently makes a gift or bequest to a U.S. citizen or resident, that U.S. recipient is liable for a 40% tax (assuming the gift or bequest is not otherwise subject to U.S. estate or gift tax).¹⁵ This provision is intended to eliminate any estate or gift tax advantages in a circumstance where the former citizen retains a particular tie to the United States—*i.e.*, a U.S. child or other beneficiary who will receive her assets.

Legal scholars have long-debated what role, if any, citizenship should play in taxing citizens who live abroad.¹⁶ A broad range of approaches have been offered regarding the taxation (or non-taxation) of citizens who reside abroad. Some scholars have defended the general approach of current law—subjecting citizens to broad U.S. taxing jurisdiction even when they reside outside of the United States (so-called “citizenship-based” taxation).¹⁷ At the other extreme, some scholars have argued that citizenship should not be relevant in asserting taxing jurisdiction, and that a U.S. citizen should be taxed on her worldwide income only if she resides in the United States (so-called “residence-based” taxation). Under a residence-based approach, a U.S. citizen living abroad would be treated no differently than a nonresident alien (*i.e.*, subject to U.S. tax only to the extent of U.S. source investment income or U.S.-connected business income). Lobbying groups representing overseas citizens generally have supported residence-based taxation. Proponents of residence-based taxation have suggested that a mark-to-market exit tax (similar to the exit tax currently imposed on individuals who lose citizenship) should apply when a citizen ceases to be a tax resident, but thereafter the non-resident citizen should be treated no differently than a nonresident alien.

Important developments in the past few years have raised the profile of this issue. In particular, the landscape of international tax enforcement has undergone sweeping changes in the past half-decade, with the United States taking steps that promise to give the IRS unprecedented access to overseas financial account information. Most notably, the United States’ success in targeting Swiss banks and bankers has led to a significant weakening of traditional foreign bank secrecy regimes, and the upcoming implementation of the

to June 17, 2008, a different regime applied. *See* I.R.C. § 877. That regime, rather than marking assets to market, instead purported to continue taxing the former citizen (or long-term lawful permanent resident) on an expanded scope of U.S.-source income for the 10-year period following loss of U.S. status.

¹⁴ This reflects the 2013 inflation-adjusted threshold under I.R.C. § 877A(3). *See* Rev. Proc. 2012-41, *supra* note 13, §3.17.

¹⁵ *See* I.R.C. § 2801.

¹⁶ For a summary of the issues surrounding the taxation of overseas citizens in the context of the first modern income tax in the early 20th Century, as well as the legislative debate regarding the enactment of the foreign earned income exclusion in 1926, see Kirsch, *supra* note 1, at 454–60.

¹⁷ The author advocated this approach in Kirsch, *supra* note 1. Another scholar who generally supports the taxation of U.S. citizens living overseas does so not based on the individual’s citizenship *per se*, but based on the view that a person’s citizenship can be viewed as an administrable proxy for the person’s domicile. *See* Edward A. Zelinsky, *Citizenship and Worldwide Taxation: Citizenship as an Administrable Proxy for Domicile*, 96 IOWA L. REV. 1289 (2011).

Foreign Account Tax Compliance Act (“FATCA”) may bring a broad scope of foreign financial institutions within the U.S. information reporting system. While these measures were primarily targeted at citizens living in the United States but hiding income abroad, they have had a significant impact on citizens living abroad. In the shadow of these expanded enforcement tools, large numbers of citizens (both those living in the United States and abroad) have attempted to clean-up past compliance problems, including failures to file information-reporting forms that carry potentially large penalties, by participating in various voluntary disclosure programs established by the IRS. Others (to a much smaller degree) have surrendered their U.S. citizenship.¹⁸

This Article examines the impact of these recent developments on proposals to eliminate citizenship-based taxation and replace it with residence-based taxation. Part I summarizes the range of proposals. Part II summarizes the recent U.S. enforcement and compliance initiatives and their impact on global information sharing norms

Part III discusses the impact of these administrative developments on overseas citizens, concluding that they increase the practicability of citizenship-based taxation. It also highlights a number of enforcement and compliance issues that would exist under the residence-based taxation proposals. Part IV then raises a number of substantive concerns with the residence-based taxation proposals—in particular, their potential influence on citizens’ choice of residence and their impact on the estate and gift tax.

While the Article concludes that the United States should retain its citizenship-based taxation regime, it acknowledges that a number of practical steps could be taken to ameliorate unnecessary compliance and other burdens faced by overseas citizens. Part V summarizes potential areas for improvement in this regard.

I. THE SPECTRUM OF VIEWS

In an earlier article, I defended the United States’ use of citizenship as a jurisdictional basis to tax individuals in a modern, global economy.¹⁹ I rejected arguments that recent economic, technological, and other developments require the abandonment of citizenship-based taxation, concluding instead that these modern developments might strengthen the case for using citizenship as a basis for taxing individuals who live outside of the country.

¹⁸ See *infra* notes 292–312 and accompanying text.

¹⁹ See Kirsch, *supra* note 1.

In response to that analysis, a number of scholars have published articles challenging the continued use of citizenship as a jurisdictional basis to tax.²⁰ These other viewpoints range from general agreement that overseas citizens should be taxed (but for reasons based on concepts of proxy domicile, rather than citizenship *per se*), to complete rejection of citizenship-based taxation. Among the latter group, there is some disagreement over the reasoning for rejecting citizenship-based taxation, and also over the details of the residence-based regime that would be implemented in place of citizenship-based taxation. The following paragraphs briefly summarize this range of views.

A. Tax Overseas Citizens Like Residents

1. The Importance of Citizenship

Perhaps the most frequently invoked reason for taxing citizens abroad relates to the benefits of citizenship—*i.e.*, those who enjoy the benefits of citizenship should share in its burdens.²¹ This benefits theory was offered as a justification for citizenship-based taxation under both the Civil War-era income tax and the 1894 income tax, as well as the Supreme Court’s *Cook v. Tait* decision,²² in which the Court upheld Congress’ right to tax the foreign income of citizens abroad. Among the most significant benefits of U.S. citizenship is the ability to enter the United States at any time.²³ While this benefit may have different subjective value to different citizens, depending, for example, on how frequently a citizen living abroad plans to visit the United States, and the likelihood that he might return permanently, the high demand by noncitizens to enter the United States suggests that this benefit undoubtedly has some significant objective value. Additional benefits of citizenship include, *inter alia*, the right to vote and potential personal and property protection.²⁴

There are, however, limits to the use of a benefits rationale to justify the income taxation of citizens abroad. As I previously observed, “[i]n the context of an income tax, where the tax level does not directly depend on the benefits received, there is no necessary correlation between the benefits and the taxes paid. Accordingly, while the existence of significant benefits might provide a strong

²⁰ Several other analyses of citizenship-based taxation pre-date the author’s earlier work. Compare, *e.g.*, Philip F. Postlewaite & Gregory E. Stern, *Innocents Abroad? The 1978 Foreign Earned Income Act and the Case for Its Repeal*, 65 VA. L. REV. 1093 (1979) (arguing that special exclusions and deductions for citizens residing overseas should be repealed); Renée Judith Sobel, *United States Taxation of Its Citizens Abroad: Incentive or Equity*, 38 VAND. L. REV. 101 (1985) (questioning foreign earned income exclusion for citizens abroad); with Pamela B. Gann, *The Concept of an Independent Treaty Foreign Tax Credit*, 38 TAX L. REV. 1, 58–69 (1982) (questioning use of citizenship-based taxation); Brainard L. Patton, Jr., *United States Individual Income Tax Policy as It Applies to Americans Resident Overseas*, 1975 DUKE L.J. 691 (advocating the elimination of U.S. tax on income of overseas citizens).

²¹ See generally *id.* at 470–79.

²² 265 U.S. 47, 56 (1924) (“the government, by its very nature, benefits the citizen and his property wherever found and, therefore, has the power to make the benefit complete”).

²³ See Kirsch, *supra* note 1, at 476.

²⁴ For a discussion of the practical and theoretical limits of these benefits, see Kirsch, *supra* note 1, at 471–76 (concluding that these benefit retain value even in a modern world).

basis to claim that the overseas citizen should pay some level of tax by reason of his citizenship, it might not dictate the form or amount of that tax.”²⁵ Of course, this same concern arises (perhaps to a lesser extent) in the purely domestic context, where a benefits rationale is sometimes invoked to support an income tax, even though not all citizens residing within the country enjoy identical benefits from the federal government.²⁶

The income tax is also sometimes justified based on ability-to-pay principles.²⁷ In the context of overseas citizens, this principle raises the question of *whose* ability to pay. Given that U.S. tax policymakers generally take a national perspective, the question is whether “citizens residing outside the United States fit within this national perspective? Is their connection to ‘U.S. society . . . so substantial that fundamental fairness requires their net incomes to be compared with the net incomes of . . . U.S. residents for purposes of making an equitable allocation of the tax burden under an ability-to-pay system[?]’”²⁸

I previously noted that “[t]here are strong arguments for treating citizens abroad as members of U.S. society for purposes of the distributional equity analysis.”²⁹ For example, a citizen living overseas who retains his U.S. citizenship is, at least indirectly, expressing a voluntary identification with the United States and, “[a]ccordingly, it is reasonable to conclude that [this retention] reflects a self-identification with the population of the United States (or the belief that the benefits of citizenship are worth the tax cost).”³⁰ Moreover, recent technological developments further reinforce the ties between citizens residing abroad and those in the United States. Whereas a citizen living abroad in the early 20th century might have gone years without having meaningful connections with U.S. society or contact with persons living in the United States, the growth of the Internet has enabled citizens abroad to stay up-to-date with national and local news in the United States, and to communicate with family and friends in the United States via Skype video calls, text messages, email and other forms of instantaneous communication, thereby strengthening potential ties to U.S. society.

In addition, citizens living within the United States often view U.S. citizens living overseas as part of the United States. Particularly in times of crisis overseas, media in the United States often focus on the plight of U.S. citizens, thereby strengthening the view that overseas citizens remain a part of U.S. society.³¹ As noted previously, “[t]his tendency of citizens in the United States to consider citizens abroad to be part of their society might, at least in part, be due to

²⁵ *Id.* at 470–71 (footnotes omitted).

²⁶ *See id.* at 478.

²⁷ For a more thorough discussion of ability-to-pay analysis in the context of overseas citizens, see *id.* at 479–88.

²⁸ *Id.* at 480 (quoting J. Clifton Fleming et al., *Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income*, 5 FLA. TAX REV. 299 (2001)).

²⁹ Kirsch, *supra* note 1, at 481.

³⁰ *Id.*

³¹ *See id.* at 483.

the country's history as a nation of immigrants," rather than a country with a long history of citizens permanently emigrating.³²

To the extent that citizenship reflects membership in U.S. society, a citizen living abroad could be expected to help support that society apart from any direct benefits she may or may not receive. After all, even a domestically resident citizen may receive no immediate direct benefit from a significant portion of federal outlays—*e.g.*, education and social welfare-related expenditures—yet we expect her to support (through her taxes) those expenditures determined by Congress to be beneficial to society as a whole. To the extent citizenship makes someone a part of U.S. society even while abroad, she could also be expected to provide support for these expenditures, despite the lack of immediate direct benefit.³³ This argument has added strength in the case of (the many) overseas citizens who might return to the United States at some point in the future, given that many Federal expenditures could be viewed as maintaining the general stability and upkeep of the country even while the citizen is overseas.³⁴

The taxation of citizens abroad can also be supported based on neutrality concerns—in particular, the effect of tax rules on where a citizen chooses to live. As I previously observed:

A citizenship-based tax regime minimizes the role of taxes in a citizen's residency decision. If a citizen is subject to U.S. tax regardless of where he lives, his residency decision will be governed primarily by ... nontax factors In contrast, a tax system that does not use citizenship as a basis to tax might significantly impact a U.S. citizen's choice of where to live.³⁵

³² *Id.*

³³ This observation also provides a response to those who suggest that citizenship-based taxation is undermined by the fact that two nonresident citizens living in different countries may pay "radically different" taxes to the United States. See Zelinsky, *supra* note 17, at 1322 (2011). More generally, a nonresident citizen's U.S. tax liability could be radically different from the U.S. tax liability of a resident citizen. See *infra* note 57. Such differences are likely to result from the foreign tax credit—to the extent a U.S. citizen resides in a country that finances its expenditures through relatively high income taxes, the United States will generally cede taxing rights to that country. Such a result, however, does not necessarily undermine the argument that U.S. citizens abroad should pay U.S. taxes at least in part to support U.S. society. Instead, in this context the foreign tax credit, in addition to alleviating double taxation, could be viewed as an acknowledgement by the United States that the citizen living abroad is a part of two societies, with the United States ceding primary taxing rights to the country where the individual has the more immediate current connection. But to the extent that the foreign country finances its activities with a level of income tax that is lower than that imposed by the United States, the residual amount of taxes should be paid to help support the United States where the individual also maintains a voluntary societal connection.

³⁴ While a citizen abroad—just like a domestic citizen—might disagree with the efficacy of a particular Federal program in ensuring the long-term health and stability of the country, that is a separate question from whether one should pay taxes to support decisions that have been made by governing officials. Cf. *infra* notes 355–366 and accompanying text (critiquing suggestion that Tiebout sorting principles support a shift to residence-based taxation).

³⁵ *Id.* at 490. See *generally id.* at 488–95 (discussing details of the neutrality argument, both with respect to an individual's decision of where to live and, if living abroad, whether to retain U.S. citizenship). This issue is discussed in greater detail *infra* Part IV.A in the context of residence-based taxation proposals.

2. Alternative Justifications

At least one other legal scholar has agreed with the general position that the United States should tax citizens living abroad, but for reasons that differ from those I have previously defended. According to Professor Edward Zelinsky, “the United States’ worldwide taxation of its citizens is less different from international, residence-based norms than is widely believed and is sensible as a matter of tax policy.”³⁶ However, rather than justifying citizenship-based taxation on a benefits theory or other basis directly connected to citizenship, Zelinsky justifies citizenship-based taxation by bootstrapping it to domicile-based taxation:

An individual’s citizenship is an administrable, if sometimes overly broad, proxy for his domicile, his permanent home. Both citizenship and domicile measure an individual’s permanent allegiance rather than his immediate physical presence. Because citizenship and domicile resemble each other, and because other nations often define residence for tax purposes as domicile, the U.S. system of citizenship-based taxation typically reaches the same results as the residence-based systems of these other nations, but reaches these results more efficiently by avoiding factually complex inquiries about domicile.³⁷

Despite his general rejection of a benefits-based rationale, Zelinsky falls back on one of the principal benefits of citizenship—the right to return to the United States—to support his domicile-based argument. In response to concerns that a long-time foreign resident who plans to live abroad for the rest of her life should not be viewed as domiciled in the United States (and thus should not be taxed under a domicile-focused approach), Zelinsky suggests that the citizen’s right to return could be considered evidence that she remains domiciled in the United States.³⁸ Thus, while situating this right to return within a domicile-based argument rather than a benefits-based argument, he nonetheless places significant emphasis on this important citizenship benefit as a justification for imposing tax.

B. Tax Overseas Citizens Like Other Nonresidents

Several legal scholars recently have argued that the United States should abandon its long-standing tradition of taxing nonresident citizens.³⁹ There is some disagreement among this group over the reasoning for rejecting citizenship-based taxation, with some scholars basing their objections on practical problems associated with taxing overseas citizens and others relying on theoretical

³⁶ Zelinsky, *supra* note 17, at 1291.

³⁷ *Id.*

³⁸ *See id.* at 1345.

³⁹ For earlier articles criticizing the use of citizenship as a basis to tax, see *supra* note 20.

concerns, and also some disagreement over the details of the regime that would replace citizenship-based taxation. The following discussion summarizes the principal arguments and proposals for eliminating citizenship-based taxation.

1. Practical Objections to Citizenship-Based Taxation

Cynthia Blum and Paula Singer take the position that the United States should abandon citizenship-based taxation on practical administrative grounds.⁴⁰ They acknowledge:

In theory, citizenship-based taxation may have merit: it is arguable that U.S. citizens living abroad generally do receive significant benefits from their status as citizens, and fairness suggests that they should be taxed differently from a nonresident alien. Ideally, the U.S. tax system should not operate to provide a tax incentive for a citizen (or an alien) to reside abroad.”⁴¹

They then emphasize, however, that “practicality also needs to be taken into account.”⁴² Blum and Singer highlight a number of practical difficulties associated with the existing tax regime, such as the difficulty overseas taxpayers face in filing accurate U.S. tax returns and the enforcement problems faced by the IRS in this area,⁴³ concluding that “[o]ur disagreement with Professor Kirsch about the wisdom of citizenship-based taxation centers on issues of compliance and administrability.”⁴⁴ Because of these concerns, Blum and Singer suggest that the United States abandon its current regime for taxing overseas citizens, and instead tax nonresident citizens in the same general manner that nonresident aliens are taxed.⁴⁵

Lobbying groups representing U.S. citizens abroad often raise similar arguments against citizenship-based taxation. For example, American Citizens Abroad (“ACA”),⁴⁶ in a submission to the House Ways & Means Committee International Reform Working Group, argues that overseas citizens face “a legislative straightjacket caused by the toxic combination of citizenship-based taxation ... [and related] reporting requirements.”⁴⁷ The organization argues that

⁴⁰ See Cynthia Blum & Paula N. Singer, *A Coherent Policy Proposal for U.S. Residence-Based Taxation of Individuals*, 41 VANDERBILT J. OF TRANSNAT’L L. 705 (2008).

⁴¹ *Id.* at 716 (footnotes omitted).

⁴² *Id.* at 716–17.

⁴³ See *id.* at 711–16.

⁴⁴ *Id.* at 710–11 (footnotes omitted).

⁴⁵ Nonresident aliens generally are taxed only on certain U.S. source investment income and income that is connected to the conduct of a U.S. trade or business. See *supra* note 5.

⁴⁶ American Citizens Abroad (“ACA”), based in Geneva, Switzerland with offices in Washington, D.C., is “a non-profit, non-partisan, volunteer association whose mission is to defend the rights of Americans living overseas.” Website of American Citizens Abroad, <http://www.americansabroad.org>. The elimination of citizenship-based taxation (and its replacement with residence-based taxation) is a principal goal of the organization. See *id.* (Issues & Hot Topics web page).

⁴⁷ American Citizens Abroad, *Residence-Based Taxation: A Necessary and Urgent Tax Reform*, at 1 (Mar. 2013), available at

the tax revenue collected by the current regime is “absolutely insignificant in the U.S. budget,”⁴⁸ while at the same time the regime imposes significant compliance costs on overseas citizens.⁴⁹ More importantly, the organization emphasizes that recent statutory and administrative initiatives—particularly those associated with the Foreign Account Tax Compliance Act (“FATCA”) and the Foreign Bank Account Report (“FBAR”)—by conflating Americans abroad with (frequently U.S.-based) tax evaders, have interfered with the ability of overseas citizens to lead a normal life. In particular, the organization notes that the complicated nature of overseas filing and the significant penalties that can apply force overseas citizens to enlist expensive attorneys and accountants, while the FATCA obligations imposed on foreign financial institutions lead many such institutions to refuse to do business with overseas citizens.⁵⁰

The tax compliance burdens faced by overseas citizens are echoed by a more neutral observer—the National Taxpayer Advocate at the Internal Revenue Service. In her 2012 report to Congress, Nina Olson (the National Taxpayer Advocate) noted that the “one-size-fits-all” approach to enforcement of the FBAR reporting requirement, with its potentially draconian penalties, often ensnares “benign actors” living overseas in addition to the “bad actors” (who might live either in the United States or abroad).⁵¹ That report also identified a number of compliance difficulties faced by overseas citizens, and noted that “the IRS has been slow in taking specific steps to meet their needs and ease their compliance burdens [and] saving enforcement resources to address egregious noncompliance.”⁵²

2. Substantive Objections to Citizenship-Based Taxation

Other scholars have objected to the taxation of overseas citizens on more substantive grounds. For example, Reuven Avi-Yonah, while noting that “administrability is perhaps the strongest argument for not taxing nonresident citizens,”⁵³ also asserts a number of other arguments for eliminating the taxation

http://waysandmeans.house.gov/uploadedfiles/american_citizens_abroad_wg_submission.pdf. This group also argues that taxing U.S. citizens abroad harms United States economic competitiveness in the world. I have addressed, and largely rejected, this argument elsewhere. See Kirsch, *supra* note 1, at 511–23.

⁴⁸ *Id.* at 3.

⁴⁹ *See id.* at 5.

⁵⁰ *See id.* at 5–7 (citing these and other difficulties faced by overseas citizens).

⁵¹ See NATIONAL TAXPAYER ADVOCATE, 2012 ANNUAL REPORT TO CONGRESS, VOL. 1, at 134–53. The “bad actors” for whom FBAR was intended include those (whether located in the United States or abroad) engaged in tax evasion, money laundering, and terrorism, while the “benign actors” include “those who have dual citizenship but have never lived or filed tax returns in the U.S., people who inherited an overseas account or opened one to send money to friends or relatives abroad, refugees or immigrants from totalitarian countries who felt compelled to conceal their assets from the governments they fled, and Holocaust survivors and their children who are frightened that persecution based on national origin could happen again.” Taxpayer Advocate Service website, at <http://www.taxpayeradvocate.irs.gov/2012-Annual-Report/offshore/>.

⁵² NATIONAL TAXPAYER ADVOCATE, *supra* note 51, at 262–80

⁵³ Reuven Avi-Yonah, *The Case Against Taxing Citizens*, 58 TAX NOTES INT’L 389, 394 (2010).

of nonresident citizens.⁵⁴ For example, he argues that the historical reason for originally implementing citizenship-based taxation—a symbolic gesture aimed at citizens living overseas and not participating in military service during the Civil War—is no longer relevant, given that the United States is not currently facing a national crisis and no longer has a draft.⁵⁵ He also rejects benefits-based arguments, asserting that a citizen’s right to enter the United States “seems a weak basis for such a heavy price as worldwide taxation,” and that the right to vote argument “is upside down”.⁵⁶ Avi-Yonah also rejects ability-to-pay arguments. He notes that through the foreign earned income exclusion and the foreign tax credit we concede the primary right to tax overseas citizens to their country of residence, resulting in little or no U.S. tax collected on U.S. citizens residing in relatively high tax countries.⁵⁷ As a result, “[w]e should not base a broad rule such as ability-to-pay taxation of nonresident citizens on the relatively few cases of citizens living overseas in countries that have no or low income taxes.”⁵⁸

Avi-Yonah explicitly avoids basing his position on efficiency or neutrality grounds, concluding that such arguments “cut both ways—neutrality is violated when tax influences either the decision to move overseas or the decision to abandon U.S. citizenship; and in the case of individuals ... the decision to move is usually motivated primarily by nontax considerations.”⁵⁹ Avi-Yonah briefly addresses Zelinsky’s argument that citizenship-based taxation can be justified as an administrable proxy for domicile, rejecting it “because it is so clearly overbroad.”⁶⁰

More recently, Avi-Yonah suggested that citizenship-based taxation should be eliminated because of the increased mobility of individuals in the modern world and the resulting availability of Tiebout sorting.⁶¹ According to Avi-Yonah:

⁵⁴ Avi-Yonah raises similar arguments more recently as the co-author of a report prepared for the International Committee of the State Bar of California’s Taxation Section. See Reuven Avi-Yonah & Patrick W. Martin, *Tax Simplification: The Need for Consistent Tax Treatment of All Individuals (Citizens, Lawful Permanent Residents and Non-Citizens Regardless of Immigration Status) Residing Overseas, Including the Repeal of U.S. Citizenship Based Taxation* (2013), available at Tax Analysts, Doc. 2013-16209, 2013 TNT 132-38.

⁵⁵ See Avi-Yonah, *supra* note 53, at 390.

⁵⁶ According to Avi-Yonah, “[i]t is legitimate to argue that nonresident citizens must be given the right to vote because they are subject to U.S. tax ... [b]ut it does not follow that because nonresident citizens vote they must be taxed.” *Id.* at 392.

⁵⁷ See *id.* at 393. But see *supra* note 33 (responding to this concern).

⁵⁸ *Id.*

⁵⁹ *Id.* at 390 n.5.

⁶⁰ *Id.* at 393. Avi-Yonah notes that “[f]or nonresident citizens, citizenship is a poor proxy for domicile because so many of them live permanently overseas and do not have any of the other indicia of U.S. domicile other than citizenship. . . . If we are looking for an administrable definition of residency, we already have one in the physical presence test.” *Id.*

⁶¹ See Reuven Avi-Yonah, *And Yet it Moves: A Tax Paradigm for the 21st Century*, U. Mich. L. & Econ. Research Paper No. 12-008 (Draft May 2012), available at <http://ssrn.com/abstract=2055160>.

We should go back to Charles Tiebout's famous conclusion from 1956 that if people are mobile, countries should set tax rates to reflect the taste of their residents, and those residents that do not like the resulting choice (which is established by democratic elections) should be free to move to other countries whose choices they like better. . . . [L]et people who do not like the result [of tax rates set by quadrennial elections] move overseas, and stop taxing them there even if they retain US citizenship, since they no longer obtain significant services from the US government.⁶²

Bernard Schneider raises a number of administrative and substantive arguments against citizenship-based taxation that are similar to those raised by the above-cited commentators. Several of Schneider's arguments are based on administrative concerns, particularly the "headaches" and compliance costs experienced by U.S. citizens living abroad.⁶³ A significant portion of his analysis is based on the concerns of particular groups of U.S. citizens living overseas who have little connection to the United States: individuals who were born in the United States to non-citizen parents temporarily present in the country on a short-term basis and who left the country soon thereafter (so-called "accidental" citizens), and individuals who were born abroad to a U.S.-citizen parent (or parents) and acquired citizenship by descent, even though the individuals may have little or no connection to the United States and may never have lived here, held a U.S. passport, or otherwise derived any benefit from U.S. citizenship status (so-called "nominal" citizens) and, in extreme cases, may not even be aware of their status as a U.S. citizen (so-called "unaware" citizens).⁶⁴

Schneider ultimately concludes that citizenship-based taxation should be abandoned, rejecting ability-to-pay and benefits concerns. He concludes that, as a general matter, overseas citizens should not be considered part of the "community" for ability-to-pay purposes. He argues that the strength of the ability-to-pay argument for a particular individual depends on how closely the person is tied to the United States. Accordingly, he concludes that "short-term expatriates clearly should be considered members of U.S. society for purposes of this analysis, [but] the argument will generally be much weaker with reference to long-term expatriates, depending on their ties to the United States. The argument for comparison falls apart completely in connection with accidental, nominal, and unaware citizens, whose connection to the United States is typically minimal to nonexistent."⁶⁵

⁶² *Id.* at 32. Avi-Yonah also recommends an exit tax on such migrants, as discussed *infra* note 92 and accompanying text. See Avi-Yonah, *supra* note 61, at 32.

⁶³ See Bernard Schneider, *The End of Taxation without End: A New Tax Regime for U.S. Expatriates*, 32 VA. TAX REV. 1, 17–39 (2012). Schneider cites a number of compliance problems faced by overseas citizens, including the foreign bank account reporting regime ("FBAR"); the new FATCA regime and its impact on the relationship between foreign financial institutions and U.S. citizen clients; the reporting requirements associated with the foreign earned income exclusion and foreign tax credit; phantom gains from foreign exchange rate variations; and the lack of coordination between U.S. and foreign retirement plans and social security systems.

⁶⁴ See *id.* at 7–8.

⁶⁵ *Id.* at 44–45.

Schneider also rejects benefits-based arguments for taxing overseas citizens. In this context he again focuses primarily on the plight of accidental, nominal, and unaware citizens. After noting that “[t]he right to move or visit the United States without restriction is probably the only substantial benefit to long-term citizen expatriates and is the only one that is relevant to most accidental, nominal, and unaware citizens,”⁶⁶ he observes that the value of this right to a particular individual depends on a number of factors. Ultimately, he concludes:

[s]ome long-term expatriates, accidental citizens, and citizens by descent will value it little. Although it is fair to say that U.S. citizenship is likely to have some value for most U.S. expatriates, this value is impossible to quantify. An unquantifiable, even inchoate right is a very weak peg on which to hang the heavy hat of worldwide taxation....⁶⁷

3. Proposed Rules to Replace Citizenship-Based Taxation

These opponents of citizenship-based taxation argue that the United States should, at least as a general matter, treat citizens in the same manner as aliens, taxing them on their worldwide income only if they reside in the United States. In order to implement such a standard, they propose new rules that address two principle areas: (i) the definition of a citizen’s residence for tax purposes; and (ii) special tax consequences upon a citizen’s loss of U.S. tax residence.

a. Definition of Tax Residence

Several opponents of citizenship-based taxation would determine a U.S. citizen’s tax residence using the same “substantial presence” test currently used to determine an alien’s tax residence status.⁶⁸ Accordingly, a citizen generally would be considered a tax resident for the year if she is physically present in the United States for 183 days under the 3-year weighted test of Code section 7701(b) (provided that she is actually present for at least 31 days during the year in question).⁶⁹ Avi-Yonah apparently would extend the existing test to citizens with no modifications.⁷⁰ Thus, various special rules that currently apply to aliens—

⁶⁶ *Id.* at 50.

⁶⁷ *Id.*

⁶⁸ *See* I.R.C. § 7701(b).

⁶⁹ More specifically, an alien (and, under the proposal, a citizen) is considered a tax resident for the current tax year if (i) the individual is physically present in the United States on at least 31 days in the calendar year, and (ii) is physically present in the United States for at least 183 days under a formula that counts 100% of the days of presence in the current year, 1/3 of such days in the immediately preceding year, and 1/6 of such days in the second preceding year. I.R.C. § 7701(b)(3)(A). As a practical matter, this formula allows an alien to spend an average of 122 days (four months) in the United States each year without being treated as a tax resident ($122 + \frac{1}{3} \times 122 + \frac{1}{6} \times 122 = 183$).

⁷⁰ *See* Avi-Yonah & Martin, *Tax Simplification*, *supra* note 54, at 11 (“The test to determine whether U.S. citizens . . . residing overseas would be taxed as a ‘resident alien’ would be the same definition as currently exists in 7701(b)(1)(A)(ii)”).

e.g., the exclusion of days of presence for certain students or commuters from Mexico or Canada,⁷¹ as well as a tax residence exception for individuals who spend fewer than 183 days in the United States in the current year and have a closer connection to a foreign country in which they have a tax home⁷²—might also apply to citizens.

In contrast, Blum and Singer merely suggest that “[t]he substantial presence test can serve as the basic criterion for a workable definition of ‘tax residence’ that would apply to citizens as well as aliens in a new tax system,”⁷³ further observing that some modifications to the substantial presence test may be appropriate in the case of citizens (although admittedly at the cost of additional complexity).⁷⁴ Blum and Singer propose one explicit modification to tax residence in the case of U.S. citizens: once a citizen met the definition of U.S. tax resident for any tax year, she would be deemed to have U.S. tax residence for the subsequent three tax years.⁷⁵ Thus, even if a citizen-resident moves abroad and cuts all physical ties with the United States, she will remain a U.S. tax resident for the three years after she last satisfied the 183-day weighted residence test. During that period, she would continue to be taxed on worldwide income in the same manner as a U.S. resident. Schneider explicitly rejects this sticky concept of residence, where a citizen would continue to be taxed on worldwide income for several years following departure.⁷⁶

Schneider is more equivocal regarding the definition of tax residence that should apply to citizens, suggesting that Congress could either extend the substantial presence test currently applicable to aliens, or implement a more subjective “bona fide residence” test based on a number of subjective factors.⁷⁷ To the extent the substantial presence test is extended to citizens, Schneider, too, would modify certain aspects of it in order to prevent perceived abuses.⁷⁸

The ACA proposal for determining a U.S. citizen’s residence relies on a self-certification process. Under that proposal, once a U.S. citizen establishes

⁷¹ See I.R.C. § 7701(b)(7)(B).

⁷² See I.R.C. § 7701(b)(3)(B).

⁷³ Blum & Singer, *supra* note 40, at 720.

⁷⁴ Blum and Singer suggest that the “closer connection” exception might be appropriate for citizens under their proposal, but then observe that “[i]t is not clear, however, that the need for such an exception is great enough to justify the additional efforts required on the part of the taxpayer and the IRS to administer it.” Blum & Singer, *supra* note 40, at 722–23. Although they mention the exclusion of certain days of physical presence under current law regarding aliens, *see id.* at 720, they do not explicitly address whether these excluded days would apply to citizens under their proposal.

⁷⁵ See Blum & Singer, *supra* note 40, at 724–25. Although Blum and Singer do not include a comparative analysis, it should be noted that some other countries, while foregoing citizenship-based taxation, apply “sticky” residence rules to their citizens, thereby retaining taxing jurisdiction over their citizens for a number of years after they lose residency status. See Zelinsky, *supra* note 17, at 1323–41 (discussing several countries’ rules).

⁷⁶ See Schneider, *supra* note 63, at 66.

⁷⁷ See Schneider, *supra* note 63, at 69–71.

⁷⁸ According to Schneider, “in order to prevent abuse, individuals who departed the United States to take up residence in Canada or Mexico but then commuted daily to their work in the United States from their new home . . . would continue to be liable for tax on a worldwide basis.” *Id.* at 71.

residence abroad, she must apply for a “departure certificate” from the IRS.⁷⁹ Thereafter, if she runs afoul of the 183-day weighted substantial presence test, she will be considered to have re-established U.S. residence.⁸⁰ The ACA proposal also suggests that if the IRS designates a foreign country as a “tax haven,” U.S. citizens residing there will be considered U.S. tax residents.⁸¹ By its terms, however, the scope of this purported anti-abuse provision would be severely limited, and the ACA report admits that “[c]lassification of countries as tax havens should be the rare exception.”⁸²

b. Exit Tax Upon Loss of Residence

The opponents of citizenship-based taxation acknowledge that, if the United States were to tax nonresident citizens in the same limited way that nonresident aliens are taxed, resident citizens might be able to undertake various strategies to limit or eliminate U.S. tax liability in ways that may be considered inappropriate. For example, in the absence of citizenship-based taxation, a resident U.S. citizen who intends to sell corporate stock at a significant gain could establish non-U.S. residence, then sell the stock and recognize the gain while outside of U.S. taxing jurisdiction.⁸³ The United States would not collect any tax on the gain, even though the gain accrued entirely during the period when the citizen resided in the United States.⁸⁴

To address this issue, Blum and Singer would impose a mark-to-market exit tax when the citizen’s tax residency ends.⁸⁵ This exit tax would be similar to the Code section 877A mark-to-market tax currently applicable to citizens who lose their citizenship.⁸⁶ The principal difference is that, in the case of a U.S.

⁷⁹ American Citizens Abroad, *supra* note 47, at 8. The ACA proposal does not explicitly define the circumstances under which a U.S. citizen will be deemed to have established residence abroad.

⁸⁰ *See id.*

⁸¹ *See id.* at 9.

⁸² *Id.* After stating that the designation “should include *only* countries where the tax laws have been designed to attract rich foreigners with fiscal privileges,” *id.* (emphasis in original), the proposal lists a number of factors that should not necessarily cause a country to be treated as a tax haven, including low taxes and the absence of a U.S. tax treaty. *See id.* Prior experience suggests that political and diplomatic considerations might significantly constrain the likelihood that the IRS will designate countries as “tax havens”. This is particularly the case when a country with a favorable tax regime for foreign citizens does not couple those low taxes with bank secrecy, which itself has been viewed as one of the hallmarks of a tax haven.

⁸³ In general, the United States does not tax nonresident aliens on gain from the sale of corporate stock, even stock of a domestic corporation. *See* I.R.C. § 871(a)(1). If, however, the individual re-establishes U.S. tax residency within three years, the special rule of I.R.C. § 7701(b)(10) might apply.

⁸⁴ Because the Internal Revenue Code generally taxes an asset’s gain only upon a realization event (*e.g.*, a sale), the gain would not have been taxed during the years that it was accumulating. *Cf.* I.R.C. § 1001 (gain is realized upon the sale or other disposition of property).

⁸⁵ *See* Blum & Singer, *supra* note 40, at 731–32. In the context of Blum and Singer’s proposal for a sticky definition of residence, the exit tax would be triggered at the end of the three-year period after no longer satisfying the 183-day weighted test.

⁸⁶ *Id.* at 734 (citing I.R.C. § 877A, which imposes an exit tax on individuals whose loss of citizenship occurred on or after June 17, 2008). While the current law is sometimes referred to as an “exit tax”, it is not triggered by a U.S. citizen physically leaving the United States. Rather, it applies only if the U.S. citizen surrenders or otherwise loses her citizenship (the law also applies to certain long-term permanent residents who lose that status). Accordingly, the relevant “exit” is the exit from citizenship status, rather than physical

citizen, “the event triggering the proposed tax would be termination of an individual’s residency status,” rather than termination of an individual’s citizenship status.⁸⁷

Blum and Singer acknowledge that their proposed exit tax could impose significant burdens on taxpayers and the IRS, given that (unlike citizenship status, which is the triggering consideration under current law and which typically can be lost only once) residency status might change frequently, resulting in potentially repeated application of the exit tax to certain citizens.⁸⁸ They suggest that these compliance and administrative burdens might be mitigated by exempting a certain amount of gain from taxation,⁸⁹ and focusing only on gain that accrues during the residency period.⁹⁰

Schneider proposes a similar mark-to-market exit tax upon a citizen’s loss of U.S. resident status. However, unlike Blum and Singer’s proposed 3-year residence status taint (and its resulting 3-year postponement of the exit tax following a citizen’s actual departure from the United States), Schneider’s proposed exit tax would apply in any year in which a citizen shifts from tax resident to nonresident status.⁹¹

Avi-Yonah also advocates a mark-to-market regime for departing citizens based on current Code section 877A. However, unlike Schneider or Blum and Singer, Avi-Yonah would not trigger the mark to market whenever a resident citizen loses tax residence status. Rather, his proposal would only mark gains to market if the citizen, upon losing U.S. tax residence, had been a U.S. tax resident for at least 8 of the immediately preceding 15 years.⁹² In combination with the substantial presence (*i.e.*, 183-day 3-year weighted formula) test for determining a citizen’s tax residence, this might provide citizens with planning opportunities for spending significant time in the United States without being subject to the proposed mark-to-market regime.

exit from U.S. territory. Under current law, a U.S. citizen who lives abroad, even for an extended period, remains within the regular United States tax system, and is not subject to the special mark-to-market regime. As noted above, the citizen residing abroad may be eligible for certain U.S. tax benefits that are not available to U.S.-resident citizens, such as the foreign earned income exclusion. *See supra* notes 6–7 and accompanying text.

⁸⁷ *Id.*

⁸⁸ *See id.*

⁸⁹ They refer to the \$600,000 gain exclusion provided under current law for individuals who lose citizenship status. *See* I.R.C. § 877A(a)(3). Presumably, this \$600,000 gain exclusion would be available for each period of residence. *See* Blum & Singer, *supra* note 40, at 735 (“only taxpayers whose assets appreciated by \$600,000 during their period of residence would be subject to the tax”) (emphasis added).

⁹⁰ In general, the individual’s basis would equal the property’s fair market value at the time the person became a resident. *See id.* at 734–35. The proposal would also incorporate other aspects of current I.R.C. § 877A, such as an exclusion for certain types of U.S. property interests that already are subject to tax in the hands of a nonresident, and the ability to defer payment of the mark-to-market tax liability until the earlier of the taxpayer’s death or sale of the assets, provided adequate security is given. *See id.* at 735.

⁹¹ *See* Schneider, *supra* note 63, at 66–67.

⁹² *See* Avi-Yonah & Martin, *Tax Simplification*, *supra* note 54, at 13. This 8-of-15-year rule is based on current I.R.C. § 877A, which triggers mark-to-market in the case of a lawful permanent resident (*i.e.*, “green card” holder) who had such status for at least 8 of the 15 years prior to losing such status. *See id.*

The ACA proposal also includes a mark-to-market exit tax if certain thresholds of assets or average income tax liability are met.⁹³ However, the proposal contains a number of exceptions. For example, a U.S. person born with dual nationality and who returns to the country of her other nationality would be exempt from the exit tax.⁹⁴ More importantly, the ACA proposal contemplates that U.S. citizens who, at the time of the proposal's enactment, had lived outside the United States for at least two years and who are compliant with their U.S. tax filing obligations "are fully exempted" from the exit tax.⁹⁵

c. Estate & Gift Taxes

Proponents of residence-based taxation give less attention to the estate tax consequences of their proposals. The ACA proposal generally would treat nonresident citizens in the same manner as nonresident aliens for transfer tax purposes.⁹⁶ Accordingly, a nonresident citizen would only be subject to U.S. estate taxes at death only to the extent she held U.S. situs assets in excess of the exclusion amount applicable to nonresident aliens.⁹⁷ To the extent the nonresident U.S. citizen held foreign assets, she would not be subject to the U.S. estate tax at death. The proposal includes a self-described "anti-abuse" provision that would treat a decedent who became a nonresident within two years of death in the same manner as a resident citizen (*i.e.*, taxable on worldwide assets, subject to the regular exemption amount).⁹⁸ Otherwise, the proposal contemplates that a citizen would be treated as a nonresident for estate tax purposes based on the existing facts-and-circumstances test currently applicable to determining an alien's estate tax residence status.⁹⁹

While the report does not explicitly address the proposed gift tax treatment of overseas citizens, it implies that the gift tax will apply to them in the

⁹³ See American Citizens Abroad, *supra* note 47, at 9–11.

⁹⁴ See *id.* at 9. Also, certain U.S. citizens born in the United States to foreign parents and who left while minors, and U.S. citizens "whose parents are both American but who have lived essentially all their lives overseas" would be exempt. *Id.*

⁹⁵ *Id.* at 11.

⁹⁶ The ACA proposal contemplates some differences between the estate taxation of nonresident citizens and nonresident aliens, particularly with respect to the definition of nonresidence. Current estate tax law, which the ACA proposal does not purport to change, does not apply the income tax's 183-day weighted test for determining residence. Instead, it relies on a facts and circumstances inquiry into the alien's domicile to determine if she is a resident for estate tax purposes. See *infra* note 388. The ACA proposal would not rely on this domicile test in determining the estate tax residence of a U.S. citizen. Instead, it would treat a citizen as a nonresident once she acquired a departure certificate. See American Citizens Abroad, *supra* note 47, at 11.

⁹⁷ See American Citizens Abroad, *supra* note 47, at 8, 11. The proposal recommends that the \$60,000 exclusion amount currently applicable to nonresident aliens be substantially increased. *Id.* at 11.

⁹⁸ See *id.*

⁹⁹ See American Citizens Abroad, *supra* note 44, at 30 n.25 (noting that the current domicile-based estate tax residence test applicable to aliens "would have to be changed to include American citizens who reside overseas"); see also *supra* notes 9–12 and accompanying text (describing current estate tax residence test).

same manner as currently applied to nonresident aliens.¹⁰⁰ Accordingly, a nonresident citizen, while still living, could make unlimited gifts (including gifts to a resident citizen) of foreign situated assets free of U.S. gift taxes or income taxes.¹⁰¹ In this context, as with nonresident non-citizens, gifts of stock of U.S. corporations would not be taxed.¹⁰²

II. THE NEW ERA IN GLOBAL ENFORCEMENT AND INFORMATION SHARING

Having summarized the different proposals in the prior Part, this Part summarizes recent enforcement and compliance initiatives and their impact on global information sharing norms. It then analyzes the effect of these administrative developments on the arguments for citizenship-based and residence-based taxation regimes.

A traditional criticism of citizenship-based taxation is that the United States faces significant obstacles in enforcing citizenship-based taxation. A century ago, Professor Seligman observed that, as a practical matter, it might be “virtually impossible” to collect tax on the foreign income of a nonresident citizen.¹⁰³ As discussed above, more recent critics of citizenship-based taxation also cite administrative concerns in arguing against citizenship-based taxation. Indeed, Blum and Singer cite administrative concerns (involving both the IRS’ ability to enforce the law and taxpayer’s ability to comply) as the principal justification for abandoning citizenship-based taxation.¹⁰⁴ I have even acknowledged that “concerns about enforcement might provide the strongest argument against taxing the foreign source income of citizens residing abroad.”¹⁰⁵

However, in the past few years, significant changes have occurred in the context of international tax enforcement that strengthen the potential for enforcing U.S. tax laws against overseas U.S. citizens. While these changes were largely instigated by U.S. enforcement initiatives and U.S. legislation, they have impacted global enforcement norms across a broad range of countries and within important multinational institutions. As a result, enforcement opportunities—such as obtaining information on accounts held by U.S. citizens in Swiss banks and other foreign financial institutions—that seemed beyond the realistic reach of

¹⁰⁰ See American Citizens Abroad, *supra* note 47, at 14, 25 (suggesting that the estate and gift tax provisions of the I.R.C. should be amended to conform with the proposal). The report characterizes I.R.C. § 2801, which currently imposes a special tax on gifts made to U.S. citizens by certain former U.S. citizens, as a “punitive measure” that should be repealed. *Id.* at 30 n.35.

¹⁰¹ See *supra* note 11 and accompanying text (describing gift tax provisions for nonresident aliens). As a practical matter, this would be most advantageous in the case of assets (including cash) that do not have significant built-in gain, because, unlike property passing at death, gifted property would not receive a fair-market-value basis step-up; but note that, in combination with the proposed exit tax, there might not be much untaxed appreciation after becoming a nonresident.

¹⁰² See *supra* note 11 and accompanying text.

¹⁰³ EDWIN R.A. SELIGMAN, *THE INCOME TAX: A STUDY OF THE HISTORY, THEORY AND PRACTICE OF INCOME TAXATION AT HOME AND ABROAD* 517 (2nd ed. 1914).

¹⁰⁴ See *supra* notes 40–45 and accompanying text.

¹⁰⁵ Kirsch, *supra* note 1, at 496.

U.S. tax administrators at the time that Seligman (one hundred years ago) and even Blum and Singer (a mere six years ago) were writing, might now be possible. Opponents of citizenship-based taxation, however, note that this enforcement expansion comes with a potential cost to overseas taxpayers, both with respect to increased complexity and cost of compliance, and through interference in their relationship with local (foreign) financial institutions.

The following paragraphs consider the relationship between this potential expansion of the IRS enforcement abilities and its potential cost to overseas taxpayers, and the resulting implications for citizenship-based taxation. The discussion also observes that, despite the administrative issues raised by the current system of citizenship-based taxation, the residence-based proposals of opponents of citizenship-based taxation raise a number of administrative problems of their own.

A. *Attack on Bank Secrecy*

During the past five years, the United States has implemented enforcement initiatives and enacted legislation that has significantly impacted overseas tax enforcement. The enforcement initiatives include leveraging the prosecution of Swiss bankers and banks to weaken bank secrecy, increased focus on taxpayers' reporting of overseas accounts, and several rounds of offshore voluntary disclosure programs ("OVDP"), while the legislative action focuses on compelling foreign financial institutions to report information on U.S. accountholders. These initiatives were not directly targeted at citizens living abroad. Rather, they were intended to increase compliance by all U.S. citizens (including, perhaps primarily, those living in the United States) who hold assets, and generate income, abroad.¹⁰⁶ Nonetheless, these efforts, both in and of themselves and through their impact on global norms, increase the potential ability of the United States to enforce U.S. tax laws against the subset of U.S. citizens living abroad who are not compliant.

Among the most significant developments are those involving Swiss banks and Switzerland's famed bank secrecy. In 2008, the United States indicted Bradley Birkenfeld, a private banker at UBS, a major Swiss bank.¹⁰⁷ Birkenfeld pled guilty to conspiracy to defraud the U.S. government based on his actions in helping a wealthy U.S. citizen (living in the United States) conceal millions of dollars of income in UBS accounts.¹⁰⁸ More importantly, Birkenfeld provided U.S. authorities with details surrounding UBS' efforts to assist American clients evade taxes, and thereby "blew a hole in the wall of secrecy surrounding the

¹⁰⁶ See American Citizens Abroad, *supra* note 47, at 1 (complaining that the FATCA legislation and IRS enforcement efforts reflect an "unjustified bundling" of citizens abroad with rich domestically-resident tax evaders who have assets hidden abroad).

¹⁰⁷ See Lynnley Browning, *Ex-UBS Banker Pleads Guilty in Tax Evasion*, N.Y. TIMES, Jun. 20, 2008.

¹⁰⁸ *Id.*

world of Swiss banking.”¹⁰⁹ As a result of this disclosure and subsequent investigations by the Justice Department, in 2009 UBS entered a deferred prosecution agreement and admitted guilt on charges of conspiring to defraud the United States.¹¹⁰ As part of that agreement, and following subsequent negotiations among the United States, UBS, and the Swiss government, the IRS received “account information about thousands of the most significant tax cheats among the U.S. taxpayers who maintain secret Swiss bank accounts.”¹¹¹ Although Birkenfeld served more than two years in prison for his actions, the IRS recently agreed to pay him a \$104 million whistle-blower award for revealing the information about the UBS activities,¹¹² which his lawyers noted will encourage other whistle-blowers around the world.¹¹³ In a related development, the Department of Justice has begun targeting offshore financial advisors who have helped U.S. taxpayers hide money in foreign accounts. For example, Edgar Paltzer, a U.S.-trained lawyer working for a Swiss law firm, recently pled guilty to conspiring with U.S. taxpayers to evade income taxes on assets held in foreign accounts.¹¹⁴ According to a former government prosecutor, “[n]ow it’s clear that the U.S. will make deals with advisers who come clean, not just with individual taxpayers and banks.”¹¹⁵ As a result, U.S. taxpayers holding secret foreign accounts are under additional pressure, given the possibility that their advisers might choose to protect themselves by giving client names to prosecutors.¹¹⁶

The actions against UBS had a cascading effect on U.S. enforcement efforts against other Swiss banks. For example, following news reports that UBS was being investigated by U.S. authorities, Wegelin & Co., Switzerland’s oldest bank, “opened and serviced dozens of new undeclared accounts for U.S. taxpayers in an effort to capture clients lost by UBS.”¹¹⁷ As a result of these and other actions, Wegelin eventually pled guilty to facilitating tax evasion by U.S.

¹⁰⁹ *Id.*

¹¹⁰ See U.S. Dep’t of Justice, Press Release, *UBS Enters into Deferred Prosecution Agreement*, Feb. 18, 2009, available at <http://www.justice.gov/tax/txdv09136.htm>. UBS agreed to pay \$780 in fines, penalties, interest, and restitution, and “to expeditiously exit the business of providing banking services to United States clients with undeclared accounts.” *Id.*

¹¹¹ U.S. Dep’t of Justice, *Offshore Compliance Initiative*, available at http://www.justice.gov/tax/offshore_compliance_initiative.htm; see also Department of Justice, Press Release, *U.S. Discloses Terms of Agreement with Swiss Government Regarding UBS*, Aug. 19, 2009, available at <http://www.justice.gov/tax/txdv09818.htm>.

¹¹² The award was authorized under I.R.C. § 7623(b).

¹¹³ David Kocieniewski, *Whistle-Blower Awarded \$104 Million by I.R.S.*, N.Y. TIMES, Sept. 11, 2012.

¹¹⁴ See U.S. Attys. Office, S. Dist. NY, Press Release, *Swiss Lawyer Pleads Guilty in Manhattan Federal Court to Conspiring with U.S. Taxpayers to Evade Federal Income Taxes and File False Tax Returns* (Aug. 16, 2013), available at <http://www.justice.gov/usao/nys/pressreleases/August13/EdgarPaltzerPleaPR.php>.

¹¹⁵ Laura Saunders, *Offshore-Adviser Plea Marks Shift in Tax Crackdown*, WALL ST. J., Aug. 23, 2013 (quoting Jeffrey Neiman).

¹¹⁶ See *id.* (quoting a criminal tax lawyer’s observation that “[i]f I were one of [Mr. Paltzer’s] clients, I’d be having a heart attack”).

¹¹⁷ U.S. Dep’t of Justice, Press Release, *Swiss Bank Pleads Guilty in Manhattan Federal Court to Conspiracy to Evade Taxes*, Jan. 3, 2013, available at <http://www.justice.gov/usao/nys/pressreleases/January13/WegelinPleaPR.php>. Although Wegelin had no branches outside of Switzerland, “it directly accessed the U.S. banking system through a corresponding bank account that it held at UBS AG in Stamford, Connecticut.” *Id.* For additional details regarding the actions of Wegelin bankers to capture business from U.S. citizens fleeing UBS, see Indictment, *U.S. v. Wegelin & Co. et al*, No. S1-12-Cr.02, available at <http://www.justice.gov/tax/2012/Wegelin%20S1%20indictment.PDF>.

taxpayers, and agreed to pay a \$74 million in restitution, fines, and forfeitures.¹¹⁸ Shortly thereafter, Wegelin shut down operations after more than two hundred seventy years in business.¹¹⁹ As a Wall Street Journal article observed, “[i]n the span of just one year, Wegelin & Co. went from being one of the most prestigious banks in Switzerland to . . . becoming essentially defunct. . . . That rapid demise is a lesson in how quickly the rules have changed in global banking, and an illustration of the U.S. Justice Department’s increasing reach.”¹²⁰

Enforcement actions have not been limited to UBS and Wegelin. According to the Department of Justice:

Since 2009, the department has charged more than 30 banking professionals and 68 U.S. accountholders with violations arising from their offshore banking activities. Fifty-four U.S. taxpayers and four bankers and financial advisors have pled guilty, and five taxpayers have been convicted at trial. One Swiss bank [UBS] entered into a deferred prosecution agreement, and a second Swiss bank [Wegelin] was indicted and pleaded guilty.¹²¹

In addition, the department currently is actively investigating fourteen other financial institutions regarding their Swiss-based activities.¹²² More importantly, the Department of Justice and the Swiss Federal Department of Finance recently released a joint statement, stating that Switzerland will encourage its banks to participate in a new Department of Justice program. That program, aimed at incentivizing Swiss banks to cooperate in the investigation of U.S. persons using foreign bank accounts to commit tax evasion, promises non-prosecution agreements and penalty caps for those Swiss banks that satisfy detailed information cooperation requirements regarding accounts in which U.S. taxpayers have a direct or indirect interest.¹²³

¹¹⁸ *See id.*

¹¹⁹ See John Tagliabue, *Swiss City Fears for Cultural Legacy in Wake of Bank’s Fall*, N.Y. TIMES, Jan. 24, 2013. The bank’s valuable assets were placed with another Swiss bank, while its bad assets remained with Wegelin under another name. *See id.*

¹²⁰ Reed Albergotti, *Wegelin’s Fall to Tax-Haven Poster Child*, WALL ST. J., Mar. 3, 2013, available at <http://online.wsj.com/article/SB10001424127887323293704578334310421785672.html>.

¹²¹ See U.S. Dep’t of Justice, Press Release, *United States and Switzerland Issue Joint Statement Regarding Tax Evasion Investigations*, Aug. 29, 2013, available at <http://www.justice.gov/opa/pr/2013/August/13-tax-975.html>.

¹²² *See id.*

¹²³ *See id.* Participating banks seeking non-prosecution agreements must agree to pay a 20 percent penalty (based on the maximum aggregate dollar value of all non-disclosed U.S. accounts held on August 1, 2008). *See id.* Because of concerns that accounts opened after the UBS affair reflect a greater degree of bank culpability (as reflected in the prosecution of Wegelin), accounts opened between August 2008 and February 2009 are subject to a 30 percent penalty, and accounts opened after February 2009 are subject to a 50 percent penalty. *See id.* According to the Department of Justice:

The program is intended to enable every Swiss bank that is not already under criminal investigation to find a path to resolution. It also creates significant risks for individuals and banks that continue to fail to cooperate, including for those Swiss banks that facilitated U.S. tax evasion but fail to cooperate now, for all U.S. taxpayers who think that they can continue to hide income and assets in offshore banks, and for those advisors and others who facilitated these crimes.

Commentators have noted that the Department of Justice's success in obtaining information and cooperation from Swiss banks, with the involvement of the Swiss government, impacts not only tax-motivated Swiss bank secrecy, but also tax-motivated bank secrecy in other countries where U.S. taxpayers may try to hide income. For example, a prominent tax attorney and contributor to *Forbes* observed:

Some said it would never happen. They were wrong. The U.S. and Swiss reached a deal that punishes Swiss banks and paves the way for even more transparency.... And it takes little imagination to know this will impact even obscure and far-flung countries too. After all, just remember the past and Switzerland's long tradition of bank confidentiality.... The watershed deal to punish Swiss banks truly closes the door on bank secrecy and a bygone era of tax evasion.... [F]or Americans holding undisclosed funds in Switzerland or anywhere else, with FATCA and now the capitulation of what amounts to all of Switzerland, it seems clear that disclosure—everywhere and of everything—is inevitable.¹²⁴

Another international tax attorney, writing in a tax practice journal, similarly concluded:

Anyone familiar with the recent U.S. activity surrounding foreign accounts knows that the [handwriting] on the wall is very clear: Swiss bank secrecy, indeed bank secrecy worldwide, is a thing of the past These developments [including the globalization of the economy, technological developments regarding information sharing, and concerns over financial secrecy associated with international terrorist financing] signal the beginning of the end of bank secrecy around the world. Of course, bank secrecy laws will still exist, and depositors will still be able to hide financial information from other individuals, such as business partners, spouses and litigation adversaries. However, the day has come when individuals can no longer hide certain financial details from governments.¹²⁵

B. Heightened Focus on Reporting Requirements

Concurrently with the Department of Justice's efforts against Swiss banks, the IRS increased its enforcement efforts against U.S. citizens in the international context. As with the Swiss bank situation, these efforts did not focus exclusively

Id.

¹²⁴ Robert W. Wood, *Every American with Money Abroad—Anywhere Abroad—Is Impacted by Massive Bank Deal*, FORBES, Aug. 31, 2013, available at <http://www.forbes.com/sites/robertwood/2013/08/31/every-american-with-money-abroad-anywhere-abroad-is-impacted-by-massive-bank-deal/>.

¹²⁵ Bryan C. Skarlatos, *The IRS Continues to Attack Unreported Foreign Bank Accounts by Criminally Indicting Three Swiss Bankers*, 13 J. OF TAX PRAC. & PROC. 17, 57 (Dec. 2011/Jan. 2012).

(or even primarily) on overseas citizens. Rather, they focused on overseas financial accounts held by U.S. persons, including U.S. citizens (regardless of whether the citizen lived in the United States or abroad). A principal focus of these efforts has been the Foreign Bank Account Report (“FBAR”).

The FBAR arose in 1970 under the Bank Secrecy Act.¹²⁶ This legislation requires certain U.S. persons to report their foreign bank and financial accounts each year.¹²⁷ The reporting is made on Treasury Form TD F 90-22.1,¹²⁸ and is required only if the aggregate balance in the foreign accounts exceeds \$10,000 at any time during the calendar year.¹²⁹ The FBAR is not an IRS form and, perhaps more importantly, it is not filed with a person’s income tax return and does not have the same due date as a tax return.¹³⁰ However, Schedule B of IRS Form 1040 asks the taxpayer whether she had a financial interest in, or signatory authority over, a foreign financial account and, if so, instructs the taxpayer to file the FBAR form in accordance with the FBAR instructions.¹³¹

Attention to the FBAR has increased significantly in recent years. Shortly after the September 11, 2001, terrorist attacks, Congress enacted the USA Patriot Act.¹³² In an effort to prevent, detect, and prosecute those involved in money laundering and terrorist financing, the USA Patriot Act instructed the Treasury department to “study methods for improving compliance with the [FBAR] reporting requirements”¹³³ In order to allow better enforcement of the FBAR requirement, in 2003 the Treasury Department’s Financial Crimes Enforcement Network (“FinCEN”), which previously had been responsible for FBAR examination and penalty assessment, delegated these responsibilities to the IRS, with its more extensive resources.¹³⁴

Because of concern about the low level of FBAR compliance, in 2004 Congress increased the penalties for willful failure to file, added a new penalty for non-willful failures, and shifted the burden of proof onto the individual in certain

¹²⁶ See 31 U.S.C. § 5314(a).

¹²⁷ For an overview of the historic evolution of the FBAR, see Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, and Why it Matters*, 7 HOUSTON BUS. & TAX L.J. 1 (2006).

¹²⁸ Effective July 1, 2013, FBARs must now be filed electronically. See IRS Website, *Report of Foreign Bank and Financial Accounts (FBAR)*, at <http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Report-of-Foreign-Bank-and-Financial-Accounts-%28FBAR%29>.

¹²⁹ See General Instructions, Dep’t of Treas. Form TD F 90-22.1 [hereinafter “FBAR Instructions”] (Rev. 1-2012).

¹³⁰ An individual’s income tax return generally is due by April 15 following the close of the calendar tax year, see I.R.C. § 6072(a), although the tax return of a U.S. citizen whose tax home and abode is outside the United States is not due until June 15. See Treas. Reg. § 1.6081-5(a)(5). In contrast, the FBAR is due by June 30 immediately following the calendar year being reported. See FBAR Instructions, *supra* note 129. Whereas a taxpayer generally can receive an automatic six-month extension for filing an income tax return, see Treas. Reg. § 1.6081-4(a), no extension of time is allowed for filing the FBAR. See FBAR Instructions, *supra* note 129.

¹³¹ See I.R.S. Form 1040, Sched. B (Interest and Ordinary Dividends), line 7a (2012).

¹³² Pub. L. 107-56, 115 Stat. 272 (2001).

¹³³ *Id.* § 361(b), 115 Stat. at 332.

¹³⁴ See 31 CFR § 103.56(g).

situations.¹³⁵ The maximum civil penalty for a willful violation of FBAR reporting is the greater of \$100,000 or fifty percent of the balance of the account at the time of the violation.¹³⁶ Because the penalty might apply for each year that the form is not filed, the total penalties could exceed the balance in the foreign account.¹³⁷ Even if the failure to file was not willful, the account holder may be subject to a \$10,000 penalty per violation.¹³⁸ Because each account that is not reported is viewed as a separate violation, more than \$10,000 of penalties might accrue each year.¹³⁹

C. FATCA and Intergovernmental Agreements

The Foreign Account Tax Compliance Act (“FATCA”),¹⁴⁰ enacted as part of the Hiring Incentives to Restore Employment Act of 2010,¹⁴¹ established another significant mechanism for overseas enforcement. As a general matter, the United States does not have direct enforcement authority over foreign financial institutions. However, the enforcement efforts against Swiss banks, discussed

¹³⁵ See generally Sheppard, *supra* note 127, at 17–19 (describing changes made by the 2004 legislation).

¹³⁶ 31 U.S.C. § 5321(a)(5). In addition, criminal penalties of up to \$500,000 and ten years in prison may apply. See *id.* § 5322; 31 C.F.R. § 1010.840.

¹³⁷ See, e.g., Complaint, *U.S. v. Carl R. Zwerner*, Case No. 1:13-cv-22082-CMA (So. Dist. Fla., Miami Div. June 11, 2013), available at <http://online.wsj.com/public/resources/documents/CivilFBARLawsuit07122013.pdf> (Treasury Department assessed cumulative penalties of more than \$3 million for four annual FBAR reporting failures, although the highest balance in the account during the four-year period was less than \$1.7 million). This assessment of cumulative penalties appears to be an exception to the more typical IRS practice of seeking only a single 50% penalty. See I.R.M. § 4.26.16.4.7(4) (“Given the magnitude of the maximum penalties permitted for each violation, the assertion of multiple penalties and the assertion of separate penalties for multiple violations with respect to a single FBAR form, should be considered only in the most egregious cases”); see also Laura Saunders, *When Are Tax Penalties Excessive*, FORBES, Jul. 12, 2013, available at <http://online.wsj.com/article/SB10001424127887324694904578598230978458720.html> (citing tax attorneys who have handled numerous FBAR cases). The IRS National Taxpayer Advocate and others have argued that these cumulative penalties may violate the “excessive fines” prohibition in the Eighth Amendment to the U.S. Constitution. See NATIONAL TAXPAYER ADVOCATE, *supra* note 51, at 147 (“The National Taxpayer Advocate is concerned that such a disproportionate civil penalty amount, particularly in the absence of clear limits on the situations in which it can be applied, is excessive to the point of possibly violating the U.S. Constitution. . . . In any event, it is certainly a scary prospect for taxpayers”); see also Marie Sapirie, *Do FBAR Fines Violate the Eighth Amendment?*, 71 TAX NOTES INT’L 499 (2013) (citing *U.S. v. Bajakajian*, 524 U.S. 321 (1988), which held that a punitive forfeiture of 100% for failing file a Customs currency report was “grossly disproportional to the gravity of the offense”); Saunders, *supra* (same).

¹³⁸ 31 U.S.C. § 5321(a)(5).

¹³⁹ According to the IRS, taxpayers who reported and paid all tax on their income for prior years, but did not file FBARs, should go ahead and file delinquent FBARs and the IRS will not impose the failure-to-file penalty, provided the taxpayer has not yet been contacted regarding an income tax examination or request for delinquent returns. See IRS Website, *Options Available to Help Taxpayers with Offshore Interests*, at <http://www.irs.gov/uac/Instructions-for-New-Streamlined-Filing-Compliance-Procedures-for-Non-Resident-Non-Filer-US-Taxpayers>; IRS Website, *2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions*, Q&A 17; but see, e.g., Amy Feldman, *The Perils of Overseas Tax Disclosure: An Immigrant’s Story*, REUTERS NEWS SERVICE, Jan. 28, 2013, available at <http://www.reuters.com/article/2013/01/28/us-column-feldman-immigrants-idUSBRE90R10Q20130128> (describing penalty concerns of resident alien who failed to report income or file FBAR forms on foreign accounts inherited from his sister, even though the foreign tax credit allegedly would have eliminated any U.S. residual tax had the account income been reported).

¹⁴⁰ FATCA is codified in I.R.C. §§ 1471–1474.

¹⁴¹ Pub. L. 111-147,

above, demonstrate that the United States can exercise some indirect enforcement influence over foreign banks that have connections to the U.S. financial system.¹⁴² The FATCA legislation goes a step further, leveraging the fact that many foreign financial institutions (“FFIs”) hold at least some U.S. investments. As summarized in the Treasury Decision publishing the final FATCA regulations:

U.S. taxpayers’ investments have become increasingly global in scope. FFIs now provide a significant proportion of the investment opportunities for, and act as intermediaries with respect to the investments of, U.S. taxpayers. Like U.S. financial institutions, FFIs are generally in the best position to identify and report with respect to their U.S. customers. Absent such reporting by FFIs, some U.S. taxpayers may attempt to evade U.S. tax by hiding money in offshore accounts. To prevent this abuse of the U.S. voluntary tax compliance system and address the use of offshore accounts to facilitate tax evasion, it is essential in today’s global investment climate that reporting be available with respect to both the onshore and offshore accounts of U.S. taxpayers. This information reporting strengthens the integrity of the U.S. voluntary tax compliance system by placing U.S. taxpayers that have access to international investment opportunities on an equal footing with U.S. taxpayers that do not have such access or otherwise choose to invest within the United States. To this end, [FATCA] extends the scope of the U.S. information reporting regime to include FFIs that maintain U.S. accounts. [FATCA] also imposes increased disclosure obligations on certain [nonfinancial foreign entities (“NFFE’s”)] that present a high risk of U.S. tax avoidance.¹⁴³

Under FATCA, if a FFI fails to report certain information to the IRS on accounts held by U.S. persons, or if certain NFFEs do not provide information on their substantial U.S. owners to withholding agents, a thirty percent withholding tax is imposed on U.S. source payments made to that FFI or NFFE, regardless of who is the ultimate beneficial owner of the payments.¹⁴⁴ The foreign entities are required to exercise due diligence in determining which accounts are held by U.S. persons, including an inquiry into whether an individual account holder was born in the United States or otherwise has indicia of U.S. status.¹⁴⁵ The final FATCA

¹⁴² See, e.g., *supra* note 117 (noting that Wegelin had no branches outside of Switzerland, but “it directly accessed the U.S. banking system through a corresponding bank account that it held at UBS AG in Stamford, Connecticut.”)

¹⁴³ T.D. 9610, 78 FED. REG. 5873, 5874 (2013).

¹⁴⁴ See *id.* at 2.

¹⁴⁵ For example, an FFI generally must review its existing individual accounts for U.S. indicia, including designation of the account holder as a U.S. citizen or resident, a U.S. place of birth, a current U.S. residence or mailing address, a current U.S. telephone number, standing instructions to make payments to an account maintained in the United States, or a current power of attorney or signatory authority granted to a person with a U.S. address. See Treas. Reg. § 1.1471-4(c)(5)(iv)(B). This suggests that, once FATCA is implemented, the IRS may be in a stronger position to identify citizens living overseas. If so, this would address one of the

regulations provide a phased-in implementation, beginning on January 1, 2014, and continuing through 2017,¹⁴⁶ although the IRS subsequently delayed the implementation of FATCA withholding until July 1, 2014.¹⁴⁷

In order to overcome concerns that some FFIs are prevented by their countries' laws from reporting FATCA information directly to the IRS (thereby exposing the FFIs to withholding on U.S. investment income), the Treasury Department has signed intergovernmental agreements ("IGAs") with a number of foreign countries, and is negotiating IGAs with a significant number of additional countries.¹⁴⁸ These IGAs are based on two different models. Under Model 1 IGAs, the FFIs in the partner jurisdiction report specified information about U.S. accounts to the partner jurisdiction's tax authorities, which then exchange this information with the IRS on an automatic basis.¹⁴⁹ Thus, the partner jurisdiction acts as the intermediary between its FFIs and the IRS. Under Model 2 IGAs, the partner jurisdiction agrees to direct and enable all non-exempt FFIs in its jurisdiction to register with the IRS and report specified information about U.S. accounts directly to the IRS.¹⁵⁰ Government-to-government exchange of information can be used under a Model 2 IGA to provide supplemental information in the case of recalcitrant account holders.¹⁵¹

Given the broad extent to which foreign financial institutions hold at least some U.S.-source investments, the FATCA regime holds the potential to significantly widen the scope of the IRS' ability to collect information on foreign accounts, whether held by U.S. citizens residing in the United States or those residing abroad. Both versions of the Model IGA contemplate that financial institutions, as part of their due diligence, will look for indicia of U.S. citizenship in their account records.¹⁵² The potential real-life impact of FATCA is evidenced

administrative criticisms raised by Schneider regarding citizenship-based taxation—the inability of the foreign countries to identify U.S. citizens and provide information on them to the IRS under existing exchange of information provisions of treaties. See Schneider, *supra* note 63, at 56.

¹⁴⁶ See I.R.S. Notice 2013-43, at 2.

¹⁴⁷ See *id.* at 6.

¹⁴⁸ For a general discussion of the issues arising in the implementation of FATCA, see Itai Grinberg, *The Battle Over Taxing Offshore Accounts*, 60 UCLA L. REV. 304, 334–39 (2012). See also *infra* note 243 (discussing legal and practical issues that might arise from the implementation of FATCA).

¹⁴⁹ See T.D. 9610, *supra* note 143, at 5877. The Model 1 IGA is drafted in both a reciprocal form (in which the United States also promises to gather and transmit FATCA-compliant information to the partner country) and a non-reciprocal form (in which the United States does not make this reciprocal promise). However, "[i]t is hard to imagine any country signing [the non-reciprocal version]". Lee A. Sheppard, *Will U.S. Hypocrisy on Information Sharing Continue?*, 69 Tax Notes Int'l 320, 323 (2013).

¹⁵⁰ See T.D. 9610, *supra* note 143, at 5877.

¹⁵¹ *Id.*

¹⁵² Under the Model 1 IGA, for pre-existing "lower value accounts" (typically those greater than \$50,000, but less than \$1 million) the reporting FFI must search its electronic records for identification of the account holder as a U.S. citizen or for an unambiguous indication of the holder's U.S. place of birth. See U.S. DEP'T OF TREASURY, MODEL 1 IGA ANNEX I, DUE DILIGENCE OBLIGATIONS FOR IDENTIFYING AND REPORTING ON U.S. REPORTABLE ACCOUNTS AND ON PAYMENTS TO CERTAIN NONPARTICIPATING FINANCIAL INSTITUTIONS [hereinafter MODEL 1 ANNEX], § II.B.1 (rev. Jul. 12, 2013), available at <http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-AnnexI-to-Model1-Agreement-7-12-13.pdf>. However, an account is not reportable based on the U.S. place of birth if the FFI obtains a self-certification from the account holder that she is not a U.S. citizen or tax resident, the account holder has a non-U.S. passport showing citizenship or nationality in a country other than the United States, and a copy of the account holders

by the significant number of foreign jurisdictions that have either agreed to, or are negotiating, IGAs, rather than have their FFIs exposed to the withholding tax.

In addition to the reporting requirements imposed on foreign financial institutions, FATCA imposes additional reporting requirements on U.S. residents and citizens, including citizens residing abroad, who hold specified foreign financial accounts.¹⁵³ This reporting is done on IRS Form 8938.¹⁵⁴ In general, a U.S. resident or citizen must file Form 8938 if the total value of her foreign bank and investment accounts is \$50,000 on the last day of the tax year or more than \$75,000 at any time during the tax year.¹⁵⁵ However, if the individual resides outside the United States, the filing thresholds are significantly higher—a U.S. individual residing abroad needs to file the form only if her foreign accounts exceed \$200,000 on the last day of the tax year or more than \$300,000 at any time during the tax year (these thresholds are \$400,000 and \$600,000, respectively, for qualified married couples residing abroad and filing a joint return).¹⁵⁶

Although there may be significant overlap between the accounts reported on Form 8938 and the FBAR report, individuals must file both forms if applicable.¹⁵⁷ Unlike the FBAR report, which is filed with FinCEN no later than June 30, the Form 8938 is filed with the IRS at the time the individual's income tax return is filed.¹⁵⁸ A taxpayer who fails to file the Form 8938 may be subject to a \$10,000 penalty.¹⁵⁹ In addition, she may be subject to an additional \$10,000 penalty if she does not file a correct and complete form within 90 days after being notified by the IRS of her failure to file (and an additional \$10,000 for each 30-

Certificate of Loss of Nationality (or an reasonable explanation of why she does not have such a certificate). *See id.* § II.B.4. For pre-existing “high-value accounts”, the FFI may need to perform not only an electronic search for this information, but also a manual search of paper records. *See id.* § II.D. For new accounts, the reporting FFI must obtain a self-certification from the account holder that allows the FFI to determine whether the account holder is a “resident in the United States for tax purposes,” which is defined to include a U.S. citizen even if she is also a tax resident of another jurisdiction. *See id.* § III.B. The FFI must confirm the reasonableness of the self-certification under standards set forth in the Model 1 Annex. *See id.* The Model 2 IGA contains similar due diligence requirements regarding the identification of U.S. citizen account holders. *See* U.S. DEP’T OF TREASURY, MODEL 2 IGA ANNEX I, DUE DILIGENCE OBLIGATIONS FOR IDENTIFYING AND REPORTING ON U.S. REPORTABLE ACCOUNTS AND ON PAYMENTS TO CERTAIN NONPARTICIPATING FINANCIAL INSTITUTIONS [hereinafter MODEL 2 ANNEX] (rev. Jul. 12, 2013), available at <http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-AnnexI-to-Model2-Agreement-7-12-13.pdf>.

¹⁵³ *See* I.R.C. § 6038D.

¹⁵⁴ *See* I.R.S. Form 8938, *Statement of Specified Foreign Financial Assets* (rev. Nov. 2012).

¹⁵⁵ *See* I.R.S., *Instructions for Form 8938*, at 2 [hereinafter “Form 8938 Instructions”] (rev. Nov. 2012). The thresholds for married taxpayers filing jointly are double these amounts (*i.e.*, \$100,000 on the last day, or \$150,000 at any time during the year). *See id.* In contrast, the FBAR form’s \$10,000 threshold applies regardless of whether the U.S. citizen resides in the United States or abroad.

¹⁵⁶ *See* Treas. Reg. § 1.6038D-2T(a)(3) & (4).

¹⁵⁷ The IRS website warns taxpayers that “[t]he new Form 8938 filing requirement does not replace or otherwise affect a taxpayer’s obligation to file [the FBAR form]. Individuals must file each form for which they meet the relevant reporting threshold.” IRS Website, *Comparison of Form 8938 and FBAR Requirements*, at <http://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements>. The website contains a detailed comparison chart explaining the differences and similarities between the two forms’ filing requirements. *See id.*

¹⁵⁸ *See* I.R.S., Form 8938 Instructions, *supra* note 155, at 1.

¹⁵⁹ *See* I.R.C. § 6038D(d)(1).

day period, or part of a period, during which the failure to file continues after the initial 90-day period.¹⁶⁰ The maximum penalty for continuing failure to file is \$50,000.¹⁶¹

D. Overseas Voluntary Disclosure Program

These enforcement developments generated significant attention not only among tax practitioners, but also in the mass media. The combination of significant penalties for failure to properly report, and the heightened possibility of detection as a result of the new enforcement developments, generated significant concern among non-compliant taxpayers. Even those U.S. citizens whose interest in a foreign bank account was benign had reason for concern. For example, a U.S. citizen might have inherited the account from a foreign relative or established the account as a routine banking matter while living overseas. Although she did not report the account's income on her U.S. tax return, that income might not have been subject to U.S. tax even if reported to the extent the income was taxed in the foreign country and was eligible for a foreign tax credit. Nonetheless, by failing to disclose the account on an FBAR form, the taxpayer could be subject to significant penalties.

Given the heightened interest among taxpayers and their advisors to “come clean” in anticipation of the IRS’ enhanced enforcement tools, and the IRS’ incentives to encourage previously non-compliant taxpayers to enter the system,¹⁶² the IRS has implemented several iterations of an Overseas Voluntary Disclosure Program (“OVDP”): in 2009, 2011, and in 2012 (which is still ongoing).¹⁶³ Perhaps not surprisingly, given the publicity surrounding the UBS enforcement action, almost half of the disclosures in the 2009 OVDP involved

¹⁶⁰ See I.R.C. § 6038D(d)(2).

¹⁶¹ See *id.* This \$50,000 penalty for continuing failure to file is in addition to the initial \$10,000 penalty for failure to file. See *id.* (noting that the \$50,000 cap applies to “this paragraph”—*i.e.*, the “continuing failure to file” paragraph).

¹⁶² A voluntary disclosure program helps the IRS, given that the IRS “doesn’t have the resources, the time, or the ability to locate all noncompliant U.S. taxpayers. Thus, a voluntary disclosure policy that encourages those persons to confess—and that fairly addresses individual circumstances—is absolutely essential if the Service is to meet its mission....” Thomas Zehnle, *Rethinking the Approach to Voluntary Disclosures*, 134 TAX NOTES 575 (2012).

¹⁶³ The 2009 program allowed disclosures between March 23 and October 15, 2009. See U.S. Dep’t of Treasury, Inspector General for Tax Administration, *The 2009 Offshore Voluntary Disclosure Initiative Increased Taxpayer Compliance, but Some Improvements Are Needed*, [hereinafter “TIGTA 2009 Report”] Ref. No. 2011-30-118, at 2 (Sept. 21, 2011), available at <http://www.treasury.gov/tigta/auditreports/2011reports/201130118fr.pdf>. The 2011 program allowed disclosures between February 8 and September 9, 2011. See IRS Website, *2011 Offshore Voluntary Disclosure Initiative*. The 2012 program, which began on January 9, 2012, is still in effect as of September 2013. See IRS Website, *2012 Offshore Voluntary Disclosure Program*, at <http://www.irs.gov/uac/2012-Offshore-Voluntary-Disclosure-Program> (noting that the IRS may end this open-ended disclosure program at any time). The IRS had tried an earlier offshore voluntary disclosure initiative in 2003, related to an offshore credit card enforcement project, but initiative had only limited impact. See Leandra Lederman, *The Use of Voluntary Disclosure Initiatives in the Battle Against Offshore Tax Evasion*, 57 VILLANOVA L. REV. 499, 504–08 (2012).

accounts in Switzerland.¹⁶⁴ The IRS has publicized the success of these programs, noting that between 2009 and 2012:

[The OVDPs] resulted in the collection of more than \$5.5 billion in back taxes, interest, and penalties from approximately 38,000 applicants. In addition, the programs provided the IRS with a wealth of information on various banks and advisors assisting people with offshore tax evasion, which the IRS is using to continue its international enforcement efforts.¹⁶⁵

Each of the OVDPs has utilized a stick-and-carrot approach to encourage taxpayers to come forward before the government discovers their wrongdoing.¹⁶⁶ The “stick” involves the threat of criminal prosecution and maximum statutory penalties, including fraud penalties and the information return-related penalties described above, in the context of weakening foreign bank secrecy regimes and increased IRS access to foreign account information.¹⁶⁷ The “carrot” involves the elimination of criminal exposure¹⁶⁸ and caps on civil penalties, although this latter aspect of the carrot has become less tasty with each OVDP iteration. The 2009 program contained the most taxpayer-favorable terms: in general, a taxpayer who voluntarily disclosed offshore accounts and fully cooperated was (i) assessed all taxes and interest going back six years; (ii) assessed either an accuracy or

¹⁶⁴ See GOV'T ACCOUNTABILITY OFFICE, OFFSHORE TAX EVASION[.] IRS HAS COLLECTED BILLIONS OF DOLLARS, BUT MAY BE MISSING CONTINUED EVASION 14 (GAO-13-318, 2013), available at <http://www.gao.gov/assets/660/653369.pdf>

¹⁶⁵ NATIONAL TAXPAYER ADVOCATE, *supra* note 51, at 144; see also IRS, Press Release, *IRS Says Offshore Effort Tops \$5 Billion, Announces New Details on the Voluntary Disclosure Program and Closing of Offshore Loophole*, IR-2012-64 (June 26, 2012), available at [http://www.irs.gov/uac/IRS-Says-Offshore-Effort-Tops-\\$5-Billion,-Announces-New-Details-on-the-Voluntary-Disclosure-Program-and-Closing-of-Offshore-Loophole](http://www.irs.gov/uac/IRS-Says-Offshore-Effort-Tops-$5-Billion,-Announces-New-Details-on-the-Voluntary-Disclosure-Program-and-Closing-of-Offshore-Loophole). For the first 10,000 cases closed under the 2009 OVDP, the median foreign account balance was approximately \$570,000, with a median FBAR-related penalty of \$108,000. GOV'T ACCOUNTABILITY OFFICE, *supra* note 164, at 13 tbl. 2. The 90th percentile account balance was \$4 million, while the 90th percentile FBAR-related penalty was \$793,000. *Id.*

¹⁶⁶ A disclosure is not considered “voluntary”, and thus not eligible for the OVDP, if the IRS has already initiated a civil examination of the taxpayer, regardless of whether or not the examination relates to undisclosed foreign accounts. See IRS Website, *Voluntary Disclosure: Questions and Answers*, at <http://www.irs.gov/uac/Voluntary-Disclosure:-Questions-and-Answers>.

¹⁶⁷ See TIGTA 2009 Report, *supra* note 163, at 2; see also IRS Website, *Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers*, Q&A 5–6, available at <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers> (containing extensive list of potential criminal and civil penalties that might apply if taxpayer does not disclose foreign accounts); see also Lederman, *supra* note 163, at 502 (concluding that the offshore voluntary disclosure programs have “encouraged quite a number of taxpayers to make voluntary disclosures, but ... the IRS’s repeated use of offshore voluntary disclosure initiatives may have diminishing returns unless the government continues to engage in well-publicized criminal prosecutions of tax evaders”).

¹⁶⁸ See *id.* at 1 & n.1 (noting that the OVDP is an extension of the IRS’ long-standing Voluntary Disclosure Practice, which generally allows taxpayers to eliminate the risk of criminal prosecution by voluntarily disclosing in a truthful and complete manner before certain events occur that might otherwise allow the IRS to discover the potential wrongdoing); see also IRS Website, *2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers*, at <http://www.irs.gov/Businesses/International-Businesses/2011-Offshore-Voluntary-Disclosure-Initiative-Frequently-Asked-Questions-and-Answers> (stating that the Department of Justice takes voluntary disclosure into account in deciding whether to criminally prosecute a taxpayer and that the IRS will not recommend criminal prosecution to the Department of Justice when a taxpayer truthfully, timely, and completely complies with the voluntary disclosure practice).

delinquency penalty on underpaid tax for all those years; and (iii) in lieu of FBAR and other penalties, assessed a penalty equal to 20% of the highest aggregate amount in the foreign accounts.¹⁶⁹

Following the success of the 2009 program, the IRS implemented the 2011 OVDP. However, its terms were not as taxpayer-favorable. Rather than a six-year lookback, taxpayers disclosing under the 2011 program were required to pay back taxes, interest, and an accuracy or delinquency penalty for the past eight years.¹⁷⁰ Moreover, the penalty in lieu of FBAR and related penalties was raised to 25% (rather than 20%) of the highest aggregate amount in the accounts during the eight-year period (this penalty was capped at 12.5% if the offshore accounts did not exceed \$75,000 in any relevant year).¹⁷¹

The 2012 program, which is still in effect,¹⁷² ratchets the potential penalties higher than the earlier programs. In particular, the FBAR-related penalty is raised to 27.5% (rather than 25%) of the highest aggregate amount in the accounts during the eight-year period.¹⁷³ As with the 2011 program, the penalty is capped at 12.5% if the offshore accounts did not exceed \$75,000 in any relevant year.¹⁷⁴ Taxpayers can opt-out of the OVDP, and have their cases handled under normal examination procedures, but the IRS Taxpayer Advocate has warned taxpayers about the potential risks of this approach.¹⁷⁵

Three categories of taxpayers are eligible for a 5% (rather than 27.5%) offshore reporting penalty under the OVDP. The first category includes taxpayers who inherited or otherwise acquired the foreign account from another person and who had only specified limited contact with the account.¹⁷⁶ The second category includes foreign-resident citizens who were “unaware” citizens—*e.g.*, those who were born in the U.S. to foreign-citizen parents but who were raised in a foreign country and had been unaware of their U.S. citizenship status.¹⁷⁷ The third

¹⁶⁹ See *id.* at 2.

¹⁷⁰ See *id.* at 3.

¹⁷¹ See *id.*

¹⁷² See *supra* note 163.

¹⁷³ See IRS Website, *Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers*, Q&A 8, available at <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers> (posted Jun. 26, 2012).

¹⁷⁴ See *id.*, Q&A 53.

¹⁷⁵ See Kristen A. Parillo, *Taxpayer Advocate Urges U.S. Taxpayers to Use Caution on Offshore Voluntary Disclosure*, Tax Analysts Doc. 2013-22663, 2013 WTD 186-1 (Sept. 25, 2013). Taxpayers might consider opting out if they had minimal underpayment of tax and believe their failure to file the FBARs was not “willful”. See, *e.g.* Jeremiah Coder, *Taxpayers Face Hurdles and Risks When Opting Out of U.S. Offshore Voluntary Disclosure Program*, Tax Analysts Doc. 2013-1137, 2013 WTD 12-4 (Jan. 17, 2013) (discussing potential benefits and risks of opting out). A recent unpublished Fourth Circuit opinion may give taxpayers pause regarding the “willfulness” standard. See *U.S. v. J. Bryan Williams*, No. 10-2230 (4th Cir., Jul. 20, 2012) (unpublished) (holding that the District Court clearly erred in finding that a taxpayer did not willfully fail to file the FBAR form, given that the taxpayer had checked “no” on the Schedule B, Form 1040, question asking whether he had any interest in a foreign financial account).

¹⁷⁶ See IRS Website, *supra* note 173, Q&A 52.

¹⁷⁷ See *id.* Schneider refers to this category of citizens as “accidental” citizens. See *supra* note 64 and accompanying text. The IRS site does not explicitly address those “unknowing” or “unaware” citizens who were born and raised abroad and obtained citizenship through descent from a citizen-parent. However, the

category includes foreign-resident citizens who timely complied with the tax requirements in their country of residence, and who had no more than \$10,000 of U.S. source income in each year.¹⁷⁸

The increased enforcement environment may have also encouraged significant numbers of U.S. citizens with foreign accounts to re-enter the tax system through another route—a “quiet disclosure”.¹⁷⁹ Under this approach, the taxpayer merely files late FBARs and an amended tax return reporting offshore income from prior years, and generally pays the tax deficiency along with interest and either an accuracy-related or delinquency penalty, but attempts to avoid FBAR-related penalties that would have been owed in the OVDP.¹⁸⁰ A more extreme approach would be to ignore prior years, and merely begin filing FBARs and reporting income in the current year from foreign accounts that had been in existence for many years, in the hope that the prior years’ omissions would not be detected by the IRS.¹⁸¹ Taxpayers attempting either of these approaches, rather than the OVDP, take the risk of maximum FBAR penalties and, depending on the circumstances, criminal prosecution.¹⁸²

The Government Accountability Office (“GAO”), in a recent report on the general success of the OVDPs, noted that there may have been a very significant number of quiet disclosures during the years of the OVDPs, and that such disclosures undermine the incentive to participate in the OVDPs.¹⁸³ The GAO report recommended that the IRS increase its efforts to detect quiet disclosures, and suggested new methodologies that the IRS might use to do so.¹⁸⁴ The IRS announced that it is taking steps to implement the GAO’s recommendations.¹⁸⁵

E. Impact on Global Information Sharing and Cooperation Norms

The foregoing summary indicates the significant changes that have taken place—and continue to take place—in U.S. overseas tax enforcement during the past five years. As important as these developments may be from the perspective of U.S. tax administrators, they are just as important in the impact they have had on global information sharing and tax enforcement norms. Perhaps in combination with the global economic downturn and the resulting efforts of national governments to find additional sources of revenue, the softening of Swiss

site makes clear that a person who knew she was a citizen but did not inquire as to U.S. tax obligations is not eligible for this lower penalty rate.

¹⁷⁸ See IRS Website, *supra* note 173, Q&A 52.

¹⁷⁹ See GOV’T ACCOUNTABILITY OFFICE, *supra* note 164, at 11.

¹⁸⁰ *Id.*

¹⁸¹ *See id.*

¹⁸² *See id.*; see also IRS Website, *supra* note 173, Q&A 15 (noting risks of making quiet disclosure without participating in OVDP).

¹⁸³ *See id.* at 23. The GAO, using a more comprehensive methodology than the IRS had been using, identified more than 10,000 potential quiet disclosures for the period examined. *See id.* at 24–26.

¹⁸⁴ *See id.* at 30.

¹⁸⁵ *See id.*

bank secrecy, upcoming implementation of FATCA IGAs, and other aspects of the U.S. enforcement efforts have significantly strengthened the willingness of other countries to expand information sharing to combat cross-border tax evasion.¹⁸⁶

For example, Angel Gurría, the Secretary-General of the Organization for Economic Cooperation and Development (“OECD”), recently observed that “[t]he political support for automatic exchange of information on investment income has never been greater,”¹⁸⁷ attributing this in part to the U.S. efforts to cooperate with other countries in implementing FATCA. The OECD recently released a report describing its efforts to improve information exchange, highlighting its efforts to establish a global standard on automatic information exchange.¹⁸⁸ In addition, the leaders of the Group of Twenty (“G20”) recently issued a declaration strongly supporting increased information sharing, concluding that “[w]e look forward to the practical and full implementation of the new standard on a global scale.”¹⁸⁹

Similarly, leaders of the G-8 nations recently expressed their support for the OECD information exchange efforts, stating “[w]e commit to establish the automatic exchange of information between tax authorities as the new global standard, and will work with the [OECD] to develop rapidly a multilateral model which will make it easier for governments to find and punish tax evaders.”¹⁹⁰ An OECD report prepared for the recent G-8 summit notes that the U.S. Department of Treasury’s Model 1 IGA is “a logical basis on which to build” a global standard of automatic information exchange.¹⁹¹ Furthermore, a proposal was

¹⁸⁶ See generally, Grinberg, *supra* note 148 (describing how recent developments in the United States and elsewhere reflect an emerging international consensus to have financial institutions act as cross-border tax intermediaries using an automatic information reporting model, rather than an anonymous withholding model).

¹⁸⁷ Kristen A. Parillo & Stephanie Soong Johnston, *G-20 Seeks Global Action on Automatic Information Exchange*, 70 TAX NOTES INT’L 386, 386 (2013).

¹⁸⁸ See OECD, OECD SECRETARY-GENERAL REPORT TO THE G20 FINANCE MINISTERS 35–36 (2013), available at Tax Analysts Doc. No. 2013-9744, 2013 WTD 77-33.

¹⁸⁹ G20 Leaders’ Declaration, Sept. 2013, available at Tax Analysts Doc. No. 2013-21295, 2013 TNT 174-39. Shortly before the G20 meeting, the United States and five other countries issued a joint statement expressing support for the OECD’s efforts on automatic information exchange and encouraging the G20’s engagement in this issue. See U.S. White House, Office of the Press Secretary, Press Release, *Joint Statement by Kingdom of Denmark, Republic of Finland, Republic of Iceland, Kingdom of Norway, Kingdom of Sweden, and the United States of America*, Sept. 4, 2013, available at <http://www.whitehouse.gov/the-press-office/2013/09/04/joint-statement-kingdom-denmark-republic-finland-republic-iceland-kingdo>; see also U.S. Dep’t of Treasury, *Joint Communiqué by France, Germany, Italy, Spain, the United Kingdom and the United States on the Occasion of the Publication of the “Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA*, available at <http://www.treasury.gov/press-center/press-releases/Documents/joint%20communique.pdf> (describing the new IGA model as “an important step forward in establishing a common approach to combat tax evasion based on automatic exchange of information”).

¹⁹⁰ G-8, 2013 Lough Erne Communiqué, Jun. 18, 2013, available at Tax Analysts Doc. No. 2013-14773, 2013 WTD 118-21.

¹⁹¹ See OECD, *A Step Change in Tax Transparency[:] OECD Report for the G8 Summit*, Lough Erne, Enniskillen, June 2013, ¶17, available at http://www.oecd.org/ctp/exchange-of-tax-information/taxtransparency_G8report.pdf.

recently introduced for an EU Council Directive to implement a FATCA-like initiative among the EU Member States.¹⁹²

Perhaps even more important than the buy-in by the larger global economies, recent U.S.-led developments have affected traditional tax havens and secrecy jurisdictions beyond Switzerland. A number of other traditional offshore financial centers have signed, or are currently negotiating, IGAs with the United States to implement FATCA. For example, the Cayman Islands, recently ranked as the second-most secretive jurisdiction in the world (behind Switzerland), announced that it has concluded negotiations and will sign a Model 1-based IGA with the United States.¹⁹³ Commenters suggested that the Model 1 IGA, which centralizes financial institutions' reporting through their government, was chosen by the Cayman Islands in anticipation that other countries might have some version of FATCA in the future, which would make future compliance easier.¹⁹⁴ Among other offshore financial centers, the United States has initiated an agreement with Bermuda,¹⁹⁵ is in final negotiations with Guernsey, Isle of Man, and Jersey,¹⁹⁶ and has begun negotiations with the British Virgin Islands.¹⁹⁷

A number of prominent tax attorneys, including former government officials, have observed that this response by traditional secrecy jurisdictions reflects an awareness that global norms have changed. For example, one attorney concluded that "2013 may very well be the watershed year resulting in the final pathway to global tax compliance and the elimination of offshore tax abuse facilitated by bank secrecy. At the bilateral and multinational levels and the statutory, legislative, and administrative levels, the many global tax initiatives are seemingly converging on the same landscape."¹⁹⁸ Similarly, another practitioner observed that "[t]he Caymans have traditionally been thought of as a secrecy jurisdiction, as was Switzerland, [but now] they're falling like dominoes."¹⁹⁹

¹⁹² See European Commission, *Proposal for a Council Directive Amending Directive 2011/16/EU as Regards Mandatory Automatic Exchange of Information in the Field of Taxation*, 2013/0188 (CNS), available at http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_cooperation/mutual_assistance/direct_tax_directive/com_2013_348_en.pdf.

¹⁹³ See Andrew Velarde, *U.S., Caymans to Sign Milestone FATCA Agreement*, 71 TAX NOTES INT'L 679 (2013).

¹⁹⁴ See *id.* (quoting tax attorney Jonathan Jackel).

¹⁹⁵ See Laura Saunders, *Offshore Accounts: No Place to Hide?*, WALL ST. J., Sept. 20, 2013.

¹⁹⁶ See *id.*

¹⁹⁷ See Kristen A. Parillo, *B.V.I. Premier "Sets Record Straight" on FATCA*, 71 TAX NOTES INT'L 962 (2013). The BVI negotiations, like the Cayman Islands agreement, centers on the Model 1 IGA. See *id.*

¹⁹⁸ William M. Sharp Sr., *Navigating Offshore Tax Hazards: An Update*, 70 TAX NOTES INT'L 695, 706 (2013).

¹⁹⁹ See Alison Bennett, *U.S.-Caymans FATCA Agreement Signals Growing Tax Transparency, Practitioners Say*, BNA DAILY TAX REPORT, Aug. 19, 2013, 160 DTR G-2; see also *id.* (quoting numerous other practitioners and former government officials regarding the global shift toward transparency). One attorney explained the participation of Caribbean and other financial centers in the FATCA process by noting "[i]n today's world, counterparties don't want to deal with noncompliant entities, regardless of whether they're deriving U.S.-source income. With the trend toward eliminating bank secrecy and enhancing transparency, you either join in or become an outlier. Jurisdictions that depend on the attractiveness of their business environment need to be very sensitive to what the trends are." Parillo, *supra* note 197, at 962 (quoting Alan Granwell of DLA Piper). Similarly, another attorney observed that China's signing of the

Another noted that he advises clients with offshore accounts that "tax havens where people can hide money are a thing of the past.... Forget about confidentiality. Transparency is here to stay."²⁰⁰ Even the Premier of the British Virgin Islands, D. Orlando Smith, observed that because automatic information exchange is becoming the new global standard, it is "incumbent on any responsible person to be straight with our people and offer solutions, not create confusion by misleading them [about the need to cooperate with the United States]."²⁰¹

III. IMPLICATIONS OF ADMINISTRATIVE DEVELOPMENTS

A. *Disproportionate Impact on Overseas Citizens*

1. Impact of Enforcement Initiatives

The recent expansion in overseas enforcement was not driven by concerns over citizens residing abroad. Rather, its focus is principally individuals living in the United States who are hiding income in foreign accounts.²⁰² Nonetheless, in a citizenship-based taxing system, enforcement actions targeting foreign accounts will, by their very nature, disproportionately impact citizens living abroad. Whereas it might be relatively unusual for a citizen living in the United States to have signatory authority over a foreign bank account, such authority is relatively routine for a citizen residing abroad. Just as a person living in New York for an extended period of time might be expected to open a local bank account in New York for her routine financial transactions, a U.S. citizen living in London or Paris might be expected to open a local bank account in that city.²⁰³ A citizen abroad might also be more likely to open investment accounts abroad and, to the extent she has family ties in the foreign country, inherit or otherwise acquire a foreign account from a family member.

In addition, although foreign-resident citizens generally are subject to U.S. taxation, it is possible that a foreign-resident citizen might not owe U.S. income tax on investment income earned from the foreign account.²⁰⁴ In particular, if the individual lives in a foreign country that taxes the income, the foreign tax credit might eliminate much or all of the U.S. tax on the income.²⁰⁵ In order to claim

Multilateral Convention on Mutual Administrative Assistance in Tax Matters, and the recent agreement between the United States and Switzerland, "show that even large and politically powerful jurisdictions have to find the proper balance between cooperation and financial confidentiality to remain viable in today's world." *Id.* (paraphrasing Bruce Zagaris).

²⁰⁰ Saunders, *supra* note 195 (quoting Henry Christensen of McDermott, Will & Emery in New York).

²⁰¹ Parillo, *supra* note 197.

²⁰² See *supra* notes 107–121 and accompanying text.

²⁰³ Of course, the citizen abroad might also open a foreign bank account in a foreign city or country in which she does not reside, which may or may not be used for routine banking activities.

²⁰⁴ The foreign earned income exclusion, discussed *supra* notes 6–7 and accompanying text.

²⁰⁵ See *supra* note 8 and accompanying text.

the credit, however, the individual is required to file a U.S. income tax return, which many overseas citizens might not do.²⁰⁶

In the context of a domestic citizen, a foreign account might be viewed (whether accurately or not) as a signal for potential tax evasion that historically has been outside of the practical enforcement reach of the IRS.²⁰⁷ Of course, in the context of a foreign-resident citizen, a foreign account might also reflect tax evasion activity. However, for the reasons just noted, it might often merely reflect routine banking and investment activity. Nonetheless, at least as a general matter, citizens living abroad who have foreign accounts are subject to the same administrative and legislative enforcement activity that initially envisioned domestic citizens with foreign accounts.²⁰⁸

Of course, the IRS does not know *ex ante* which citizens abroad fall within the most sympathetic group (*e.g.*, foreign accounts opened for benign reasons, with no residual U.S. tax owed because of foreign taxes paid on the income),²⁰⁹ and which fall within some variation of a more worrisome group (*e.g.*, residual U.S. tax would have been owed on the foreign income). Even within this latter group, there might be varying degrees of culpability, such as a U.S. citizen who had not been aware of her citizenship status, a citizen who had been aware of her status but not her filing and tax payment obligations, and a citizen who willfully disregarded known obligations with an intent to evade taxes.

The recent developments in offshore enforcement raise the stakes in this context, increasing the chances of detection and potentially significant penalties.²¹⁰ Citizens abroad who negligently failed to report foreign source

²⁰⁶ See generally I.R.S. Form 1116, *Foreign Tax Credit*.

²⁰⁷ Not every foreign account held by a domestic citizen is evidence of tax planning—*e.g.*, many such accounts might have been inherited from, or had the domestic citizen's name added by, a nonresident non-citizen relative.

²⁰⁸ See Schneider, *supra* note 63, at 32 (the FBAR “is a good example of a requirement that may be reasonable in regards to U.S. taxpayers but that falls disproportionately on and unfairly burdens U.S. persons abroad”).

²⁰⁹ At the extreme, one individual alleged that she felt threatened by the reporting requirements “even if she did everything to fulfill her responsibilities. . . . A simple loyalty card at the local grocery store caused her anxiety when she realised it was linked to a bank account she never knew she had.” Tom Geoghegan, *Why are Americans Giving Up Their Citizenship?*, BBC NEWS, Sept. 26, 2013, at <http://www.bbc.co.uk/news/magazine-24135021>.

²¹⁰ Another possible point of detection arises in the context of U.S. passport applications and renewals. Under I.R.C. § 6039E, a passport applicant (including a renewal) is required to furnish her social security number and, if residing abroad, the name of the foreign country in which she lives. I.R.C. § 6039E; see also U.S. Dep't of State, *Form DS-11, Application for a U.S. Passport*. The Department of State, upon collecting this information, is required to furnish it to the Department of Treasury, and is also required to furnish the name of any passport applicant who refuses to furnish this information. See I.R.C. § 6039E(d). A person who fails to furnish the information (other than for reasonable cause and not willful neglect) may be subject to a \$500 penalty (although the statute does not contemplate that the passport application will be denied for such failure). See *id.* § 6039E(c); see also Prop. Treas. Reg. § 301.6039E-1 (prop. Jan. 26, 2012) (proposing the requirement that applicants include, and the Department of State transmit to Treasury, the applicant's date of birth); Sharp, *supra* note 198, at 702 (suggesting that the publication of these proposed regulations, which replaced proposed regulations published in 1992, “provide a strong signal that the IRS will begin matching up passport applications” to U.S. citizen's tax returns); see generally GOVERNMENT ACCOUNTABILITY OFFICE, FEDERAL TAX COLLECTION[.] POTENTIAL FOR USING PASSPORT ISSUANCE TO INCREASE COLLECTION OF

income (or file an FBAR report) face much greater concerns than those faced by similarly situated domestic citizens who, with the same level of culpability, fail to report U.S. source income or file a required information return regarding U.S. source income.²¹¹ For example, if a U.S.-resident citizen negligently fails to report income from a domestic investment, she may be subject to a negligence penalty (typically 20% of the underreported tax liability) plus interest. In contrast, because a foreign-resident citizen's local bank or investment account will typically be a "foreign" account, her negligent failure could result not only in a negligence penalty plus interest, but also an FBAR-related penalty of at least \$10,000 (if the IRS agrees that the failure was not willful),²¹² and up to the greater of \$100,000 or 50% of the balance in the account if the IRS determines the failure was willful.²¹³

While the OVDPs were intended to encourage taxpayers with past compliance failures to enter the system, the programs—particularly some aspects of the initial programs—might have discouraged taxpayers from doing so. For example, Nina Olson, the IRS National Taxpayer Advocate, noted in her 2012 annual report to Congress that some Q&As on the IRS website implied that the IRS would often seek maximum FBAR penalties, regardless of the situation, thereby discouraging some "benign" taxpayers from participating.²¹⁴ Moreover, she asserted that "some benign actors were so fearful of opting out [of OVDP] that they accepted the IRS settlement and paid more than they owed."²¹⁵

The IRS has, to some extent, acknowledged the potentially disparate impact of its enforcement initiatives on citizens residing abroad. Accordingly, it has implemented special provisions for nonresident citizens in certain circumstances. For example, as noted above,²¹⁶ it has lowered the FBAR-related penalties under the OVDP from 27.5% to five percent for overseas citizens in two categories: first, "unaware" citizens—*e.g.*, those who were born in the U.S. to foreign-citizen parents but who were raised in a foreign country and had been unaware of their U.S. citizenship status; and second, foreign-resident citizens who timely complied with the tax requirements in their country of residence, and who had no more than \$10,000 of U.S. source income in each year.

Last year, the IRS also established "streamlined" filing compliance procedures outside of the OVDP and designed for nonresident taxpayers deemed

UNPAID TAXES (GAO-11-272, 2011), available at <http://www.gao.gov/assets/320/316478.pdf> (discussing legal and practical issues arising from proposal to condition passport issuance or renewal on compliance with tax laws).

²¹¹ Of course, given the more sophisticated system of information reporting in a wholly domestic context, it is less likely that a domestic-based citizen's failure to report domestic investment income would continue for an extended period of time.

²¹² See *supra* note 138 and accompanying text.

²¹³ See *supra* notes 136–137 and accompanying text.

²¹⁴ See NATIONAL TAXPAYER ADVOCATE, *supra* note 51, at 136–37.

²¹⁵ *Id.* at 137.

²¹⁶ See *supra* notes 177–178 and accompanying text.

to be a “low compliance risk.”²¹⁷ Under these procedures, eligible U.S. persons²¹⁸ living abroad file delinquent tax returns for the past three years (with payment of past taxes due, plus interest), and delinquent FBARs for the past six years.²¹⁹ All submissions will be reviewed by the IRS, although “the intensity of review will vary according to the level of compliance risk presented by the submission.”²²⁰

For those taxpayers presenting low compliance risk, “the review will be expedited and the IRS will not assert penalties or pursue follow-up actions.”²²¹ A submission will generally be treated as “low risk” if the taxpayer has less than \$1,500 of tax due in each of the years.²²² Submissions that exceed the \$1,500 threshold are not automatically disqualified from the streamlined program, but will be subject to additional scrutiny to determine whether they present a higher risk. Relevant factors include the amount of tax due, indications of sophisticated tax planning, material economic activity in the United States, and any additional history of noncompliance with U.S. tax laws.²²³ A taxpayer determined to be higher risk may be subject to additional penalties and may be subject to a full examination (perhaps for more than three tax years) in a manner similar to opting out of the OVDP.²²⁴

The streamlined procedures have been welcomed by those who fit within its \$1,500 “low risk” threshold.²²⁵ For those who do not meet that threshold but may be close, IRS officials have encouraged them to consider participating,²²⁶ but practitioners caution that such taxpayers should carefully weigh the possibility of being labeled “higher risk”, and should consider the possibility of using the OVDP instead.²²⁷

²¹⁷ See IRS Website, *Instructions for New Streamlined Filing Compliance Procedures for non-Resident, Non-Filer U.S. Taxpayers*, at <http://www.irs.gov/uac/Instructions-for-New-Streamlined-Filing-Compliance-Procedures-for-Non-Resident-Non-Filer-US-Taxpayers>. A commentator noted that these streamlined rules “came long after taxpayers, their representatives, and IRS agents had spent much time and money navigating” the 2009 and 2011 OVDP and other possible solutions. Marie Sapirie, *The Personal Impact of Offshore Enforcement*, 71 TAX NOTES INT’L 199, 203 (2013).

²¹⁸ The streamlined procedure “is available for non-resident U.S. taxpayers who have resided outside of the U.S. since January 1, 2009, and who have not filed a U.S. tax return during the same period.” IRS Website, *supra* note 217.

²¹⁹ See IRS Website, *supra* note 217.

²²⁰ *Id.*

²²¹ *Id.*

²²² *Id.* Even if this \$1,500 threshold is satisfied, the submission might not be treated as “low risk” if it shows any “high risk factors”. *Id.*

²²³ *See id.*

²²⁴ *See id.*

²²⁵ See Sharp, *supra* note 198, at 701 (noting that the streamlined procedure “has been very popular”).

²²⁶ See Shamik Trivedi, *Low-Risk Offshore Account Holders Urged to Use Streamlined Filing*, 68 TAX NOTES INT’L 1121 (2012) (summary of American Bar Association conference discussion between IRS official and practitioner, in which IRS official encouraged taxpayers who are slightly over the threshold to consider participating in the streamlined process, noting that the IRS “will not necessarily beat up on a taxpayer just because he’s a little bit over or doesn’t meet one of the criteria....It’s just we’re not guaranteeing that the returns will just be processed without any further inquiry from the Service.”).

²²⁷ See Sharp, *supra* note 198, at 702; Shamik Trivedi, *Streamlined FBAR Filing Procedures Might Have Limited Application*, 67 Tax Notes Int’l 1013 (2012) (noting that taxpayers residing in Europe often have an account outside their country of residence due to geographic factors, thereby giving them one of the potential risk factors); see also IRS Website, *Frequently Asked Questions Regarding the Streamlined Filing*

2. Impact of FATCA

As with the recent expansion of enforcement initiatives, the enactment of FATCA was not principally driven by concerns over U.S. citizens abroad, but instead focused on individuals in the United States hiding assets in foreign accounts.²²⁸ Yet it, too, may have a disproportionate impact on overseas citizens, given the fact that they are more likely to hold foreign financial accounts. One significant complaint of overseas citizens concerns the impact of FATCA on their daily banking activities. The tax press, as well as the ACA report, contain numerous stories of overseas citizens complaining that foreign banks and financial institutions, which they rely on for local banking and investment activities, no longer will conduct business with customers who are U.S. citizens.²²⁹ According to these reports, the foreign financial institutions fear that having U.S. clients will expose the institutions to unwanted administrative and legal entanglement with the IRS, so the institutions are terminating relationships with existing U.S. citizen customers, and are refusing to open new accounts for U.S. citizens.²³⁰ This, in turn, allegedly has made it very difficult for U.S. citizens living overseas to engage in routine, local banking activities.

To the extent this phenomenon occurs, it should be of some concern to U.S. policymakers, particularly if non-engagement by FFIs became so great that overseas residents in a particular locale are left with no reasonably available banking or investment institution options. It is understandable that, as an initial reaction to FATCA and in the absence of further guidance regarding its implementation, some FFIs might have taken steps to try to avoid its reach—*e.g.*, attempting to eliminate all U.S. citizen clients—rather than face the possibility of having to interact with the IRS and face potential sanctions under U.S. law.²³¹ However, more recent developments suggest that this initial reaction by FFIs, to the extent it occurred, may have been an overreaction.

Compliance Procedures for Non-Resident, Non-Filer Taxpayers, Q&A 2, at <http://www.irs.gov/Individuals/International-Taxpayers/FAQRStreamlinedFilingComplianceProceduresNRNFTPs>

²²⁸ See, *e.g.*, U.S. Congress, News Release, *Baucus, Rangel, Kerry, Neal Improve Plan to Tackle Offshore Tax Abuse Through Increased Transparency, Enhanced Reporting and Stronger Penalties*, at 3 (Oct. 27, 2009) (“[m]any U.S. individuals looking to evade their tax obligations in the United States have sought to hide income and assets from the [IRS] by opening secret foreign bank accounts with foreign financial institutions”).

²²⁹ For example, the ACA report states that “Americans abroad have become pariahs in the international world of finance; foreign banks do not want them as clients because of FATCA legislation.... Bank accounts of Americans abroad are being forcibly closed, mortgages are being denied, securities have to be parked in expensive SEC registered ghettos, and Americans are excluded from joint bank accounts with foreign spouses....” American Citizens Abroad, *supra* note 47, at 6; see also J. Richard Harvey Jr., *FATCA—A Report from the Front Lines*, 136 TAX NOTES 713 (2012) (describing initial reaction to FATCA by Swiss banks against U.S. citizen account holders)

²³⁰ According to Dick Harvey, “[a] more Machiavellian explanation might be that Swiss FIs are purposely ... [making U.S. citizens’] lives difficult as a way of punishing the United States, or more likely, in an effort to get U.S. citizens to advocate the repeal of FATCA.” Harvey, *supra* note 229, at 715.

²³¹ Some of this initial reaction by foreign banks may have been due to a lack of understanding about FATCA and how it would be implemented. See Marie Sapirie & Stephanie Soong Johnston, *Solving the Expatriation Enigma*, 71 Tax Notes Int’l 766, 768 (citing attorney Andrew Mitchel).

There are several reasons why, once FATCA is implemented, FFIs should not be expected to abandon U.S. citizen clients (and their deposits and investments) in large numbers (certainly not to the extreme extent posited by opponents of FATCA). The principal factor that will bring an FFI within the reach of FATCA is whether or not the FFI holds U.S. investments, either on its own behalf or for customers (regardless of whether those customers are U.S. citizens or not). If it holds U.S. investments, the FFI generally will be required to comply with FATCA in order to avoid the 30% withholding on U.S. investment income, even if it has no U.S. customers. Once FATCA is implemented, such an FFI will (in the absence of a Model 1 IGA that provides otherwise), at a minimum, need to register with the IRS, obtain a Global Intermediary Identification Number from the IRS, and comply with FATCA due diligence requirements to determine whether it has any account holders that are U.S. persons.²³² The Department of Treasury, on its “Myth vs. FATCA” website, makes a similar point.²³³ After noting that “[s]ome claim that U.S. citizens living overseas will become outcasts in the international financial world,” the website counters that “FATCA withholding applies to the U.S. investments of FFIs whether or not they have U.S. account holders, so turning away known U.S. account holders will not enable an FFI to avoid FATCA.”²³⁴

An FFI will be able to ignore FATCA only if it is willing to forego all U.S. investments, and therefore is not concerned about U.S. withholding. Indeed, in the (unlikely) event it has no U.S. investments potentially subject to FATCA withholding, the FFI should not be worried about whether or not its customers are U.S. citizens and should have no need to terminate relationships with U.S. citizens. But as long as the FFI holds some U.S. investments, it must undertake at least some interaction with the IRS.²³⁵ The only potentially significant benefit gained by forcing out all U.S. customers is that the FFI would not have any customer account information that it might need to disclose to the IRS after registration (potentially in violation of local law),²³⁶ and would not need to potentially withhold on payments to recalcitrant U.S. account holders.²³⁷

²³² See T.D. 9610, *supra* note 143, at 5875–77; see also Sheppard, *supra* note 149, at 323 (“[FFI] agreements will only be for banks in non-IGA countries that have U.S. investments. It is important to note that the mere absence of U.S. customers does not let a bank off the hook”).

²³³ See U.S. Dep’t of Treasury Website, *Myth vs. FATCA: The Truth About Treasury’s Effort to Combat Offshore Tax Evasion* (statement by Robert Stack, Deputy Assistant Secretary for International Tax Affairs, posted Sept. 20, 2013).

²³⁴ *Id.*

²³⁵ As Avi-Yonah notes, it is increasingly difficult for an FFI to avoid all connections to the U.S. markets and financial system. See Avi-Yonah, *supra* note 61, at 28 (it is “hard to find” a foreign “financial institution that has no connections to the US and therefore is not intimidated by the 30% levy”).

²³⁶ See T.D. 9610, *supra* note 143, at 5877 (noting that “[i]n many cases, foreign law would prevent an FFI from reporting directly to the IRS the information require by the FATCA statutory provisions and [regulations], thus potentially exposing the FFI to withholding”).

²³⁷ See *id.*, at 5875 (describing I.R.C. § 1471(b)(1)(D) and the requirement of participating FFIs to potentially withhold on payments to recalcitrant U.S. account holders).

These concerns—especially the concern about an FFI potentially violating local law by disclosing account information²³⁸—are being significantly mitigated by the increasing trend toward Intergovernmental Agreements—in particular, the Model 1 IGA. As discussed above,²³⁹ a number of countries—including Switzerland and other offshore financial centers—have concluded (or anticipate concluding) IGAs based on Model 1. The implementation of these IGAs will not only allow FFIs to avoid problems with local secrecy laws, but also will allow FFIs to avoid dealing directly with the IRS, something that most would prefer not to do. The Model 1 IGA also contains explicit language intended to prevent FFIs from discriminating against U.S. citizens.²⁴⁰ Moreover, the Model 1 IGA approach, with its focus on an FFI providing the information to its own government, could be a scalable template as more countries embrace the growing global norm of automatic information sharing.²⁴¹ As more countries move to this approach, FFIs might become more accustomed to the need to cooperate in furnishing information (directly or indirectly) to foreign governments.²⁴²

Accordingly, while the initial response of some FFIs may have adversely impacted overseas U.S. citizens, this response can be expected to lessen over time. Moreover, it is very unlikely that the United States will abandon the FATCA approach, at least without first continuing the significant efforts to implement it. As discussed above, the United States has had significant initial success in negotiating IGAs, including with traditional financial centers, and is unlikely to back away from that success. Moreover, FATCA (along with the United States' enforcement efforts against Swiss banks) has been the impetus in a global shift toward broader cross-border information sharing. Accordingly, absent a major problem with FATCA implementation,²⁴³ the United States is

²³⁸ See *id.* at 5877 (noting that a significant purpose of the IGA regime is to allow FFIs to overcome disclosure limitations of local law).

²³⁹ See *supra* notes 148–149 & 193–197 and accompanying text.

²⁴⁰ Annex II of the Model 1 IGA allows certain FFIs with a local client base to be treated as non-reporting foreign financial institutions that are deemed to be compliant with FATCA. See U.S. DEP'T OF TREASURY, MODEL 1 IGA ANNEX II, ¶ III.A (rev. Aug. 19, 2013). In order to meet this standard, “[t]he Financial Institution must not have policies or practices that discriminate against opening or maintaining Financial Accounts for individuals who are Specified U.S. Persons and residents of” the FATCA partner jurisdiction. *Id.* ¶ III.A.10. It is unclear how effectively this requirement will be enforced once an IGA containing the language becomes operational. See Jared Burns et al., *FATCA Now a Reality—What This Means for Those Doing Business in Japan and Australia*, 70 TAX NOTES INT'L 1205, 1207 (2013) (after noting the IGA language, observing that “it is yet to be seen how seriously the new FATCA regime will affect the ability of U.S. persons living abroad to secure banking services”).

²⁴¹ See *supra* note 194 and accompanying text.

²⁴² See Harvey, *supra* note 229, at 716.

²⁴³ Some commentators have raised questions regarding the legal validity of IGAs under U.S. law. Compare, e.g., Allison Christians, *The Dubious Legal Pedigree of IGAs (and Why It Matters)*, 69 TAX NOTES INT'L 565 (2013) (arguing that IGAs may not be valid under U.S. law, thereby putting FFIs who rely on them at risk of the 30% withholding tax in FATCA and undermining the rule of law); with Susan Morse, *Why FATCA Intergovernmental Agreements Bind the U.S. Government*, 70 TAX NOTES INT'L 245 (2013) (countering Christians' arguments). Another potential implementation problem concerns reciprocity—in particular, the legal authority and practical ability of the IRS providing U.S. financial account information to foreign governments under a reciprocal Model 1 IGA. See, e.g., Colleen Graffy, *How to Lose Friends, Citizens and Influence*, WALL ST. J., Jul. 17, 2013 (citing letter from Rep. Bill Posey to Treasury Secretary Jacob Lew alleging that Treasury has exceeded its authority in promising reciprocal financial reporting to foreign countries); Sheppard, *supra* note 232, at 324–25 (describing practical problems with the United

unlikely to back away from FATCA or IGAs that strengthen the IRS' enforcement ability abroad, including enforcement against overseas citizens.

B. *Implications for Citizenship-Based Taxation*

The dramatic shifts in cross-border enforcement during the past half-decade have important implications for citizenship-based taxation. Critics have often argued against citizenship-based taxation because of both the administrative impracticability of the IRS enforcing the law, as well as difficulties faced by overseas citizens in complying with the law. The concerns regarding the impracticability of enforcement go back at least a century.²⁴⁴ More recently, in 2008 Blum and Singer argued against citizenship-based taxation due, in significant part, to the IRS' inability to enforce the law.²⁴⁵ They observed that “[t]he IRS is at a serious disadvantage in monitoring compliance by U.S. citizens overseas because of the lack of many of its usual sources of information,” including information on income derived from foreign financial assets.²⁴⁶ This lack of enforcement, in effect, allowed significant numbers of overseas citizens (whether due to lack of knowledge or willful evasion) to implement a self-help version of residence-based, rather than citizenship-based, taxation.

Because the Blum and Singer article was written shortly before Birkenfeld plead guilty,²⁴⁷ the authors would not have been aware of the significant changes on the horizon regarding Swiss bank secrecy, increased FBAR enforcement, FATCA, and voluntary compliance programs. As a result of these developments, the IRS' potential enforcement ability in this area is significantly stronger. The developments suggest that the IRS will have access to information on offshore investments that would not have been envisioned even a half-decade ago. Accordingly, arguments against citizenship-based taxation due to the IRS' inability to enforce the law are much weaker than they previously were, particularly once FATCA enforcement begins.

A related practical concern, expressed by Blum and Singer and others,²⁴⁸ involves the ability of overseas citizens to understand and comply with U.S. tax

States providing information to Latin American countries on a reciprocal basis). Moreover, some commentators have expressed concern that, if the United States were to offer U.S. financial account information to foreign countries under IGAs, large amounts of money might be withdrawn from U.S. banks. *See, e.g.*, Letter from Rep. Bill Posey at al. to President Barack Obama, Mar. 2, 2011, *available at* <http://posey.house.gov/uploadedfiles/irs-delegationletter-march3-2011.pdf> (letter signed by 26 Members of Congress, asserting that reciprocal information sharing will cause hundreds of billions of dollars held in the United States by nonresident aliens to flee to foreign financial institutions).

²⁴⁴ As noted above, in 1914 Professor Seligman observed that it is “virtually impossible” to collect tax on the foreign income of a nonresident citizen. *See supra* note 103 and accompanying text.

²⁴⁵ *See supra* notes 42–45 and accompanying text.

²⁴⁶ Blum & Singer, *supra* note 40, at 713–14. Indeed, I previously acknowledged that “concerns about enforcement might provide the strongest argument against taxing the foreign source income of citizens residing abroad.” *See Kirsch, supra* note 1, at 496.

²⁴⁷ Their article was published in May 2008, the same month that the Birkenfeld indictment was unsealed.

²⁴⁸ *See* Blum & Singer, *supra* note 40, at

obligations. For example, critics noted that many U.S. citizens living overseas might not be aware of their status and, even if they are, may not be aware of their obligations to file U.S. tax returns, FBARs, and otherwise comply with U.S. tax law.²⁴⁹ The recent developments—in particular, the widespread publicity surrounding FATCA—have also had a significant impact on this concern. FATCA has received widespread attention abroad among the overseas citizen community, in large part due to concerns, discussed above, that FFIs might discriminate against U.S. citizen account holders. As a result, even its critics acknowledge that one side-effect of FATCA is that many more citizens abroad have become aware of their U.S. tax and reporting obligations.²⁵⁰

High compliance costs are another frequent complaint of overseas taxpayers.²⁵¹ In this regard, the widespread publicity surrounding new enforcement initiatives and FATCA may have an unintended benefit. As this area becomes more important, additional tax preparers might enter the field, thereby increasing the availability of professional help and lowering its cost. For example, H&R Block recently issued a press release highlighting its availability to assist overseas citizens comply with new reporting requirements, and launched a “microsite” to assist overseas taxpayers.²⁵²

While these recent developments support the increased practicability of citizenship-based taxation, they also heighten the importance of ensuring that the compliance requirements imposed on overseas citizens are reasonable. In the past, the reporting and other compliance requirements, while technically relevant, may have been of lesser practical concern for many overseas citizens, at least to the extent they were unaware of, or underappreciated, the rules. However, now that the IRS plans to increase enforcement in the overseas area, and citizens abroad have become more aware of the need to comply, it is important that the IRS provide clear guidance, and attempt to simplify the compliance burden as much as possible (consistent with the underlying law), so that overseas taxpayers can both understand the requirements and comply with them without the need to incur unreasonable professional expenses. Perhaps it is understandable that during the current transition period, as the IRS implements the new FATCA regime and overseas taxpayers transition into a world where compliance is fully expected and enforcement is possible, there might be one-time transition costs. As discussed above, the IRS has attempted to address at least some of the

²⁴⁹ See, e.g., *supra* note 64 and accompanying text (arguments of Bernard Schneider); American Citizens Abroad, *supra* note 47, at 15.

²⁵⁰ See, e.g., Steven J. Mopsick, *Tax Justice for Americans Abroad*, 136 TAX NOTES 189, 189 (2012) (“[b]ecause of [FATCA], many Americans who have chosen to live abroad are only now learning that they should have been filing U.S. income tax returns all along”); Sapirie, *supra* note 217, at 199–202 (providing anecdotal descriptions of several overseas U.S. citizens who learned of U.S. reporting obligations through news reports about IRS enforcement efforts).

²⁵¹ See Blum & Singer, *supra* note 40, at 712 (“overseas citizens find it harder and more expensive to obtain private tax preparation services...”).

²⁵² See H&R Block, Press Release, *H&R Block Launches Remote Service, Augments In-Office Tax Prep for U.S. Citizens Living, Working Abroad*, May 30, 2013, available at <http://newsroom.hrblock.com/hr-block-launches-remote-service-augments-in-office-tax-prep-for-u-s-citizens-living-working-abroad/>; see also H&R Block, Website, *U.S. Expat Tax Services*, at <http://expats.hrblock.com>.

problems overseas citizens face during this transition. But the IRS must also ensure that practical ongoing issues unique to overseas citizens are also addressed. This concern is discussed in more detail in Part V, *infra*.

C. Implications for Residence-Based Proposals

So far, Part III has focused on administrative concerns surrounding citizenship-based taxation, concluding that recent developments have increased the enforceability of U.S. tax laws against overseas citizens. This subpart briefly addresses some of the administrative concerns arising from the residence-based taxation regimes that others have proposed as a replacement for the current regime applicable to U.S. citizens.²⁵³ In particular, it illustrates that those proposals, although based in part on possible administrative problems with citizenship-based taxation, raise significant administrative problems of their own.

The administrative problems associated with residence-based taxation proposals center, in large part, on the need to define a citizen's residence, and the tax consequences associated with a change in residence. Some proposals suggest determining a citizen's tax residence (and hence, her general taxability) using the 183-day weighted "substantial presence" test that currently applies to aliens²⁵⁴ As noted above, that test allows an individual to spend, on average, approximately four months per year in the United States without being considered a tax resident.²⁵⁵

The substantial presence test, although centered on an objective day-counting test, incorporates some subjective elements that would complicate both taxpayer compliance and IRS enforcement. For example, under current law applicable to aliens, an individual who runs afoul of the 183-day weighted test can, nonetheless, be treated as a nonresident if he is present in the United States for fewer than 183 days during the year and has a tax home in a foreign country to which he has a "closer connection" than to the United States.²⁵⁶ Not only would this exception add administrative complexity to the determination of a citizen's tax residence, but it increases the planning flexibility for a citizen who wants to

²⁵³ See *supra* notes 69–102 and accompanying text (describing residence-based proposals).

²⁵⁴ Avi-Yonah apparently would extend the test to citizens with no modifications, see *supra* notes 70–72 and accompanying text, while Blum and Singer suggest using the test as "the basic criterion" for determining a citizen's tax residence. See *supra* notes 73–74 and accompanying text. Blum and Singer consider some modifications to the substantial presence test, but acknowledge that the modifications might create additional administrative problems. See *supra* note 74. The substantial presence test currently applies to citizens in very limited circumstances—not to determine their general taxability on worldwide income, but rather to determine isolated collateral issues. See, e.g., Code § 877A(g)(1)(B)(i)(II) (cross-referencing substantial presence test in determining whether a person renouncing citizenship fits a narrow exception to the exit tax); Treas. Reg. § 301.7701(b)-1(a) (noting that the determination of a citizen's residence under the substantial presence test "may be relevant, for example, to the application of section 861(a)(1) which treats income from interest-bearing obligations of residents as income from sources within the United States").

²⁵⁵ See *supra* note 69.

²⁵⁶ I.R.C. § 7701(b)(3)(B).

spend significant amounts of time in the United States (potentially up to half the year) while still remaining a nonresident for tax purposes.²⁵⁷

Apart from the closer-connection exception, even the objective day-counting aspect of the substantial presence test may raise significant enforcement problems for the IRS with respect to citizens. While the individual will have direct knowledge of the number of days she is present in the United States, the IRS will not have ready access to this information. Even Blum and Singer, who advocate residence-based taxation of citizens, acknowledge that this lack of information “would appear to place a considerable burden on the IRS, which would have to rely on taxpayers to provide information in each case about the number of days that they have been present.”²⁵⁸ They note that “[w]ithout an entry-exit system, tax rules regarding individuals entering and exiting the United States do not work well.”²⁵⁹

Blum and Singer, writing in 2008, envisioned that a pending biometric entry/exit system being developed by the Department of Homeland Security (primarily to address terrorism concerns) could also be used to track U.S. citizens’ entry and exit, thereby providing data the IRS could use under a residence-based taxation regime.²⁶⁰ They envisioned that the system’s “information could be transmitted to the IRS ... [and] the IRS could easily determine whether a citizen had met the 183-day test.”²⁶¹ That system—the US-VISIT program²⁶²—is now operational. However, contrary to Blum and Singer’s expectations, U.S. citizens are not required to scan their passports or otherwise participate in the program (which focuses on non-citizens entering and leaving the country).²⁶³ Thus, the system does not provide to enable the IRS to easily enforce a residence-based test for citizens.

Enforcement under the Blum and Singer proposal is further complicated by their three-year residence retention rule, under which a U.S. citizen would

²⁵⁷ See generally *infra* Part IV.A.

²⁵⁸ Blum & Singer, *supra* note 40, at 720. Blum & Singer acknowledge that a day-counting test for residence “‘is probably enforceable in countries that exercise tight control over their borders,’ but is ‘extremely difficult for the tax authorities ... to enforce ... when many individuals are frequently entering and leaving the country without border checks.’” *Id.* (quoting BRIAN J. ARNOLD & MICHAEL J. MCINTYRE, INTERNATIONAL TAX PRIMER 17 (1995))

²⁵⁹ Blum & Singer, *supra* note 40, at 721 n.60. The IRS’ experience with “sailing permits” provides a useful analogy.

²⁶⁰ See Blum & Singer, *supra* note 40, at 720–21. Although the program had begun tracking entry to the United States in 2006, it had not yet begun tracking exits when Blum and Singer wrote their article. See U.S. GOVERNMENT ACCOUNTABILITY OFFICE, HOMELAND SECURITY[:] KEY US-VISIT COMPONENTS AT VARYING STAGES OF COMPLETION, BUT INTEGRATED AND RELIABLE SCHEDULE NEEDED 1 (GAO-10-13, 2009), available at <http://www.gao.gov/new.items/d1013.pdf>.

²⁶¹ Blum & Singer, *supra* note 40, at 721.

²⁶² The acronym US-VISIT stands for “U.S. Visitor and Immigration Status Indicator Technology.” See *id.* In 2013, the program was renamed the Office of Biometric Identity Management. See Dep’t of Homeland Security Website, *Office of Biometric Identity Management Identification Services*, at <http://www.dhs.gov/obim-biometric-identification-services>.

²⁶³ See 73 FED. REG. 77473, 77476 (final rule implementing US-VISIT, noting that “United States citizens are not subject to US_VISIT by the terms of this rule”).

continue to be treated as a tax resident, taxable on worldwide income, for three years after she triggered the substantial presence test.²⁶⁴ While this three-year retention might be useful in limiting citizens' ability to manipulate the proposed tax residence test, by continuing to tax foreign-resident citizens on their income after they no longer are in the United States, it would undermine some of the purported administrative benefits of switching away from a citizenship-based system.

Schneider also suggests that the 183-day weighted test (without the "closer connection" exception) might be applied to determine a citizen's residence.²⁶⁵ As an alternative, he proposes a facts and circumstances test to determine whether the citizen is a "bona fide resident," a standard he characterizes as falling "between the ordinary definitions of residence and domicile."²⁶⁶ Schneider lists a number of factors that would be used in this determination.²⁶⁷ Schneider acknowledges that this subjective inquiry might be "considered impractical," but notes that a similar standard is used under current law to determine a citizen's eligibility for the foreign earned income exclusion.²⁶⁸ While it is true that "bona fide resident" test exists under current law, its vagueness results in efforts by overseas citizens to meet the 330-day alternative test, if possible, to qualify for the foreign earned income exclusion. Thus, it would be a problematic standard (both from a taxpayer compliance and an IRS enforcement perspective) upon which to base a new residence-based tax regime for citizens. Indeed, Congress previously abandoned the use of subjective residence determinations in the context of aliens, enacting the 183-day weighted test in its place.²⁶⁹

The ACA proposal relies on a self-certification process for determining a citizen's residence. Under that proposal, once a U.S. citizen establishes residence abroad, she notifies the IRS and receives a departure certificate.²⁷⁰ Apparently, as long as the proper documents are submitted, the IRS would not conduct an independent inquiry or apply any standard to determine the citizen's residence, but instead would automatically issue the certificate, immediately treating the

²⁶⁴ See *supra* note 75. During this period, the deemed-resident taxpayer would be eligible for an unlimited foreign earned income exclusion, so U.S. taxation would focus on investment income. See Blum & Singer, *supra* note 40, at 725. Qualification for this proposed unlimited foreign earned income exclusion would be based on the same qualification standards as current I.R.C. § 911, including the requirement of a foreign tax home and satisfaction of either the "bona fide resident" test or 330-day test, thereby adding yet another layer of complexity. See *id.* at 725–26 (suggesting that new tests could be considered based on the anticipated entry/exit system).

²⁶⁵ See *supra* note 77 and accompanying text.

²⁶⁶ See Schneider, *supra* note 63, at 69–70.

²⁶⁷ See *id.* at 69.

²⁶⁸ See *id.*

²⁶⁹ See Blum & Singer, *supra* note 40, at 720 (citing 1984 legislative history, which noted that the then-existing subjective test for residence "did not provide adequate guidance [and] a more objective definition of residence" was needed).

²⁷⁰ See *supra* notes 79–80

citizen as a non-resident for tax purposes.²⁷¹ Perhaps in anticipation of arguments that the proposed regime would encourage tax-motivated changes in residence, the ACA proposal contains an exception for U.S. citizens residing in countries deemed by the IRS to be “tax havens”, who would continue to be treated as U.S. tax residents.²⁷² However, the proposal defines a tax haven extremely narrowly, thereby making it unlikely that many, if any, countries would be treated as tax havens or that many, if any, U.S. citizens would continue to be treated as U.S. residents under this exception.²⁷³

Of the various residence proposals, the ACA’s proposed test for determining residence (apart from the “tax haven” kickout) appears to be the most objective, at least with respect to the initial establishment of foreign residence. However, it too raises significant administrative issues. For example, after receiving a departure certificate, a citizen would be treated as a U.S. tax resident in the future if she triggers the 183-day weighted test (which presumably would also have a “closer connection exception”), thereby raising many of the same enforcement problems discussed above.

A further complication arises from the use of departure certificates. The proposal contemplates that these certificates will be used to ensure that overseas citizens are not impacted by FATCA—a U.S. citizen who shows the certificate to an FFI would not be treated as a U.S. person for purposes of FATCA, and would not be subject to the FATCA reporting requirements.²⁷⁴ This approach could raise significant enforcement problems for the IRS. According to the proposal, a citizen would not be required to renew a departure certificate or otherwise notify

²⁷¹ See American Citizens Abroad, *supra* note 47, at 8. The citizen would be required to submit proof of foreign residence and proof of residence in a foreign tax home, and would be required to pay any income taxes due for prior periods, along with an exit tax, if applicable. See *id.*

²⁷² See *id.* at 9.

²⁷³ Indeed, the ACA proposal explicitly asserts that “[c]lassification of countries as tax havens should be the rare exception.” *Id.* According to the ACA proposal, “[t]he list of countries so designated should include only those countries where the tax laws have been designed to attract rich foreigners with fiscal privileges.” *Id.* (emphasis in original). The proposal, rather than focusing on factors that would make a country a tax haven, instead provides a lengthy list of factors that should not be viewed as creating tax haven status:

Low tax countries, such as countries in the Persian Gulf, where excise taxes on oil or minerals substitute for income taxes, are not *prima facie* tax havens, nor are countries where very high indirect taxes such as the VAT or high social security taxes or payroll taxes lead to low income tax rates. Absence of a U.S. tax treaty with a foreign country should not be, a priori, a criteria for labeling a country a tax haven.

Id. These factors, by narrowly focusing on the intent of the foreign country and providing a number of exceptions, offer significant opportunities for a U.S. citizen to move to a low-income tax country without the tax haven kickout applying. For example, a retiree with significant investment income might gain significant tax savings by going to a country with low income taxes but a high VAT or high social security or payroll taxes (which factors would not make it a “tax haven”)—the high social security and payroll taxes would largely be irrelevant to a retiree, while the VAT would only be relevant to the extent the taxpayer spends a portion of large investment income on consumption in that country. Moreover, prior experience in labeling countries tax havens suggests that there might be strong U.S. political opposition to the IRS labeling a country a “tax haven” merely because it has a low income tax rate. While bank secrecy has often been a more acceptable reason for labeling a country a “tax haven”, the earlier discussion suggests a global shift away from bank secrecy (and, in any event, under a residence-based regime, a U.S. citizen would not necessarily be seeking a bank secrecy jurisdiction as his foreign residence).

²⁷⁴ See American Citizens Abroad, *supra* note 47, at 8.

the IRS as long as the citizen remains in the initial foreign country of residence. If the individual moves to another country, she would be required to inform the IRS of the new address (presumably, the IRS would want to know about this move in order to ensure the individual had not moved to a tax haven, thereby becoming a U.S. tax resident under the proposal's anti-abuse provision). Moreover, if the individual triggers the 183-day weighted test and again becomes a U.S. tax resident, the departure certificate is no longer valid.²⁷⁵ In these contexts, an enforcement problem could arise because the citizen still would have the departure certificate in her physical possession. Because the certificate has no expiration date, and the FFI would have no way of knowing whether the citizen had re-established U.S. tax resident status, once an initial departure certificate is issued it could be used indefinitely by a U.S. citizen to avoid FATCA, even if that citizen had again become subject to U.S. tax.

Regardless of which proposed definition of tax residence is adopted, the introduction of a residence-based regime for citizens could be further complicated by tax treaties. Presumably, a shift to residence-based taxation for citizens would be accompanied by the elimination of the "saving clause" from future U.S. treaties (or renegotiated treaties).²⁷⁶ If so, a U.S. citizen residing abroad could be treated as a non-resident for tax purposes even if she meets the (proposed) statutory test for U.S. tax residence, provided that she is treated as a resident of the treaty country under a treaty's tie-breaker rules. This could lead to significant numbers of new claims for treaty benefits that the IRS would need to administer.

Under the proposals, the determination of an individual's tax residence has significant collateral consequences. In particular, the proposals contemplate a mark-to-market "exit tax" when a U.S. citizen's tax status changes from resident to non-resident.²⁷⁷ A change in status could trigger the recognition of significant amounts—perhaps millions—of dollars of previously unrecognized gain.²⁷⁸ Thus, both taxpayers and the IRS have a strong interest in a residence definition

²⁷⁵ *See id.*

²⁷⁶ Blum and Singer explicitly call for the elimination of treaty saving clauses in this context. *See* Blum & Singer, *supra* note 40, at 722. The saving clause in U.S. tax treaties generally provides that the treaty will not affect the United States' ability to tax its "residents" (as defined in the treaty) or its citizens. *See* U.S. DEPT OF TREASURY, UNITED STATES MODEL INCOME TAX CONVENTION OF NOVEMBER 15, 2006, art. 1, ¶ 4 [hereinafter "U.S. Model Treaty"], available at <http://www.treasury.gov/press-center/press-releases/Documents/hp16801.pdf>. Accordingly, under current treaties the United States is allowed to enforce its citizenship-based taxation, even if the citizen resides abroad. If the saving clause is deleted, then a U.S. citizen who is a resident of the other treaty country could invoke the treaty, thereby significantly limiting the ability of the United States to tax her. In the absence of this treaty clause, the United States would be able to exercise residence-based taxation over the citizen only if she were a "resident" as defined in the treaty. In general, treaty residence is determined by looking at the tax laws of each treaty country. If the citizen is treated as a resident under both countries' laws (e.g., the citizen is a U.S. resident under whichever proposed residence test is implemented, and is also a resident of the other treaty country), the treaty utilizes fact-based tie-breakers to determine the individual's residence. *See id.* art. 4, ¶ 3. Accordingly, if the saving clause is removed, it is possible that the United States would not be able to tax the U.S. citizen, even if she is a U.S. resident under a proposed statutory residence test.

²⁷⁷ *See supra* notes 83–95 and accompanying text.

²⁷⁸ The proposals could also create administrative problems when a citizen re-establishes tax residence, given that she would need to re-establish the basis in her assets based on their value at that time.

that is both understandable and enforceable. The administrative problems associated with the proposed residence tests discussed above could create significant problems in this context.

In general, the less objective the residence test, the more problematic is this concern²⁷⁹ The ACA proposal, with its self-certification regarding loss of U.S. residence, provides the brightest line in this exit context, although it is subject to other concerns partially addressed above.²⁸⁰ The problems with IRS enforcement and taxpayer compliance under a 183-day weighted test could be significant under an exit tax. Given the IRS' lack of information regarding a taxpayer's physical location, the IRS would not know when a citizen lost tax residence status and thereby became subject to the exit tax, other than perhaps when the citizen stops filing U.S. resident tax returns. This problem is compounded under Blum and Singer's three-year residence retention rule, because by the time the citizen triggers the exit tax she might not have had significant contacts with the United States for several years, and thus might be less likely to comply with U.S. tax obligations. The concerns in this context might be greatest with Schneider's proposed facts and circumstances test for residence. Given the uncertainty of that standard, the IRS and citizen might reach different conclusions as to whether, and in what year, a citizen became a non-resident, thereby triggering the exit tax. While the change in residence status and triggering of the exit tax might be either good or bad for a particular taxpayer (depending on their mix of foreign source income and built-in gain in property), it is disconcerting to have a system where significant consequences are subject to this type of uncertainty.

Schneider himself acknowledges the enforcement difficulties that may arise in this context. He notes the difficulty the United States has had in enforcing tax laws against departing aliens. Despite the regulatory requirement that departing aliens file IRS forms and receive a Departing Alien Clearance (known as a "sailing permit"), "[c]ompliance with this regime is widely recognized to be poor."²⁸¹ He suggests that "compliance with a departure tax regime can be expected to be better, after an initial period of education, because it would be seen as fairer than the current system," although he ultimately acknowledges that compliance "is likely to be poor where the individual has few connections or does not expect to return to the United States."²⁸² He minimizes concern about this latter group by observing they "are precisely the individuals who see little risk in not complying with the current regime."²⁸³ However, the recent developments in global international enforcement with respect to U.S.

²⁷⁹ Of course, a less objective test might have non-administrative merits, such as the ability to address special circumstances or limit the ability of a taxpayer to manipulate residence status.

²⁸⁰ The ACA's proposed exemption from the exit tax for citizens living abroad for at least two years at the time of enactment certainly provides the easiest rule in the context of the exit tax (by totally eliminating the tax), but raises significant fairness and other concerns.

²⁸¹ Schneider, *supra* note 63, at 72–73.

²⁸² *Id.* at 73.

²⁸³ *Id.*

citizens suggest that there may be reason to believe that these individuals' level of compliance under a citizenship-based tax regime may be expected to improve.

Admittedly, administrative issues exist even under current law with respect to the exit tax in Code section 877A. However, that provision is triggered by formal, objective events that are unlikely to occur without the taxpayer's intent and the IRS' reasonable likelihood of being informed. For example, in the context of loss of citizenship, as a constitutional matter a citizen generally cannot change this status without a specific intent to do so,²⁸⁴ and the Code requires the Department of State to inform the IRS of the loss.²⁸⁵ In the context of long-term permanent residents, the individual generally lose their status for tax purposes only by taking explicit steps to do so.²⁸⁶

The foregoing analysis is not intended as a thorough critique of the enforcement and compliance issues associated with residence-based taxation proposals, nor does it imply that the administrative problems associated with a residence-based system are necessarily greater than those associated with the current citizenship-based system. Rather, it is merely intended to emphasize that a shift to a residence-based tax system for citizens would not be a panacea for the administrative concerns associated with citizenship-based taxation—instead, it would exchange some administrative concerns for others. Admittedly, problems with enforcement and compliance under the proposals are not, by themselves, fatal to the proposals.²⁸⁷ Indeed, citizens residing abroad would most likely be willing to live with one of the proposed regimes, even if created a different set of compliance problems than those under the current regime. Nonetheless, it is important to take these and other administrative concerns into account if a shift to a residence-based regime were contemplated.

As a final note, it is important to recognize that abandoning citizenship-based taxation would not significantly impact the debate over the advisability of FATCA. FATCA was not primarily driven by concerns over citizens residing abroad.²⁸⁸ Thus, the elimination of U.S. tax on citizens residing abroad would not impact the more significant FATCA-related concerns concerning U.S.-resident citizens holding assets abroad. At most, the elimination of citizenship-based taxation might modify certain technical aspects of FATCA's implementation, such as the due diligence required of FFIs under FATCA,²⁸⁹ and

²⁸⁴ See Michael S. Kirsch, *The Tax Code as Nationality Law*, 43 HARV. J. LEG. 375, 381–83 (2006) (describing constitutional, statutory, and administrative procedures for renouncing U.S. citizenship).

²⁸⁵ See I.R.C. § 6039G(d).

²⁸⁶ See I.R.C. § 7701(b)(6) (lawful permanent residence status ceases for tax purposes if the status has been revoked, or administratively or judicially determined to have been abandoned).

²⁸⁷ However, for the reasons I have previously argued, as well as those set forth *supra*, I do not believe an abandonment of citizenship-based taxation is warranted.

²⁸⁸ See *supra* note 202 and accompanying text.

²⁸⁹ However, the IRS might still require FFIs to perform due diligence as to the account holder's place of birth, because even in the case of a citizen residing in the United States this might be a more reliable indicator of citizenship than the address that the individual gives to the FFI. The ACA implicitly acknowledges that place of birth might remain a part of the FATCA inquiry even under a residence-based

might collaterally affect the relationship between FFIs and U.S. citizens abroad.²⁹⁰ However, for those opposed to FATCA in general, the elimination of citizenship-based taxation would not directly undermine the case for FATCA.

IV. SUBSTANTIVE CONCERNS WITH RESIDENCE-BASED PROPOSALS

The preceding Part addressed the practical, administrative aspects associated with citizenship-based taxation—in particular, how the significant changes in global tax enforcement and information sharing during the past few years impact the case for citizenship-based taxation. That Part suggested that these changes generally support and reinforce the viability of citizenship-based taxation. It also concluded that residence-based taxation raises many administrative concerns of its own, which have been underappreciated by its proponents. This Part IV addresses the substantive concerns regarding residence-based taxation. In particular, it focuses on selected arguments that are particularly relevant in comparing a citizenship-based regime to proposed alternative regimes that would tax citizens only under residence principles.

A. *Neutrality and the Post-Reform World*

A significant criticism of citizenship-based taxation is that it encourages citizens living abroad to surrender their U.S. citizenship in order to avoid U.S. taxation and reporting requirements, even when the individual would otherwise prefer to remain a citizen. Critics note that, in contrast, a residence-based regime would eliminate this incentive—because citizens living abroad would not be subject to U.S. taxation, there would be no tax-based incentive to surrender U.S. citizenship. While this argument is correct as far as it goes, it fails to address (or downplays) an important new incentive that residence-based taxation would introduce: an incentive for U.S. citizens to reside abroad in order to escape U.S. taxation.²⁹¹

In support of their position, critics of citizenship-based taxation point to the significant increase in citizenship renunciations during the past few years. Between 1998 and 2005, the number of individuals who surrendered or otherwise lost their U.S. citizenship gradually increased from approximately 400 per year to

regime, given the proposal's attempt to use a departure certificate as a means for addressing FATCA-related concerns. *See supra* note 274 and accompanying text.

²⁹⁰ However, as discussed *supra* notes 229–243 and accompanying text, the problems initially reported by some overseas citizens in dealing with local financial institutions can be expected to subside with the implementation of FATCA (particularly through the Model 1 IGA) and the more widespread acceptance of a global information sharing norm.

²⁹¹ A similar issue arises with arguments that citizenship-based taxation raises very little tax revenue, and thus does not justify the associated administrative complexity. *See supra* notes 48–49 and accompanying text (citing ACA arguments). Such arguments fail to consider the potential revenue loss were there to be significant numbers of U.S. citizens who become nonresidents under a residence-based taxation proposal.

approximately 800 per year.²⁹² Data for earlier years going back to 1991 reflects a similar number of annual renunciations.²⁹³ Because citizens who surrender citizenship are not required to give a reason, there is no way to know how many of these individuals surrendered citizenship for tax reasons. While a number of high-profile individuals who surrendered citizenship in those earlier years apparently did so for tax purposes,²⁹⁴ a significant number of individuals did so for non-tax reasons.²⁹⁵

The number of reported citizenship losses dropped significantly in 2006 through 2008.²⁹⁶ The reported number had dwindled to 167 for the twelve-month period ending in the middle of 2009.²⁹⁷ However, beginning with the report for the third quarter of 2009, the number of reported losses of citizenship began to increase dramatically, resulting in 743 losses reported in calendar year 2009, 1534 in 2010, and 1,781 in 2011.²⁹⁸ After a brief drop during 2012 (932),²⁹⁹ the reported losses have again increased dramatically, with 1,809 reported during the first six months of 2013.³⁰⁰

²⁹² See NATIONAL TAXPAYER ADVOCATE, *supra* note 51, at 264. These numbers are based on the quarterly reports of citizenship loss published by the IRS. Under I.R.C. § 6039G(d), each calendar quarter the IRS is required to publish the names of individuals who have lost U.S. citizenship (as furnished by the Department of State).

²⁹³ See Michael S. Kirsch, *Alternative Sanctions and the Federal Tax Law: Symbols, Shaming, and Social Norm Management as a Substitute for Effective Tax Policy*, 89 IOWA L. REV. 863, 876 & n.50 (2004) (noting that between 1991 and 2001, approximately 600 people per year lost their U.S. citizenship).

²⁹⁴ See *id.* at 893–94 n.142 & 897 n.156 (citing examples of high profile renunciations that apparently were tax motivated).

²⁹⁵ See, e.g., *id.* at 876 n.51 (citing a Joint Committee on Taxation study suggesting that during the 1990s a significant number of Korean-Americans returning to Korea upon retirement surrendered their U.S. citizenship due to restrictions in Korea on holding dual citizenship); *cf. id.* (noting that Valdas Adamkus surrendered U.S. citizenship upon becoming President of newly-democratic Lithuania).

²⁹⁶ NATIONAL TAXPAYER ADVOCATE, *supra* note 51, at 264.

²⁹⁷ See IRS, *Quarterly Publication of Individuals, Who Have Chosen to Expatriate, as Required by Section 6039G*, 74 FED. REG. 35911 (15 individuals reported for the quarter ending Jun. 30, 2009); IRS, *Quarterly Publication of Individuals, Who Have Chosen to Expatriate, as Required by Section 6039G*, 74 FED. REG. 20105 (67 individuals reported for the quarter ending Apr. 30, 2009); IRS, *Quarterly Publication of Individuals, Who Have Chosen to Expatriate, as Required by Section 6039G*, 74 FED. REG. 6219 (63 individuals reported for the quarter ending Dec. 31, 2008); IRS, *Quarterly Publication of Individuals, Who Have Chosen to Expatriate, as Required by Section 6039G*, 73 FED. REG. 65036 (22 individuals reported for the quarter ending Sept. 30, 2008);

²⁹⁸ [insert Federal Register cites]

²⁹⁹ [insert Federal Register cites]. The drop in reported names in 2012 is largely attributable to the very low number of renunciations (only 45) reported in the fourth quarter. See IRS, *Quarterly Publication of Individuals, Who Have Chosen to Expatriate, as Required by Section 6039G*, 78 FED. REG. 10692. Given the typical delay in conveying the names between the Department of State and IRS, this likely reflects individuals who renounced citizenship during the early summer of 2012. One plausible explanation (although admittedly conjecture) for this one-time drop is that a number of citizens may have expected Mitt Romney to win the then-pending Presidential election, which may have raised expectations that tax burdens on higher-income people (those most likely to renounce citizenship for tax purposes) would be lowered, and may have also raised expectations that FATCA and overseas enforcement initiatives might be softened. This explanation is consistent with the record number of renunciations reported in the second quarter of 2013 (1,130), which would reflect renunciations in late 2012, immediately after President Obama's re-election in November. An alternative explanation, offered by an attorney who tracks the citizenship renunciation lists, is that the data for the last quarter of 2012 is incomplete. See Sapirie & Johnston, *supra* note 231, at 766 (citing attorney Andrew Mitchel).

³⁰⁰ [insert Federal Register cites] Among the most prominent citizenship renunciations during this recent period was that of Eduardo Saverin, a Brazilian-born naturalized citizen and co-founder of Facebook, who

It is important to note that the quarterly lists of citizenship renunciations published by the IRS reflects a delay—approximately six months according to one source—from the time the individual actually lost citizenship.³⁰¹ Accordingly, the spike in reported names beginning in the third quarter of 2009 likely reflects individuals who surrendered citizenship beginning in early 2009. This timing strongly correlates with the publicity over the UBS deferred prosecution agreement in February 2009,³⁰² and the IRS’ announcement of increased enforcement efforts in the context of the rollout of the OVDP in March 2009.³⁰³ The continuing increase in 2011 correlates with the publicity regarding FATCA, while the most recent increase in 2013 might reflect the upcoming (although again delayed) implementation of FATCA reporting.³⁰⁴

This data strongly supports assertions that the recent increase in citizenship renunciations is largely driven by tax and related reporting concerns.³⁰⁵ While many of these surrenders may reflect individuals who do not want to be subject to U.S. tax liability, critics of citizenship-based taxation suggest that some may reflect individuals who may not have had any U.S. tax liability (*e.g.*, because of the foreign tax credit) but were concerned about running

renounced his citizenship shortly before Facebook’s initial public offering. *See* Quentin Hardy, *A Facebook Co-Founder Reflects on the Path Forward*, N.Y. TIMES, May 16, 2012 (suggesting that Saverin may have saved \$100 million in future taxes by renouncing citizenship, even after the application of the I.R.C. § 877A exit tax).

³⁰¹ *See* Laura Saunders, *The Renouncers: Who Gave Up U.S. Citizenship, and Why?*, WALL ST. J., Aug. 2, 2012.

³⁰² *See supra* note 110 and accompanying text.

³⁰³ *See supra* note 163 and accompanying text.

³⁰⁴ *See also supra* note 299 (suggesting that the most recent spike reported in Q2 of 2013, for surrenders that most likely occurred in late 2012, may reflect a response to President Obama’s election victory over Mitt Romney).

³⁰⁵ *See, e.g.*, National Taxpayer Advocate, *supra* note 51, at 142 (concluding that “[t]he OVD programs may be prompting [overseas citizens] to renounce U.S. citizenship,” given the significant recent increase in citizenship losses); Liam Plevin & Laura Saunders, *Number of Americans Renouncing Citizenship Surges*, WALL ST. J., Aug. 9, 2013 (quoting tax attorneys’ observations that “the recent rise is [in citizenship renunciations] is likely due to tougher laws and enforcement,” and “[t]he IRS crackdown on U.S. taxpayers living abroad seems to be having an effect”). In contrast, Avi-Yonah suggests that the spike in citizenship renunciations is attributable to the enactment of the I.R.C. § 877A exit tax in 2008, because after its enactment “expatriation was no longer a shameful act” Avi-Yonah, *supra* note 61, at 31. This focus on the exit tax enactment, rather than the stepped-up international enforcement efforts and FATCA, seems to be much less powerful explanation for the increase in renunciations. First, if the enactment of the exit tax was a principal trigger for expatriation, one might have expected a significant increase in renunciations shortly after its June 17, 2008, effective date. However, renunciations in the half year following the exit tax’s enactment (as reflected in the IRS quarterly lists published in the first and second quarter of 2009, given the typical 6-month delay in Department of State reporting to the IRS) were among the lowest numbers reported since publication began in 1997, with only 67 attributable to renunciations that likely took place in the third quarter of 2008, and a mere 15 renunciations that likely took place in the fourth quarter of 2008. *See* IRS, *Quarterly Publication of Individuals, Who Have Chosen to Expatriate, as Required by Section 6039G*, 74 FED. REG. 35911 (names reported during Q2 2009); IRS, *Quarterly Publication of Individuals, Who Have Chosen to Expatriate, as Required by Section 6039G*, 74 FED. REG. 20105 (names reported during Q1 2009). As noted above, the timing of the significant increase in renunciations that likely began in mid-2009 correlates much more closely with the IRS enforcement efforts and FATCA. In addition, as I have argued elsewhere in a related context, shaming concerns are unlikely to have much effect on citizens overseas who renounce citizenship. *See* Kirsch, *supra* note 293, at 908–12.

afoul of the increased reporting requirements and associated penalties for failure.³⁰⁶

The fact that the existing U.S. tax system may create an incentive for some citizens to surrender their status should not be taken lightly. However, in and of itself, it is not a reason for abandoning citizenship-based taxation. While the numbers of renunciations are at their highest level in years, in relative terms they still reflect a very small number—for example, approximately 0.00066% of the total number of citizens in 2011.³⁰⁷ As reflected in renunciations reported during the first half of 2013, these numbers might be expected to increase somewhat as FATCA and the other IRS enforcement efforts continue to be publicized and implemented. However, it is not unreasonable to assume that at some point, those who are most likely to renounce citizenship for tax-related purposes will have done so, and the numbers may trend down again.

Moreover, many of the individuals who have surrendered their citizenship in recent years, presumably for tax purposes, already had very strong connections to a foreign country, in some circumstances holding dual-citizenship at birth and having spent much of their life abroad. Accordingly, while tax-related factors may have been the “final straw” that caused them to renounce their citizenship, these individuals’ connections to the United States may have been tenuous already. Even the most high-profile person to renounce recently—Facebook co-founder Eduardo Saverin—was born in Brazil and had held U.S. citizenship for only a decade.³⁰⁸

More theoretically, and perhaps more importantly, the possibility that citizens take tax burdens into account is not inconsistent with the underlying justifications for imposing citizenship-based taxation. To the extent that citizenship-based taxation is justified, in part, on the grounds that an overseas citizen, by retaining U.S. citizenship, voluntarily remains a part of broader U.S. society for purposes of ability-to-pay equity analysis,³⁰⁹ it is not surprising that some individuals would choose to abandon that voluntary connection. Similarly, to the extent citizenship-based taxation is based, in part, on the benefits associated with citizenship (even though, admittedly, the benefits derived by an overseas citizen are not as high as those derived by a domestic citizen), it is not surprising that an individual who believes that the benefits of citizenship are too limited in light of potential increases in tax liability would consider renouncing

³⁰⁶ See, e.g., American Citizens Abroad, *supra* note 47, at 1 (alleging that “increasing numbers are compelled to renounce their U.S. nationality to be able to lead a normal life”).

³⁰⁷ There were 1,781 renunciations reported in 2011, *see supra* note 298 an accompanying text, out of approximately 260,000,000 U.S. citizens. [cite] As noted above, at least a baseline number of these renunciations reflect individuals who surrendered citizenship for non-tax reasons. *See supra* note 295 (Joint Committee on Taxation study suggesting that “many” of the approximately 600 annual losses in the 1990s were attributable to non-tax factors).

³⁰⁸ *See supra* note 300.

³⁰⁹ *See supra* notes 29–32 and accompanying text.

citizenship.³¹⁰ Indeed, despite the political backlash against tax-based renunciations in recent decades,³¹¹ individuals who choose to surrender their citizenship are exercising a “natural and inherent” right that has played an important role in U.S. history.³¹² Thus, while the possibility that citizenship-based taxation may incentivize a limited number of individuals to renounce citizenship is not a desirable outcome, it is not inconsistent with the underlying norms of the U.S. tax system, and must be weighed against other relevant considerations.

In this context, the most important consideration supporting citizenship-based taxation, and potentially undermining residence-based taxation, is the impact that a residence-based system would have on future residency decisions. Critics of citizenship-based taxation often assert that citizens do not move abroad for tax-motivated reasons. For example, Avi-Yonah asserts that “in the case of individuals, I believe the decision to move is usually motivated primarily by nontax considerations.”³¹³ Similarly, Schneider concludes that “[i]n most cases ... individuals choose their residence on the basis of more than just taxation.... The United States should not assume that a move abroad is motivated by a desire to decrease U.S. tax liability and therefore should be ignored for tax purposes.”³¹⁴

It would not be surprising if these assertions are correct and that, under current law, U.S. citizens do not move abroad for tax-motivated reasons. After all, under current law, which generally continues to tax overseas citizens, the tax savings from moving abroad (apart from potential evasion opportunities) are limited.³¹⁵

However, these appeals to the lack of tax motive for citizens living abroad fail to acknowledge the important role that current citizenship-based taxation, with its limited potential for tax windfalls by moving abroad, plays in this result. The situation might change significantly if the United States were to move to a residence-based tax system for citizens. While many citizens would continue to live abroad primarily for non-tax reasons, a residence-based tax system might create significant incentives for many other U.S. citizens to move abroad

³¹⁰ Cf. Alice G. Abreu, *Taxing Exits*, 29 U.C. DAVIS L. REV. 1087, 1158 (1996) (in arguing against an exit tax, observing that “individuals who are willing to give up the substantive benefits of U.S. citizenship should be allowed to shed its tax burdens”).

³¹¹ See Kirsch, *supra* note 1, at 493–94.

³¹² See generally Kirsch, *supra* note 293, at 902–03 (describing role of citizenship renunciation in U.S. history).

³¹³ Avi-Yonah, *supra* note 53, at 390 n.5.

³¹⁴ Schneider, *supra* note 63, at 53. On a related note, the ACA report states that “[c]ontrary to myths held by many that Americans abroad are the privileged wealthy, the community of Americans overseas is comparable to the community of hard-working average Americans resident in the United States,” American Citizens Abroad, *supra* note 47, at 17, and “[m]ost Americans abroad reside in OECD countries with tax rates higher than U.S. tax rates,” so they do not owe any residual U.S. tax after the foreign tax credit and foreign earned income exclusion. *Id.* at 4.

³¹⁵ The only significant tax savings would be for an individual residing in a relatively low-tax country and who is eligible for the foreign earned income exclusion.

primarily for tax reasons. After all, under a residence-based tax system, a U.S. citizen residing abroad (unlike a citizen residing in the United States) would no longer be taxed on income arising outside the United States. Indeed, she might not even be taxed on significant types of income arising within the United States, such as interest on U.S. bank accounts or gains from the sale of stock in U.S. companies.³¹⁶ In addition, a U.S. citizen residing abroad could significantly reduce, or eliminate, U.S. gift and estate tax liability.³¹⁷

Of course, not every citizen would be in a position to make such a move. Moving abroad may involve substantial costs—both up-front financial costs, as well as psychological costs—and some individuals might not have locational flexibility, in particular with respect to their job. However, for citizens who are retired (or otherwise derive most of their income from investments), or for those whose profession provides geographic flexibility, the prospect of moving abroad to save significant amounts of income or estate taxes would be inviting.

Furthermore, a citizen who moves abroad could still spend significant amounts of time in the United States each year without becoming a tax resident.³¹⁸ For example, if the current “substantial presence” test applicable to aliens were extended to citizens,³¹⁹ a citizen could spend, on average, four months per year in the United States without being considered a tax resident.³²⁰

It is difficult to predict how many additional citizens would relocate abroad if a residence-based tax were adopted.³²¹ A number of factors other than tax savings would be relevant.³²² It should be noted, however, that modern developments in travel and instantaneous global communication make moving abroad for tax purposes a much more viable option than it would have been in earlier times.³²³ While the large majority of U.S. citizens undoubtedly would “continue residing in the United States, and thereby be taxed as residents on their worldwide income, many might decide that significant tax savings justify moving from the United States to a low-or no-tax jurisdiction.”³²⁴

³¹⁶ Under current law, a resident alien generally is not taxed on interest from U.S. bank accounts, *see* I.R.C. § 871(i)(2)(A), or gain from the sale of stock in a domestic corporation. *See* I.R.C. § 865(a)(2) (treating such gains as foreign source).

³¹⁷ The impact of a residence-based tax system on U.S. estate and gift taxes is discussed *infra* Part IV.B.

³¹⁸ The individual would still be a U.S. citizen, so there would be no immigration-related bars to re-entry.

³¹⁹ *See supra* notes 68–82 and accompanying text (summarizing proposed residence tests).

³²⁰ *See supra* note 69. If the citizen were also a resident of a country with which the United States has a tax treaty, the individual might be able to spend even more time in the United States, provided she is a resident of the other treaty country under the treaty’s tie-breaker provision. *See supra* note 276.

³²¹ *See, e.g.*, Dylan Matthews, *Do Millionaires Move to Avoid High Taxes?*, Wash. Post, Nov. 28, 2012, available at <http://www.washingtonpost.com/blogs/wonkblog/wp/2012/11/28/do-millionaires-move-to-avoid-high-taxes/> (citing difficulty of making estimates of interstate tax flight).

³²² *See Kirsch, supra* note 1, at 489 (noting non-tax factors, including “personal and family history, social or cultural connections, nationality status, economic opportunities, and climate preferences”).

³²³ *See id.* at 490 (quoting a commentator in 1926 stating that he had “no fear” of tax-motivated changes in residence because of the difficulty of living abroad, and a 1975 commentator claiming that such concerns were unwarranted because “the frequent occurrence of abuse would require a mobility of population which probably does not exist”); *see also id.* at 466–67 (describing impact of modern technology on mobility).

³²⁴ *Id.* at 490.

The experience of other countries, which generally use a residence-based system, might be instructive. For example, in the 1970s a number of high-profile musicians, including members of the Rolling Stones and Pink Floyd, along with David Bowie, abandoned their British residence because of taxes.³²⁵ More recently, tens of thousands of high-income French and German citizens have reportedly established residence outside of France and Germany, respectively, in response to increased home-country taxes.³²⁶ A recent economic study analyzed the French tax system (at a time when its highest marginal income tax rate was 40%), and concluded that a 40% marginal income tax rate “might be too high to prevent French top-income earners from emigrating to very close tax havens like Monaco, Andorra, Liechtenstein and the Channel Islands.”³²⁷ Given that the highest marginal U.S. tax rate approximates 40%,³²⁸ this study may have some relevance.³²⁹ Moreover, it suggests that the propensity to move abroad would depend, in part, on how high future U.S. income tax rates are.

The experience within the United States, with states imposing tax on a residence basis, also demonstrates that high-income taxpayers can be sensitive to income tax rates (as well as estate & inheritance taxes). For example, a disproportionate number of professional golfers reside in Florida and Texas (as opposed to other warm-weather states, such as California), in large part because these states do not impose an income tax.³³⁰ Studies have also shown the impact

³²⁵ See Matthews, *supra* note 321.

³²⁶ A recent economic study on the propensity of high-income taxpayers to move to a low-tax country cited claims that 34,000 individuals have left France each year during the past decade to relocate to lower-tax countries, and that 145,000 taxpayers left Germany in a single year for tax reasons. See Laurent Simula & Alain Trannoy, *Optimal Income Tax Under the Threat of Migration by Top-Income Earners*, 94 J. Pub. Econ. 163, 163 (2010); see also Randall Jackson, *Former President Sarkozy Could be Next Tax Exile*, 69 TAX NOTES INT’L 336 (2013) (citing several examples, including France’s richest person who “is thought to be heading to Belgium”); Jean-Philippe Delsol, *Can the Last Taxpayer Leaving France Please Turn Out the Lights?*, Forbes, Dec. 18, 2012, available at <http://www.forbes.com/sites/realspin/2012/12/18/can-the-last-taxpayer-leaving-france-please-turn-out-the-lights/> (citing estimates of 5,000 “tax exiles” leaving each year); *Taxpayers Fleeing Wealth Tax Seen Costing France Millions in Lost Revenue*, BNA Int’l Tax Monitor, May 22, 2008. The German statistic cited in Simula & Trannoy, *supra*, was furnished by the German Chamber of Commerce, which presumably advocates for lower tax rates, so it might not reflect a disinterested estimate.

³²⁷ Simula & Trannoy, *supra* note 326, at 163.

³²⁸ Under I.R.C. § 1(c)–(d) the highest marginal rate is 39.6%. In addition, a 3.8% surtax is imposed on a high-income taxpayer’s net investment income. See I.R.C. § 1411.

³²⁹ See also James B. Stewart, *The Myth of the Rich Who Flee from Taxes*, N.Y. Times, Feb. 15, 2013 (citing studies that reports of large migrations due to taxes are overblown, but noting that “[o]f course, some people do move for tax reasons, especially wealthy retirees, athletes and other celebrities without strong ties to high-tax locations, like jobs and families”), available at http://www.nytimes.com/2013/02/16/business/high-taxes-are-not-a-prime-reason-for-relocation-studies-say.html?pagewanted=2&_r=1&pagewanted=all.

³³⁰ See, e.g., Robert W. Wood, *Golfer Phil Mickelson is Not Alone in Fleeing Taxes*, FORBES, Jan. 21, 2013, available at <http://www.forbes.com/sites/robertwood/2013/01/21/phil-mickelson-is-not-alone-in-fleeing-taxes/>. Professional golfers are a particularly ripe group for becoming non-residents if the U.S. were to start treating U.S. citizens in the same manner as aliens. Under current law, in determining the number of days of physical presence under the 183-day weighted test, a “professional athlete who is temporarily in the United States to compete in a charitable sports event” need not count those days toward the 183-day test. I.R.C. § 7701(b)(5)(A)(iv). Because PGA Tour events generally are run as charitable events, non-citizens currently can rely on this exclusion in determining their tax residence status. If this provision applied to U.S. citizens under the proposed residence-based regimes, it would enable U.S. citizen PGA golfers to spend significantly

that low state taxes have in attracting other athletes.³³¹ Recently, professional golfer Phil Mickelson caused a furor when he complained that, due to his high combined federal and state (California) tax rates, “I’m not going to jump the gun and do it right away, but there are going to be some drastic changes for me...”³³² In context, it was not clear whether he was referring to merely changing his state of residence (from California to, say, Florida), or whether the “drastic changes” might include a move abroad with a renunciation of citizenship. However, if the United States had a residence-based (rather than citizenship-based) tax system, it is not unreasonable to believe that he and those like him would be much more likely to move abroad (given that he could retain his citizenship). Ultimately, Mickelson backed away from his comments, in part because they were potentially damaging to his reputation, and therefore might impact his significant endorsement income.³³³

A prominent practitioner, in response to an economic study suggesting that tax flight among U.S. states might be a “myth”, countered that “[b]ased on my experience as a practitioner who works with wealthy individuals and corporations every day, I can assure you that taxes often play a major role in these decisions and that in many cases, they are the sole reason for the move.”³³⁴ Of course, a change in state residence is not directly comparable to a change in country residence, given that the latter may involve more significant cultural and lifestyle changes than merely moving within the same country.³³⁵

In addition to professional athletes, other candidates for tax-motivated migration include wealthy retirees and also professionals whose activities provide geographic flexibility. This latter group might be expected to expand significantly in the future, as technological developments expand the range of professions that can be conducted remotely.³³⁶ Already a number of medical fields—such as radiology—can be practiced remotely. It is not unreasonable to envision such U.S. citizen professionals—including certain physicians and

more time in the United States than would otherwise be allowed without triggering the substantial presence test.

³³¹ See Victor Fleischer, *How Local Tax Rates Affect High-Income Professionals*, N.Y. TIMES, Dec. 18, 2012 (citing studies), available at http://dealbook.nytimes.com/2012/12/18/how-local-tax-rates-affect-high-income-professionals/?nl=business&emc=edit_dlbkpm_20121218&_r=1.

³³² Karen Crouse, *Uneasy in the Political Climate, Mickelson Talks Like Someone Ready to Step Away*, N.Y. TIMES, Jan. 20, 2013, available at http://www.nytimes.com/2013/01/21/sports/golf/mickelson-citing-taxes-hints-at-stepping-away.html?_r=0.

³³³ See Karen Crouse, *A Mulligan by Mickelson on Tax Talk*, N.Y. TIMES, Jan. 23, 2013.

³³⁴ Peter L. Faber, *Taxes Play Major Role in Moving Out of States*, 69 STATE TAX NOTES 243 (2013) (citing numerous examples, including situations where the move of three wealthy individuals could cost New York State up to \$200 million in lost revenue). A recent conference sponsored by the American Bar Association’s Section of Real Property, Trust and Estate Law was titled “Snowbirds Fleeing State Taxing Authorities: Becoming a Resident of Another State for Estate Tax Benefits,” further supporting Faber’s assertion that significant numbers of high-wealth taxpayers may change state residences to avoid tax.

³³⁵ Cf. Zelinsky, *supra* note 17, at 1320 (noting that, in practice, it is more difficult to move between nations than between local municipalities).

³³⁶ For a discussion of the tax implications of this new technology-driven flexibility, particularly with respect to the traditional focus on physical presence as a touchstone of source-based taxation, see Michael S. Kirsch, *The Role of Physical Presence in the Taxation of Cross-Border Personal Services*, 51 B.C. L. REV. 993 (2010).

attorneys already holding U.S. licenses, along with consultants and others—establishing tax residence outside the United States, conducting the majority of their activity through videoconferences or other electronic means, yet still coming to the United States for significant amounts of time each year.

Of course, a decision to change residences for tax purposes requires not only a potential destination country that has a favorable tax system, but also one that has satisfactory cultural, lifestyle, safety, and other features. While a U.S. citizen might still be able to spend significant time in the United States each year and still maintain a non-U.S. tax residence under a proposed residence-based regime, she would still need to reside in the foreign country (or countries) for much of the year. Some European tax havens cater to wealthy citizens of high-tax European countries,³³⁷ so those destinations might be available to at least some wealthy U.S. citizens. Closer to the United States, a number of countries are often mentioned as safe, tax-friendly locations for wealthy individuals to retire.³³⁸ It is not unreasonable to assume that if the United States were to adopt a residence-based tax system for its citizens, strong incentives would exist for additional countries to adopt favorable special tax regimes to attract high-income U.S. citizens.³³⁹ Indeed, Puerto Rico, utilizing its special tax status as a U.S. commonwealth (whereby U.S. citizens residing there are not subject to U.S. tax), recently established a special tax regime for wealthy U.S. citizens who relocate there, reportedly with at least some initial success.³⁴⁰ Moreover, given that a not-insignificant number of individuals have surrendered citizenship to avoid U.S. taxes (a factor that some critics use in favor of a move to residence-based taxation), it is not unreasonable to assume that a (potentially much greater) number would be willing to move abroad if they could retain their U.S. citizenship, particularly when they could still spend significant periods of time in the United States each year under a residence test.

American Citizens Abroad dismisses arguments that a residence-based tax system might induce U.S. citizens to establish residence abroad. While noting that population movements are very difficult to project, it suggests that the United States remains a destination for immigrants, and that “[t]he number of immigrants moving into the United States each year far exceeds the number of Americans

³³⁷ See *supra* note 327; see also David Leigh, *The Tax haven that Today's Super Rich City Commuters Call Home*, THE GUARDIAN, Jul. 9, 2006 (discussing Monaco).

³³⁸ A number of websites and advisors provide advice (currently targeted to non-U.S. citizens, given the U.S. citizenship-based regime) regarding the best tax-friendly destinations. See, e.g., U.S. News & World Report Website, *The Most Tax-Friendly Places to Retire Abroad*, at <http://money.usnews.com/money/blogs/On-Retirement/2011/12/05/the-most-tax-friendly-places-to-retire-abroad>; Live and Invest Overseas Website, at <http://www.liveandinvestoverseas.com/>.

³³⁹ Although the ACA proposal suggests that citizens residing in “tax havens” would still be treated as U.S. tax residents, such a provision is unlikely to have much, if any, practical effect. See *supra* notes 272–273 and accompanying text.

³⁴⁰ See Lynnley Browning & Julie Creswell, *Puerto Rico Creates Tax Shelters in Appeal to the Rich*, N.Y. TIMES, Mar. 25, 2013 (reporting that during the first three months of the regime, “a handful of under-the-radar millionaires” have relocated, and “Puerto Rican officials say another 40 persons, mostly from the United States, have applied).

moving abroad.”³⁴¹ Even if this net inbound migration were to continue after a switch to residence-based taxation, it is not relevant. The question is not whether residence-based taxation would impact the total population of the United States. Rather, the issue is whether it would induce high-income citizens to move abroad (regardless of the independent question of how many immigrants, who are often lower-income, move to the United States).

The proposals to eliminate citizenship-based taxation contemplate a mark-to-market “exit tax” when a U.S. citizen’s tax status changes from resident to non-resident.³⁴² As discussed above, there might be significant administrative difficulties in enforcing this provision.³⁴³ If implemented and enforced, it might have some limiting effect on the number of citizens who abandon U.S. residence, although for some individuals it would have little or no effect. Because it would treat an individual as if she sold all of her assets at the time U.S. residence is lost, it would only immediately affect those individuals who have significantly appreciated non-exempt assets. The gain in those assets typically would be taxed at a 23.8% rate, to the extent the deemed gain exceeds the exemption amount.³⁴⁴ However, to the extent the individual’s assets consist primarily of cash-equivalents or other assets with minimal built-in gain, the exit tax will have little impact. Also, if there is a future downturn in the stock market, individuals might take advantage of that downturn to become a non-resident, due to the (perhaps temporary) reduction in the deemed gain in their assets. Even if the individual has significant built-in gain, if she expects to receive significant amounts of future income, or is primarily concerned about future estate tax liability,³⁴⁵ the imposition of the mark-to-market tax might not dissuade her from changing residence.

Regardless of the precise number of U.S. citizens who abandon U.S. residence if the United States eliminates citizenship-based taxation, if any non-trivial number do so there could be problematic impacts on both the U.S. tax system and on U.S. society more generally. Obviously, if a significant number of high-income individuals did so (or even a smaller number of extremely high-income individuals did so), there could be some direct revenue impact.³⁴⁶ More

³⁴¹ American Citizens Abroad, *supra* note 47, at 19.

³⁴² See *supra* notes 85–95 and accompanying text.

³⁴³ See *supra* notes 277–286 and accompanying text.

³⁴⁴ Long-term capital gain generally is taxed at a 20% maximum rate. See I.R.C. § 1(h)(1)(D). In addition, the recently-enacted 3.8% surtax under I.R.C. § 1411 could apply to the deemed gain. That tax is imposed on “net gain . . . attributable to the disposition of property. . . .” I.R.C. § 1411(c)(1)(iii). Although the proposed regulations under that section do not explicitly refer to § 877A, they do provide that the tax applies in certain other mark-to-market situations. (applying surtax to gains from mark-to-market election under I.R.C. § 1296). In addition, the Treasury Department explanation accompanying the proposed regulations states that “[u]nder certain statutory or regulatory provisions, a non-trader may (or may be required to) mark assets to market These proposed regulations treat amounts of gain or loss recognized as a result of marking to market as net investment income.” RIN 1545-BK44, 77 FED. REG. 72612 (2012).

³⁴⁵ See *infra* Part IV.B.

³⁴⁶ American Citizens Abroad also argue that the amount of tax revenue raised from citizens abroad is “absolutely insignificant” in the context of the U.S. budget. See *id.* at 3. However, it is possible that the amount of revenue collected from overseas citizens might increase with the introduction of enhanced enforcement programs and FATCA. More importantly, this estimate does not consider the potentially more

importantly, there could be important indirect impacts on the tax system. It is very likely that there would be widespread news reports of wealthy U.S. citizens who establish foreign residence to escape U.S. taxation, just as there was broad press coverage when U.S. corporations engaged in inversion transactions to reduce U.S. taxes.³⁴⁷ This activity could receive additional publicity if members of Congress call for hearings, as occurred in the context of corporate inversions.³⁴⁸ As I previously observed, as a result of this publicity “those at home might conclude that citizens abroad are ‘getting away with something’ and consequently lose confidence in the tax system and the social norm of tax compliance.”³⁴⁹ While this risk of public loss of confidence could also exist in a citizenship-based tax system to the extent the IRS is not enforcing the tax laws against overseas citizens,³⁵⁰ such a risk has probably been reduced in recent years with the increased overseas enforcement programs and introduction of FATCA.

More generally, the creation of a system where significant numbers of U.S. citizens (or even somewhat smaller numbers of athletes, entertainers, or other high-profile citizens) can voluntarily excuse themselves could further undermine the cohesion of American society, creating the perception that some citizens are exempt from a fundamental obligation of citizenship—the payment of taxes—while others are not.³⁵¹ This could be particularly problematic because the individuals avoiding tax would be a self-selecting, high-income group. While there has been some public concern with individuals who, under the current regime, abandon their citizenship to avoid taxes, the public reaction is likely to be much stronger in the case of citizens who avoid taxes by living abroad under a residence-based regime. In the former case, while the citizenship-renouncers may be viewed as “unpatriotic”, at least they are exiting the community (and also abandoning the benefits associated with citizenship),³⁵² so they are unlikely to be viewed as an ongoing source of concern. In contrast, with non-resident citizens allowed to spend significant time in the United States, yet not be subject to U.S.

significant amount of income and estate tax revenue that might be lost if the United States were to only tax U.S.-resident citizens and a number of high-income citizens moved abroad.

³⁴⁷ See generally, Michael S. Kirsch, *The Congressional Response to Corporate Expatriations: The Tension Between Symbols and Substance in the Taxation of Multinational Corporations*, 24 VA. TAX REV. 475 (2005); see also David Gelles, *New Corporate Tax Shelter: A Merger Abroad*, N.Y. Times, Oct. 8, 2013 (describing more recent use of foreign mergers in place of traditional inversions). Such reports often occur in Europe with respect to high-profile individuals who establish residence in Monaco or elsewhere.

³⁴⁸ See Kirsch, *supra* 347 (describing three-year response of Congress to corporate inversions).

³⁴⁹ Kirsch, *supra* note 1, at 502.

³⁵⁰ See *id.*

³⁵¹ Of course, even under current law not all citizens pay Federal income taxes. For example, citizens abroad might not owe U.S. income tax because of the foreign earned income exclusion and the foreign tax credit. However, at least those individuals may be subject to tax if their income is high enough, and most citizens could understand the importance of preventing double taxation by allowing the foreign tax credit. On the low-income side, many citizens' income is below the threshold at which income tax is due. Such people, however, often pay payroll taxes.

³⁵² Cf. *infra* note 413 and accompanying text (criticizing provisions, such as the Reed Amendment, that attempt to punish such former citizens).

(or perhaps any other) income tax, the perceived abuse might be viewed as ongoing.³⁵³

In the case of the other traditionally important obligation of citizenship—the obligation to defend the country if called upon—current U.S. law does not generally relieve citizens living abroad of their obligations. While the United States does not currently have a military draft, all male citizens—including those residing outside the United States—are required to register with the Selective Service upon reaching age eighteen.³⁵⁴ The implementation of a residence-based tax system for citizens would move away from this standard of treating all U.S. citizens, regardless of where they live, as members of the same community, at least with respect to the fundamental obligations of citizenship.

Avi-Yonah takes a contrary view of tax-motivated citizens moving abroad under a residence-based tax system.³⁵⁵ While acknowledging that significant numbers of citizens may move abroad under a residence-based tax system, he defends this result using the Tiebout sorting rationale, which envisions individuals “voting with their feet” to determine the population’s desired level of tax and expenditures:

We should go back to Charles Tiebout’s famous conclusion from 1956 that if people are mobile, countries should set tax rates to reflect the taste of their residents, and those residents that do not like the resulting choice (which is established by democratic elections) should be free to move to other countries whose choices they like better. . . . [L]et people who do not like the result [of quadrennial elections in which proper tax rates are debated and decided] move overseas, and stop taxing them there even if they retain US citizenship.³⁵⁶

While the Tiebout model may be appealing under certain ideal assumptions, it has a number of significant shortcomings in the case of citizens escaping U.S. tax by moving to a foreign country. Tiebout’s analysis, by its own terms, focuses on the level of expenditures for “local public goods”.³⁵⁷ Tiebout explicitly states that his population sorting model does not apply at the federal

³⁵³ See also Harvey, *supra* note 229, at 19 (noting that such a situation could result in “a public uproar”). Harvey suggests that, were Congress to enact residence-based taxation of citizens, it should significantly tighten the number of days a present can be present in the United States before becoming a tax resident. See *id.*

³⁵⁴ See 50 U.S.C. § 453(a) (generally requiring registration by “every male citizen of the United States”); see also Selective Service System Website, *Frequently Asked Questions* (instructing citizens living outside the United States to contact an embassy or consulate for assistance in registering), at <http://www.sss.gov/QA.HTM#quest9>. In addition, many categories of male non-citizen residing in the United States must register, including lawful permanent residents and unauthorized immigrants. See 50 U.S.C. § 453(a).

³⁵⁵ See Avi-Yonah, *supra* note 61, at 32.

³⁵⁶ *Id.* (citing Charles Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 418 (1956)).

³⁵⁷ Tiebout, *supra* note 356, at 416.

level.³⁵⁸ This focus on the local level is grounded in a number of necessary assumptions underlying the model. For example, one of Tiebout's assumptions is that "[t]he public services supplied exhibit no external economies or diseconomies between communities."³⁵⁹ In other words, for his model to work, there can be no spillover benefits or costs between communities. While this assumption might be fulfilled with the local public goods that are the focus of Tiebout's hypotheticals,³⁶⁰ it does not apply at the international level. A U.S. citizen who moves to another country might still obtain some indirect benefits from the expenditures occurring within the United States. For example, he might benefit from military protection provided by the United States (either indirectly if he resides in an allied country that comes within the United States' defensive sphere or, less often, directly if he is in a country where direct U.S. military intervention might be called on). The citizen abroad (along with non-residents non-citizens) might also receive a number of other spillover benefits from United States expenditures, such as technological improvements arising from U.S. research and development funding, or economic benefits by investing in relatively stable U.S. banks or financial markets. Given these significant spillover possibilities, the population sorting envisioned by Tiebout at the local level would not necessarily provide accurate results regarding the optimal level of public expenditure at the U.S. federal level.

The application of Tiebout's model in the citizen migration context also suffers from a more general flaw. Under the model, an individual "votes" by "picking that community which best satisfies his preference pattern for public goods."³⁶¹ An implicit assumption is that the individual can pick only a single community at any given time. Living in that community will subject him to the benefits of the community, including the right to vote and the ability to benefit from the local public goods, and will subject him to the obligations of that community (namely, taxes). This single-community assumption breaks down in a fundamental way in the context of citizens moving abroad in a residence-taxation system. As described by Avi-Yonah, a quadrennial U.S. election would decide the proper rate for taxing all income,³⁶² and those citizens who do not like the

³⁵⁸ Tiebout acknowledges that other economists' conclusion that "no 'market type' solution exists to determine the level of expenditures on public goods" is "valid for federal expenditures." *Id.* at 416. He then offers his model to show that this limitation "need not apply to local expenditures." *Id.* Later in the paper, he reiterates that his model and its assumptions applies to local governments, but acknowledges that it might apply, "with less force," to state governments. *Id.* at 418.

³⁵⁹ *Id.* at 419.

³⁶⁰ Tiebout acknowledges that even some apparently local public goods—such as police protection and pesticide programs aimed at invasive insect species—do not satisfy his model's no-spillover requirement. *See id.* at 423. He suggests that this concern might be mitigated by some form of integration between adjacent communities to address these specific concerns. *See id.* Such an approach is not applicable to spillover issues described above among nations.

³⁶¹ *Id.* at 418.

³⁶² This approach seems to reflect another difference from Tiebout's model, which relies on local governments pre-determining the level of public expenditure, then allowing individuals to choose which of the various communities (with different levels) they prefer. According to Tiebout, "[i]n this model there is no attempt on the part of local governments to 'adapt to' the preferences of consumer-voters. Instead, those local governments that attract the optimum number of residents may be viewed as being 'adopted by' the economic system." *Id.* at 420. In contrast, the above-described proposal (consistent with Tiebout's

resulting level of tax could move abroad to avoid taxation. Under such a system, the non-resident citizens, after “voting with their feet” to move abroad, would not bear the burden of tax. However, not only would they still receive some spillover benefits (described above), but more importantly they would still, it is assumed, have the right to vote in the United States.³⁶³ They could continue to vote for relatively high taxes and federal expenditures (from which they would derive at least some benefits), while not being subject to the tax cost, thereby bypassing a fundamental check inherent in Tiebout’s model.³⁶⁴

A final difference between the Tiebout model and the citizen migration context concerns the role of citizenship. In Tiebout’s model, individuals have no allegiance to a particular community,³⁶⁵ nor do members of a community have particular allegiance to an individual. Accordingly, there is no psychic or similar cost to either the individual or a particular community when the individual makes his residence decision based purely on where his expenditure preference patterns are best satisfied. In contrast, the proposals to adopt residence-based taxation involve individuals with U.S. citizenship. As discussed above,³⁶⁶ if citizens were able to avoid U.S. tax liability by moving abroad, there could be significant tax compliance and non-tax social costs. These costs do not appear to fit squarely within Tiebout’s model.³⁶⁷

B. Reform Proposals and the Estate Tax

The criticism of citizenship-based taxation and proposals for residence-based taxation generally focuses on the income tax consequences of each regime. However, it is important to consider the impact of proposals on the estate and gift tax. A significant number of the high-profile citizenship renunciations in recent decades, both under the pre-2008 expatriation regime and the current exit tax-based expatriation regime, reportedly were driven by U.S. estate tax concerns. For example, U.S. estate tax concerns were said to be the principal motivation for citizenship renunciations for J. Paul Getty’s grandson, Jacob Stolt-Nielsen Jr. (the

description of a central government for which the model does not apply) relies on the voters expressing their preferences every four years, with the government trying to adjust to the pattern of these preferences. *See id.*

³⁶³ None of the proposals for residence-based taxation of citizens explicitly proposed eliminating the voting rights of overseas citizens. However, Avi-Yonah suggests that “it would be legitimate” for the United States to prevent overseas citizens from voting if they no longer were subject to tax. *See* Avi-Yonah, *supra* note 53, at 392.

³⁶⁴ At least in this limited context, the current citizenship-based tax system seems closer to Tiebout’s model, given that an individual can escape the tax imposed by the U.S. community only by fully removing himself (i.e., both physically and with respect to citizenship, with its voting and other benefits); *cf.* Zelinsky, *supra* note 17, at 1347 (arguing that citizenship-based taxation does not fit within the Tiebout model).

³⁶⁵ Tiebout’s first assumption is that “[c]onsumer-voters are fully mobile and will move to that community where their preference patters, which are set, are best satisfied.” *Id.* at 419.

³⁶⁶ *See supra* notes 346–354 and accompanying text.

³⁶⁷ As a final observation regarding the Tiebout model in this context, even in a hypothetical world where all the assumptions could be satisfied, it is not clear that the model would be appropriate for purposes of guiding U.S. tax policy. The goal of the model is to create a “market type” solution for a collection of communities to determine the optimal level of expenditures on public goods. It is not clear that this is, or should be, the goal of a particular nation’s tax policy.

son of a shipping magnate), and Joseph J. Bogdonavich Jr., heir to the StarKist tuna fortune, among others.³⁶⁸ Similarly, some tax lawyers suggested that the recent citizenship renunciation by Facebook co-founder Eduardo Saverin may have been driven primarily by future estate and gift tax concerns, despite his relatively young age.³⁶⁹

Under current citizenship-based law, a citizen living abroad generally is subject to the same estate tax rules that apply to a domestic citizen, and generally is taxable at a 40% rate on worldwide assets in excess of the \$5.25 million exemption amount.³⁷⁰ In contrast, a non-citizen non-resident is subject to the U.S. estate and gift tax only with respect to U.S.-situs assets, although he only receives a \$60,000 exemption.³⁷¹ For estate tax purposes, stock in a domestic corporation is treated as U.S.-situs, and is therefore subject to tax. However, for gift tax purposes, a non-citizen non-resident is not taxed on the transfer of intangibles (including stock in a domestic corporation).³⁷² A number of planning opportunities are available to help non-citizen non-residents minimize their U.S. transfer tax exposure under these rules.³⁷³

A shift to residence-based taxation for citizens could provide significant transfer tax benefits, thereby adding to the above-discussed income tax incentives. Given that a number of high-profile U.S. citizens have been willing to go so far as renounce citizenship for these estate tax benefits, it is reasonable to assume that an even greater number will be willing to take the less drastic step of establishing a foreign tax residence while retaining U.S. citizenship and the ability to return to spend significant amount of time in the United States each year. Again, while a change in state residence is a less drastic step than a change in country residence, the willingness of high-wealth individuals to relocate to states without estate or inheritance taxes supports the idea that high-wealth individuals are sensitive to significant tax liability, and are willing to undertake some changes in their personal circumstances to minimize taxes.³⁷⁴

The extent of the estate tax-driven incentive will depend, in part, on the particular mix of assets that the departing individual owns.³⁷⁵ An individual who primarily holds cash-equivalents or other assets with minimal built-in gain will be able to eventually save a tax on 40% on her total net worth, while incurring little if any exit tax upon her change of residence.³⁷⁶ Even an individual with

³⁶⁸ See Sapirie & Johnston, *supra* note 231, at 768.

³⁶⁹ See Hardy, *supra* note 300.

³⁷⁰ See *supra* notes 9–12 and accompanying text.

³⁷¹ See *supra* note 12 and accompanying text.

³⁷² See I.R.C. § 2501(a)(2).

³⁷³ See Schneider, *supra* note 63, at 29–30 and accompanying text.

³⁷⁴ See *supra* note 334 and accompanying text.

³⁷⁵ There would be no benefit for an individual whose taxable estate is below the exclusion amount (currently \$5.25 million).

³⁷⁶ The non-resident citizen would avoid U.S. estate tax only to the extent she holds non-U.S. situs assets. To the extent she holds U.S. situs assets immediately after the residence change, she could sell them without any U.S. income tax liability (although she would already have recognized any built-in gain as a result of the exit tax).

significant built-in gains could benefit by changing residence, given that a 23.8 percent exit tax on the built-in gain would be much less than a 40 percent tax on her net worth.³⁷⁷

The ACA proposal implicitly acknowledges this potential for large estate tax savings, but suggests only a modest anti-abuse provision. Under the proposal, a departing citizen would be treated as a non-resident for estate tax purposes only if her death occurs more than two years after her non-resident status was established.³⁷⁸ While this would eliminate the most blatant abuses—*e.g.*, a terminally ill individual moving outside the United States just a few weeks before her death—it still provides significant opportunities for individuals who survive the two-year waiting period. While most high-wealth individuals would probably conclude that the disruption to their personal life would not justify the tax savings, it is reasonable to assume that a significant number of people would consider (and perhaps act on) the option. Moreover, the personal cost to relocating abroad would be softened if the substantial presence test, or some variant thereof, were used to determine a citizen's residence for transfer tax purposes. As discussed above, under that test an individual could spend a significant amount of time in the United States each year while still remaining a tax non-resident (*e.g.*, four months per year if the existing 183-day weighted test is extended to residents).

The tax incentives might be even greater when the gift tax is considered. Under current law, a special transfer tax rule applies in the case of an individual who surrenders citizenship. Under Code section 2801, if a “covered expatriate” makes a gift or bequest to a U.S. citizen or resident, that U.S. recipient is liable for a 40% tax (assuming the gift or bequest is not otherwise subject to U.S. estate or gift tax).³⁷⁹ This provision is intended to eliminate any estate or gift tax advantages in a circumstance where the renouncing citizen retains a particular tie to the United States—*i.e.*, a U.S. child or other beneficiary who will receive her assets.

The residence-based taxation proposals generally do not suggest retaining the special rule of Code section 2801. While most of the above-discussed proposals are silent on this issue, American Citizens Abroad explicitly addresses it, calling section 2801 a “punitive provision” that “will not apply in any way whatsoever” to U.S. citizens under a residence-based system.³⁸⁰ Another more recent proposal by Avi-Yonah suggests that a modified version of section 2801 would be retained, although that revised version would still enable individuals to

³⁷⁷ Again, the individual would need to ensure she held no U.S. situs assets after her departure.

³⁷⁸ See American Citizens Abroad, *supra* note 47, at 11. The Code contains other provisions that impose waiting periods to ensure that individuals do not reap tax benefits by making transfers shortly before a person's death. See, *e.g.*, I.R.C. §§ 1014(e) (1 year look-back period denying basis step-up in certain appreciated property acquired by decedent by gift); 2035 (3-year estate tax look-back for certain property interests transferred by gift).

³⁷⁹ See I.R.C. § 2801.

³⁸⁰ American Citizens Abroad, *supra* note 47, at 10 & 30 n.35.

engage in the type of planning discussed below, provided the donee was willing to also establish foreign residence for a brief period of time.³⁸¹ Given that the other proposals generally advocate treating non-resident citizens in the same way that other non-residents currently are treated, those other proposals would probably agree that section 2801 would not apply to non-resident citizens transferors under a residence-based system.

In the absence of section 2801, residence-based taxation could open the spigot for U.S. citizens to avoid the U.S. transfer tax system. In the simplest scenario, an individual could establish non-resident status, convert U.S.-situs assets to foreign assets or cash (to the extent they weren't already foreign situs or cash),³⁸² and make a substantial gift of those assets to her children (who might still be U.S.-resident citizens).³⁸³ The non-resident citizen could even give stock in a domestic corporation directly to the U.S. donee, given that a non-resident non-citizen's gift of intangibles is not currently subject to U.S. gift tax.³⁸⁴ This gift-tax approach has a significant benefit over the estate tax approach—a U.S. citizen would only have to live abroad for a limited amount of time and could then return to the United States, rather than needing to spend the rest of her life as a non-resident.

Various anti-abuse provisions could be envisioned to limit this approach. For example, although the ACA proposal is silent regarding a gift-tax waiting period, its proposed two-year estate tax taint could be extended to the gift tax.³⁸⁵ However, if sufficient amounts were involved, many high-wealth individuals would probably be willing to leave the United States for this period before

³⁸¹ Avi-Yonah's more recent residence-based taxation proposal, co-authored on behalf of the International Committee of the State Bar of California's Taxation Section, recommends extending section 2801 so it would apply not only to long-term lawful permanent residents who lose that status (as under the current version), but also to all other former long-term residents as well as all non-resident citizens. *See* Avi-Yonah & Martin, *supra* note 54, at 1. If this were the only change to section 2801, it might limit the potential avoidance opportunities described *infra* in the text. However, Avi-Yonah further observes "[i]mportantly, the current provisions of Section 2801 which taxes gifts and bequests to any U.S. citizens and U.S. residents would need to be modified to impose such taxation only upon any U.S. residents (which would exclude U.S. citizens residing overseas)." *Id.* at 14. This proposed modification, by calling off section 2801 when the donee is a non-resident (even if he is a U.S. citizen) would preserve the ability of high-wealth individuals to avoid U.S. transfer taxes in the manner described *infra* in the text—it would merely add an additional hurdle. In order to avoid section 2801, not only would the U.S. citizen donor need to move abroad temporarily, but the U.S. citizen donee would also need to do so. While this might discourage many families from engaging in this approach (because, for example, the donee might still be working in the United States and be unable to put his career on hold for a year or two), for situations where the amounts were large enough (*e.g.*, the potential to save tens or hundreds of millions or more of U.S. transfer taxes), there probably would be at least some donees willing to join their donor parents abroad temporarily. After receiving the gift tax-free, these donees could return to the United States.

³⁸² Given that certain assets—*e.g.*, U.S. real property—are exempt from the exit tax under the proposals, and instead are taxed upon disposition by the non-resident (as under current law), the individual would probably not want to use those assets in this context.

³⁸³ As noted *supra*, Avi-Yonah & Martin's proposal would require the U.S. citizen donee to also (perhaps temporarily) become a non-resident in order to avoid U.S. tax on the gift. *See supra* note 381.

³⁸⁴ *See supra* note 372 and accompanying text.

³⁸⁵ A somewhat analogous provision currently exists in the income tax area for certain non-citizens who lose their tax-resident status but then re-establish it within 3 years. *See* I.R.C. § 7701(b)(10) (subjecting such individuals to taxation under I.R.C. § 877(b) to the extent it would increase their tax liability).

making gifts. Indeed, one can envision a retired high-wealth couple undertaking an extended around-the-world trip for a few years (with the ability to spend significant time back in the United States after the first year of non-residence)³⁸⁶ in order to satisfy an anti-abuse waiting period.

Other anti-abuse provisions could also be considered. For example the gift tax could be imposed on gifts of domestic stock by non-resident citizens. However, anti-abuse provisions might raise additional administrative problems, thereby undermining one of the principal arguments for moving to a residence-based system.³⁸⁷ Indeed, the taxation of gifts of domestic stock by nonresident aliens was previously abandoned because of the enforcement difficulties it entailed.

Another possibility would be to use a more subjective test of residence for transfer tax purposes, rather than a test based on day counting. For example, the domicile-based test currently used to determine an alien's transfer tax residence could be extended to citizens in a residence-based system.³⁸⁸ However, given the difficulty of determining an individual's intentions, and an individual's control over objective indicators of intent (*e.g.*, location of bank accounts, driver's license, etc.), such an approach might open further avenues for tax planning under a residence-based transfer tax system for citizens.

A final transfer tax concern involves analogies that some residence-based proponents have made between the proposed exit tax and Canada's departure tax. For example, Blum and Singer note that "[a]n 'exit tax' on departing residents has long been employed in Canada,"³⁸⁹ while Schneider asserts that "[t]he best, and conceptually cleanest, approach is to follow broadly the [exit tax] approach of Canada."³⁹⁰ Schneider, for example, defends residence-based taxation coupled with an exit tax by noting that Canada.

These analogies to Canada's exit tax omit an important consideration—the absence of a Canadian estate tax. The proposed exit tax, like current Code section 877A in the context of individuals surrendering citizenship, focuses on protecting

³⁸⁶ If the current "substantial presence" for non-citizens is extended to citizens, a citizen who previously lived exclusively in the United States might have to limit her physical presence in the United States to no more than 31 days during the first year of desired non-residence (because she will have difficulty avoiding the 183-day weighted aspect if she spent 365 days in the United States during each of the prior two years before departure). See I.R.C. § 7701(b)(3) (an alien is a tax resident only if she is *both* physically present for 31 days in the current year, *and* triggers the 183-day weighted test). Thereafter, she could spend significant time in the United States (particularly because the small number of days of physical presence in the first year would be useful in lowering the weighted total the next year.

³⁸⁷ See *supra* notes 254–275 and accompanying text (discussing enforcement difficulties associated with proposed residence tests).

³⁸⁸ See Treas. Reg. § 20.0-1(b)(2) (defining "nonresident" as a non-citizen "who, at the time of his death, had his domicile outside the United States"). Under the regulations (which are based on the common law test), "[a] person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom." *Id.* § 20.0-1(b)(1).

³⁸⁹ Blum & Singer, *supra* note 40, at 732.

³⁹⁰ Schneider, *supra* note 63, at 67.

the U.S. income tax base (at least with respect to accumulated gains from property that have not yet been taxed). However, it would not protect the estate tax. This lack of attention to the estate tax is not a problem in Canada—in 1972 Canada eliminated its estate tax, substituting in its place a mark-to-market tax at death, whereby a decedent is treated as if he sold all of his capital property at death and must recognize any deemed gains (subject to various exceptions). Under the Canadian system, where the income tax and the deemed-disposition-at-death tax both focus on the same thing (i.e., gain from property), a mark-to-market departure tax protects both. However, a U.S. exit tax under the proposals would only backstop the U.S. income tax, potentially leaving the U.S. estate tax exposed.

C. *The Relevance of the United States' Outlier Status*

Almost every critic of citizenship-based taxation emphasizes that the United States stands almost alone in taxing its non-resident citizens.³⁹¹ While this is true as a formal matter,³⁹² it is only partially true in practice, given that many countries define tax residence in broad terms that often result in taxing their nationals living abroad for extended period.³⁹³ As Zelinsky observed, at least for those countries that use “domicile” as the test for tax residence, “the outcome in many cases is the same whether the criterion for taxation is residence defined as domicile or citizenship.”³⁹⁴

Moreover, the mere fact the United States exercises broader taxing rights than most other countries does not, of itself, justify a move to residence-based taxation of citizens. As discussed extensively *supra* (and elsewhere),³⁹⁵ I believe there are significant justifications for citizenship-based taxation compared to residence-based taxation of citizens. In light of these justifications, the United States' (partial) outlier status is relevant only to the extent it creates problems

³⁹¹ See, e.g., Avi-Yonah, *supra* note 53, at 389; Avi-Yonah & Martin, *supra* note 54, at 5; Blum & Singer, *supra* note 40, at 706 n.3; Schneider, *supra* note 63, at 3. Schneider objects to citizenship-based taxation by asking “what is the justification for U.S. exceptionalism on this point? Why should political allegiance to the United States be any more demanding and costly than to any other country?” Schneider, *supra* note 63, at 46; see also Avi-Yonah, *supra* note 53, at 392 (“[i]f the other democracies do not impose worldwide taxation on their nonresident citizens because of the benefits they provide, it is unclear why we should exact such a high price for our benefits”). These are legitimate questions. However, whereas Schneider asks them rhetorically in criticism of the U.S. policy, my discussion in the text suggests that the mere fact that the United States is an outlier is not dispositive, particularly when, as I believe, the U.S. tax policy reasons for imposing the tax outweigh the instrumental or other downsides to doing so. I also address these questions from the opposite direction, suggesting that some countries might reconsider their residence-based taxation of citizens as a result of the new global information sharing norm.

³⁹² See *supra* notes 4–5 and accompanying text.

³⁹³ See Kirsch, *supra* note 1, at 449 n.15 (listing several countries that use expansive definitions of “resident” in this context). Moreover, given the availability of the foreign tax credit and the foreign earned income exclusion, the United States does not exercise these taxing rights to their full possible extent.

³⁹⁴ Zelinsky, *supra* note 17, at 1325;

³⁹⁵ See Kirsch, *supra* note 1; see also Zelinsky, *supra* note 17 (justifying citizenship-based taxation as an administrative proxy for domicile-based taxation).

whose cost (in connection with other potential problems raised by citizenship-based taxation) outweigh the benefits.

One potential problem with the United States' approach is that, by using a system that is different than that of most other countries, it might undermine the goal of harmonizing the manner in which countries' tax regimes interact with each other. While this may be a laudable goal, this area would hardly be the only area in which countries take different approaches. Moreover, even those countries that use residence-based (rather than citizenship-based) taxation do not use a uniform definition of tax residence, thereby creating the possibility that an individual could be treated as a tax resident of two or more countries.³⁹⁶

A related concern is that this lack of coordination among countries, potentially aggravated by the United States' use of citizenship-based taxation, will adversely impact U.S. citizens—*e.g.*, causing double-taxation of some income and creating excessive compliance burdens. This is a legitimate concern, although the potential for double-taxation is ameliorated by the availability of the foreign tax credit and the foreign income exclusion. Of course, while these provisions may alleviate the double-taxation concern, they may aggravate the administrative concerns, particularly by requiring imposing compliance burdens on overseas citizens. This concern, and the importance of addressing it, are discussed further *infra* in Part V.A.

It is also worth contemplating that, rather than the United States moving to a residence-based regime for its citizens, other countries might move toward a citizenship-based regime in the future (although I am not currently aware of any movement in this direction). One of the principal problems with the taxation of citizens abroad relates to enforcement difficulties—indeed, the Philippines abandoned citizenship-based taxation in 1997 primarily because of enforcement concerns.³⁹⁷ However, as discussed extensively above, global norms are shifting toward more widespread automatic information sharing, which might enable countries to collect more information on at least certain types of income received by their citizens abroad.³⁹⁸ Also, as populations become more mobile, if news reports of citizens establishing foreign residency in order to avoid taxation become more prevalent, some countries may be tempted to act in order to address concerns that high-income citizens were abusing the system. Of course, some countries, due to differing views of citizenship or other historical, social and

³⁹⁶ Zelinsky, looking at the definitions of residence used by just three English-speaking nations, identified four alternative forms of the definition: objective counting of days of physical presence; subjective inquiry into various factors that might augment less physical presence; inquiry into “ordinary” residence; and inquiry into a person’s domicile, or permanent home. *See* Zelinsky, *supra* note 17, at 1324.

³⁹⁷ *See* Kirsch, *supra* note 1, at 47–48.

³⁹⁸ Of course, there still could be problems converting this information into actual collection of taxes. While the United States is attempting to use FATCA to leverage its unique role in financial markets, other countries might not be able implement enforcement tools, such as withholding taxes on foreign financial institutions, without risking the loss of significant foreign investment.

cultural factors,³⁹⁹ might refrain from adopting citizenship-based taxation even if enforcement were more practicable. Yet, even these factors might change. For example, in the past, some other countries might have viewed themselves as countries of emigration, where once citizens emigrated they generally did not return. However, in a modern global economy, it might become more common even in these countries for citizens to move abroad for extended periods, yet eventually return. Under such circumstances, the country might be more willing to continue viewing that nonresident citizen as an ongoing member of society (who should pay taxes to support the society). Of course, moving to a citizenship-based system under any of these scenarios would run the risk that the individual might surrender her citizenship if she decided the taxes were no longer worth the benefits. But such a result would be consistent with the general rationale underlying citizenship-based taxation.

A final observation in the context of the United States' (partial) outlier status concerns a particular country. Eritrea is often identified as one of the only other countries that taxes its citizens living abroad.⁴⁰⁰ In late 2011, the United Nations Security Council adopted a resolution condemning the "diaspora tax" imposed by Eritrea on its nationals living outside the country. Some critics of U.S. citizenship-based taxation have seized upon this Security Council resolution to taint the U.S. citizenship-based taxation system. For example, the ACA report, after mentioning the Security Council's condemnation of Eritrea's diaspora tax, asserted that the United States' "[c]itizenship-based taxation is nothing more than a tax on the American diaspora under a different name."⁴⁰¹ Similarly, a Wall Street Journal commentator noted that "[i]ronically, then-U.S. Ambassador to the U.N. Susan Rice condemned this practice by Eritrea in 2011 as 'the extortion of a diaspora tax from people of Eritrean descent living overseas.'"⁴⁰² The commentator then quipped that "[m]any would describe U.S. practice in similar terms."⁴⁰³

As described by these critics, one might think that the U.N. Security Council (with the United States' backing) had taken it upon itself to make pronouncements upon general international tax policy matters. However, this was not the goal of the Security Council and, seen in context, it is clear that the resolution was concerned with unique facts specific to Eritrea, which have no applicability to the United States tax system. In the years leading up to the U.N. resolution, the Security Council had adopted a number of other resolutions concerning violence and political instability in Somalia, Eritrea, and elsewhere in the Horn of Africa.⁴⁰⁴ Eritrea had continued to supply weapons and financial

³⁹⁹ Cf. Kirsch, *supra* note 1, at 37 (discussing historical and cultural factors that might make the United States more willing to tax its citizens abroad).

⁴⁰⁰ See *supra* note 4 (also mentioning North Korea and Vietnam).

⁴⁰¹ American Citizens Abroad, *supra* note 47, at 28 n.22.

⁴⁰² Graffy, *supra* note 243.

⁴⁰³ See *id.*

⁴⁰⁴ See S.C. Res. 2023, ¶ 10, U.N. Doc. S/RES/2023 (Dec. 5, 2011) (citing prior resolutions); Gianluca Mezzofiore, INT'L BUS. TIMES, *Eritrea Extorts UK Refugees to Fund Somalia's al-Shabaab Islamist Fighters*,

support to opposition groups, including al-Shabaab, in defiance of these resolutions.⁴⁰⁵ Eritrea financed these activities, in part, by collecting “diaspora taxes” from nationals living abroad. These collections were not conducted through ordinary international-law compliant channels, which restrict the ability of one country to perform collection activity in the territory of another. Rather, Eritrea had its overseas consular officials use “extortion, threats of violence, fraud and other illicit means to collect taxes outside of Eritrea.”⁴⁰⁶ These methods included threats to harm relatives still living in Eritrea if the overseas national did not pay.⁴⁰⁷ Eventually, Canada expelled an Eritrean diplomat because of these illicit activities in demanding money from expatriates in Canada.⁴⁰⁸ A recent U.N. Security Council committee report states that Eritrean consular officials abroad are still using illicit means to collect the “diaspora tax” for purposes of funding banned activities.⁴⁰⁹

The U.N. Security Council resolution cited by critics of citizenship-based taxation was carefully worded to condemn the two specific aspects of the Eritrean “tax” that the Council found objectionable: (i) the use of the proceeds “to destabilize the Horn of Africa region or violate relevant resolutions,”⁴¹⁰ and (ii) the use of “extortion, threats of violence, fraud and other illicit means to collect taxes outside of Eritrea from its nationals or other individuals of Eritrean descent.”⁴¹¹ Thus, Ambassador Rice’s condemnation of Eritrea’s “extortion” of its nationals abroad was a reference to actual extortion, including physical threats to the individuals and their relatives, rather than a metaphorical reference to the general imposition of tax. Accordingly, the Security Council’s resolution regarding Eritrea has no relevance to the analysis of U.S. citizenship-based taxation.

July 29, 2013, available at <http://www.ibtimes.co.uk/articles/495268/20130729/eritrea-shabaab-somalia-diaspora-tax-horn-islam.htm>.

⁴⁰⁵ See *id.*

⁴⁰⁶ *Id.* ¶ 10.

⁴⁰⁷ See Mezzofiore, *supra* note 404 (Eritrean national in London stating that she was forced to pay after authorities threatened her parents living in Eritrea); BBC, *Canada Expels Eritrean Envoy Over Diaspora “Tax”*, May 30, 2013, available at <http://www.africareview.com/News/Canada-kicks-out-Eritrea-envoy/-/979180/1866812/-/p76vn3z/-/index.html> (Eritrean national living in Canada describing the collection methods, and noting “... they don’t give you a reason. You have to pay the money.... My family [in Eritrea] would get in trouble if I don’t pay”).

⁴⁰⁸ See BBC, *supra* note 407; see also Mezzofiore, *supra* note 404 (stating that Eritrean diplomats in London continued their collection activities even after U.K. officials warned them to stop).

⁴⁰⁹ See Rep. of the Monitoring Group on Somalia and Eritrea Pursuant to Security Council Res. 2060 (2012): Eritrea, S/2013/440, at 34–35 (Jul. 25, 2013) (documenting that this activity continues to occur in numerous countries, including Canada, Italy, Sweden, and the United Kingdom). The report “recommends that Member States exercise police powers to implement their obligations under the 2011 Security Council resolution. See *id.* at 35.

⁴¹⁰ S.C. Res. 2023, *supra* note 404, ¶ 10.

⁴¹¹ *Id.*, ¶ 11.

V. ACKNOWLEDGING PRACTICAL PROBLEMS WHILE MAINTAINING THE PRINCIPLES

The above analysis suggests that recent developments in global tax enforcement and information sharing generally support and reinforce the viability of citizenship-based taxation. Moreover, proposals to tax citizens only under a residence-based system raise a number of significant concerns. Accordingly, I believe that citizenship-based taxation will, and should, remain the general rule for the United States.

However, it is important to acknowledge the practical impact that the U.S. tax regime has on overseas citizens. While the complexity of the U.S. income tax system imposes some degree of compliance costs and annoyances on all taxpayers, whether residing domestically or abroad, overseas citizens often face unique circumstances. But just as we do not eliminate the entire tax code because some domestic citizens face significant burdens from tax complexity (although some suggest we should), these problems faced by overseas citizens do not, of themselves, justify eliminating citizenship-based taxation. Rather, if there are significant other reasons for retaining this system (which I believe there are for reasons discussed above), we should attempt to fix the administrative problems to the extent possible.⁴¹² Congress, the IRS, and other relevant parts of the U.S. government should keep these administrative problems in mind when developing and enforcing U.S. law, and should be willing to mitigate these problems to the extent consistent with the policies underlying citizenship-based taxation.

I have already written at length proposing the repeal of certain “alternative sanctions” whose principal purposes is to punish, shame, or otherwise burden former citizens who surrender their citizenship, at least in part, for tax purposes.⁴¹³ The following subparts highlight a few additional areas where

⁴¹² A recent article by Dick Harvey reached a similar conclusion that recent developments do not justify the abandonment of citizenship-based taxation, but that the U.S. should take steps to simplify the compliance burden on overseas taxpayers. See Harvey, *supra* note 229, at 14–19.

⁴¹³ My previous work suggested that Congress should eliminate “alternative sanctions” whose principal purpose is to punish, shame, or otherwise burden former citizens. For example, I have previously proposed the repeal of the Reed Amendment, which provides that “[a]ny alien who is a former citizen of the United States who officially renounces United States citizenship . . . for the purpose of avoiding taxation by the United States” is inadmissible to the country. See Kirsch, *supra* note 293. In response to the renunciation of citizenship by Facebook co-founder Eduardo Saverin, and given the impracticability of the Department of Homeland Security ever applying the Reed Amendment, Sen. Charles Schumer proposed a bill known as the “Ex-PATRIOT Act”, which was intended to address some of the administrative shortcomings of the Reed Amendment. See S.3205, 112th Cong. § 3(2012). Given citizenship-based taxation is justified, at least in part, on the idea that an individual can surrender citizenship if she believes that the benefits do not justify the costs, the existence of the exit tax to address any gains that have accumulated while an individual was a citizen, and the historical importance of the right to surrender citizenship, I would oppose the enactment of the Ex-PATRIOT Act and other alternative sanctions similar to the Reed Amendment.

In my earlier work I also proposed the repeal of the quarterly publication requirement regarding individuals who have surrendered citizenship. See Kirsch, *supra* note 293. In place of this requirement, however, it might be useful for the Department of State (or IRS) to continue to publish the aggregate numbers of individuals who surrender citizenship, so that general inferences might be drawn regarding the impact of citizenship-based taxation under the new global enforcement and FATCA regimes.

practical problems could be addressed to help those who retain their citizenship while overseas, without harming the principles underlying citizenship-based taxation. There are certain to be other examples not listed. Advocates for overseas citizens are well-positioned to identify other potential areas for improvement. While such groups undoubtedly will continue to advocate for a residence-based tax system, they should also continue to identify ways to improve the circumstances of overseas citizens in the context of a continuing citizenship-based tax regime.⁴¹⁴

A. *Continue Efforts to Simplify Reporting and Compliance*

Simplified reporting and compliance efforts may be the ripest area for addressing the practical issues faced by overseas citizens. The recent IRS enforcement and FATCA developments have brought increased attention to this area. Prior to these developments, the IRS might not have placed significant emphasis on these practical issues—many overseas citizens either were not aware of their obligations or may have underestimated their importance,⁴¹⁵ while the IRS had only limited enforcement tools. However, in an era of heightened enforcement tools, decreased bank secrecy, and FATCA, and the resulting publicity they have generated overseas, the circumstances have changed for both parties.

In this context, the IRS apparently has started to realize that one size might not fit all, and that overseas citizens are impacted by these developments in a way that domestic citizens are not, particularly in the context of having a foreign financial account,⁴¹⁶ as well as the possibility that a failure to file a particular form or return does not necessarily indicate a failure to pay required taxes.⁴¹⁷ The IRS has begun to show some sensitivity to this situation. For example, the new streamlined filing compliance program allows certain “low risk” overseas citizens—generally, those who underpaid their U.S. tax liabilities by less than \$1,500 in each relevant year—to come into compliance with tax returns and FBARs without any FBAR-related penalties.⁴¹⁸ In addition, the IRS has raised the FATCA-related reporting thresholds for individuals residing abroad,⁴¹⁹ and has announced certain forms of compliance relief for U.S. citizens (both resident domestically and abroad) who failed to report or make deferral

⁴¹⁴ Cf. American Citizens Abroad, Letter to Hon. Jack Lew et al., Jul. 19, 2013 (while noting that ACA continues to lobby Congress for a residence-based taxation system, “in the interim” providing suggestions for changes to the IRS compliance programs that will better serve overseas citizens attempting to become compliant), *available at* Tax Analysts, Doc. No. 2013-18429.

⁴¹⁵ Of course, those overseas citizens who attempted to comply were faced with these practical problems even before the recent increase in enforcement activity. See, e.g., Blum & Singer, *supra* note 40, at 711–12 (discussing practical problems faced by overseas citizens even before the current developments).

⁴¹⁶ See *supra* notes 202–208 and accompanying text.

⁴¹⁷ In particular, the individual’s tax liability may have been significantly reduced or eliminated by a foreign tax credit or foreign earned income exclusion, had the returns been filed.

⁴¹⁸ See *supra* notes 217–224 and accompanying text.

⁴¹⁹ See *supra* note 156 and accompanying text.

elections with respect to Canadian retirement plans.⁴²⁰ The IRS has also provided some relief for overseas citizens in areas outside of the recent enforcement initiatives. For example, the IRS announced that citizens satisfying the non-residence tests under Code section 911 are not subject to the individual mandate of the Affordable Care Act.⁴²¹

In this context, overseas citizens have a high-profile advocate. In her annual reports to Congress, Nina Olson, the IRS National Taxpayer Advocate, has stressed the importance of addressing the practical problems overseas citizens face in their efforts to comply.⁴²² In addition, several others, including Dick Harvey, have suggested ways in which to eliminate or simplify certain filing obligations for these citizens.⁴²³ Among the more frequently suggested changes is the combination of the FBAR form and the new FATCA-imposed Form 8938. Congress and the IRS should continue to consider these and other ways to simplify the compliance burdens on overseas citizens. The IRS should continue to move toward (and publicize) positions that recognize that many past compliance failures by overseas citizens do not necessarily reflect bad faith. Such an approach would not only provide fair treatment, but would also encourage more overseas citizens to voluntarily return to the system (or enter it for the first time), thereby furthering the goals of the enforcement initiatives and FATCA.⁴²⁴

While the recent IRS efforts to address compliance concerns of overseas citizens are welcome, the form of some recent guidance raises concerns. Much of the guidance has been issued in very informal ways, such as press releases or pages on the IRS website.⁴²⁵ The distribution of information through the IRS

⁴²⁰ See generally Hale E. Sheppard, *IRS Introduces Two Unique Remedies for U.S. Persons with Unreported Canadian Retirement Plans and Accounts*, INT'L TAX J., Jan.-Feb. 2013, at 13.

⁴²¹ See IRS Website, *Questions and Answers on the Individual Shared Responsibility Provision*, Q&A 12, at <http://www.irs.gov/uac/Questions-and-Answers-on-the-Individual-Shared-Responsibility-Provision>.

⁴²² See NATIONAL TAXPAYER ADVOCATE, 2012 ANNUAL REPORT TO CONGRESS, *supra* note 51, at 262–280 (listing “Challenges Persist for International Taxpayers as the IRS Moves Slowly to Address Their Needs” as one of the “Most Serious Problems” facing the IRS, and including a list of recommendations); see also NATIONAL TAXPAYER ADVOCATE, FISCAL YEAR 2013 OBJECTIVES REPORT TO CONGRESS, at 21–31 (noting that the National Taxpayer Advocate intends to continue her focus on compliance problems faced by overseas citizens, particularly those involving excessive FBAR and other international penalties); see also Schneider, *supra* note 63, at 57–58 (“increasingly harsh enforcement of tax and reporting compliance against expatriates has led to great distress, anger and alienation among expatriates”).

⁴²³ See Harvey, *supra* note 229, at 16–18; see also Sharp, *supra* note 198, at 706. Harvey also suggests substantive changes that could reduce compliance burdens, such as an increase in the foreign earned income exclusion and providing a *de minimis* exemption for passive income. See *id.* While I have criticized the normative underpinnings of the foreign earned income exclusion elsewhere, I have acknowledged that enforcement and compliance benefits are the strongest case for the exclusion. See *supra* note 105 and accompanying text.

⁴²⁴ Cf. Sapirie, *supra* note 217, at 202 (“everyone interviewed for this story thought the compliance effort should focus on giving taxpayers three things: certainty, an equitable resolution, and an opportunity to explain and be heard”);

⁴²⁵ See, e.g., *IRS Officials Discuss Streamlined Voluntary Compliance*, 69 Tax Notes Int'l 252 (2013) (noting that the informal instructions for the streamlined compliance program had not yet been issued as a revenue procedure or other more formal guidance); Sheppard, *supra* note 420, at 20 (describing taxpayer confusion with IRS guidance issued via fact sheets and news releases regarding Canadian retirement plans);

website—including the website’s efforts to aggregate links to relevant information on a single page⁴²⁶—can be a very useful resource for overseas citizens, particularly given complaints in the past that overseas citizens were isolated from sources of information. However, while the website can be a useful delivery vehicle (*e.g.*, linking to, or repeating verbatim, more authoritative sources of guidance), the use of web pages themselves as a source of authority (*e.g.*, where the guidance only appears in the text of a web page) is problematic. Taxpayers and practitioners may be wary of relying on them, as a website can be revised or deleted at any time.⁴²⁷ This is particularly problematic given that some topics covered by FAQs on the website—*e.g.*, OVDI-related guidance—may have potential criminal law implications for taxpayers. Moreover, a web page, although giving the appearance of being current, may be out of date and not reflect subsequent developments. Accordingly, the IRS should provide guidance through more formal means that are less ephemeral than a web page, and use the website as a delivery vehicle for that guidance.

B. Consider Lenient Treatment for Certain Unknowing Citizens

Another common complaint concerns U.S. citizens whose connection to the United States is tenuous, such that they may not be aware of their status or obligations. A broad spectrum of individuals is often placed within this umbrella of “unknowing citizens”. The most sympathetic group are those individuals who had not realized they are U.S. citizens until recently—*e.g.*, those who were born in the United States to non-citizen parents (*e.g.*, a parent was temporary studying at a U.S. school), but who moved back to the parents’ home country while still an infant and had no connection to the United States until recently discovering their citizenship status (perhaps because “place of birth” is now relevant under FATCA).⁴²⁸ These individuals are sometimes referred to as “accidental” citizens, although not all accidental citizens present sympathetic cases (*e.g.*, an accidental citizen who was born while her parents were temporarily in the United States, but who was aware of her U.S. citizenship status and took advantage of it). A related group might be individuals who derived citizenship by descent upon birth abroad to a U.S.-citizen parent, but had never acquired a U.S. passport and may not have ever visited the United States. These individuals are sometimes referred to as “nominal” citizens or, if they were not even aware of their U.S. status, “unaware” citizens.⁴²⁹ At the other end of the spectrum are individuals who are fully aware of the U.S. citizenship status—indeed, they may have been born in the United

see also supra note 421 (website information for overseas citizens regarding Affordable Care Act individual mandate).

⁴²⁶ *See* IRS Website, *International Taxpayer*, at <http://www.irs.gov/Individuals/International-Taxpayers>.

⁴²⁷ *See also* NATIONAL TAXPAYER ADVOCATE, FISCAL YEAR 2013 OBJECTIVES REPORT TO CONGRESS, *supra* note 422, at 22 (expressing concern “that the fact sheet does not have the same level of authority as changes made to the IRM itself or items of guidance published in the Internal Revenue Bulletin—and the IRS itself would be the first to point out that taxpayers generally cannot rely on fact sheets and press releases”).

⁴²⁸ *See* Blum & Singer, *supra* note 40, at 713 (describing accidental citizens as a “particularly striking example of overseas U.S. citizens facing considerable burdens in becoming tax compliant”); *see also* Schneider, *supra* note 63, at 7.

⁴²⁹ *See, e.g.*, Schneider, *supra* note 63, at 7–8.

States to U.S. citizen parents, spent most of their life in the United States, and are travelling abroad on a U.S. passport—but they claim to have been unaware of their U.S. tax obligations while living abroad. While it is possible that individuals in this latter group may warrant some kind of relief in particular cases (and, in any event, this latter group might be shrinking, given the increased publicity surrounding the OVDPs and FATCA), they raise a different set of issues.⁴³⁰ This subpart is more concerned with individuals in the former groups. Of course, some individuals might fall somewhere in between the two extremes.

Some critics cite the circumstances of accidental and unaware citizens as justification for the repeal of all citizenship-based taxation.⁴³¹ However, the fact that a certain subgroup of overseas citizens has special facts that may warrant relief does not justify eliminating citizenship-based taxation on all overseas citizens, particularly given the potential problems with residence-based taxation discussed above. Instead, as with the more targeted response to administrative problems described in the preceding subpart, a better approach is to implement rules that provide relief to particular groups, where warranted.

The Code already provides relief from the exit tax for a narrow group of individuals surrendering their citizenship.⁴³² More recently, in the context of enhanced IRS enforcement efforts, the IRS has provided limited relief under the OVDP to certain categories of “unaware” citizens—*i.e.*, those who had been unaware of their U.S. citizen status.⁴³³ However, this relief is only partial (a 5% cap on the FBAR-related penalty), so an unaware citizen might need to take the risk of seeking more fact-specific relief by opting-out of the OVDP (unless she qualifies for full reporting-penalty relief under the streamlined procedures).

The IRS should continue to consider whether additional forms of penalty relief are warranted for certain categories of unaware citizens. Given the fact-dependent nature (*i.e.*, based on subjective representations regarding an individual’s awareness), it is understandable that blanket relief on a groupwide level might be difficult. Nonetheless, in an effort to encourage these individuals to enter the system, the IRS should consider whether there are certain objective

⁴³⁰ The IRS, in providing a cap for certain “unaware” citizens under OVDP, explicitly provided that this latter group of citizens is not eligible for this blanket relief. *See supra* note 177.

⁴³¹ *See, e.g.*, Schneider, *supra* note 63, at 75; *see also id.* at 45 (rejecting argument that overseas citizens are members of U.S. society because the “argument for comparison falls apart completely in connection with accidental, nominal, and unaware citizens, whose connection to the United States is typically minimal to nonexistent).

⁴³² The exit tax does not apply to an individual who surrenders citizenship in two contexts: (i) the individual was, at birth, a dual citizen of the United States and another country, continue to be a citizen and to be taxed by that other country, and was a resident of the United States in no more than 10 of the past 15 taxable years, or (ii) the individual relinquished citizenship before age 18 ½ and was a resident of the United States for not more than 10 taxable years before the relinquishment. *See* I.R.C. § 877A(g)(1)(B).

⁴³³ *See supra* note 177 and accompanying text. The IRS website guidance gives an example of an “accidental” citizen who had not been aware of her U.S. citizenship status until recently when she obtained a copy of her birth certificate in order to acquire a passport in her home country. Although the website does not explicitly address the unknowing citizen who acquired citizenship by descent, the website’s general reference to “[t]axpayers who are foreign residents and who were unaware they were U.S. citizens” presumably would apply to her. *See* IRS Website, *supra* note 173, Q&A 52.

factors⁴³⁴ that could perhaps justify the waiver of reporting-related penalties, rather than just capping them at 5 percent, in order to have the individual pay back taxes and interest and enter the U.S. tax system. Of course, as FATCA is implemented, particularly given the relevance of “place of birth” in an FFI’s due diligence, the scope of accidental citizens who might be eligible to claim relief based on being unaware of their citizenship status might shrink. Congress could also consider providing statutory relief from tax liability for narrowly defined categories of unaware citizens. A 1998 report by the Department of Treasury’s Office of Tax Policy raised this possibility, and included a list of factors that might be relevant in order to prevent abuse.⁴³⁵

C. Mitigate Perception of Second-Class Status

Some arguments raised by overseas citizens against U.S. taxation relate to a perception that they are subject to indignities or otherwise are treated as second-class citizens. A long-standing complaint in this area related to the inability to vote in federal elections.⁴³⁶ This concern was mitigated, at least in part, by the Uniformed and Overseas Citizens Absentee Voting Act, which allows a citizen abroad to cast an absentee ballot in the state in which he last resided prior to moving outside the United States.⁴³⁷

Other perceived indignities may arise less often, but nonetheless may be viewed as further evidence of less-than-full status. For example, one often-cited benefit of U.S. citizenship is consular and military protection in times of crises outside the United States. While some have questioned the relevance of this protection in the 21st century,⁴³⁸ it sometimes is called upon. For example, in response to fighting in Lebanon in 2006, the United States helped thousands of U.S. citizens evacuate the country.⁴³⁹ More recently, in 2011 the State Department chartered flights to evacuate U.S. citizens from Egypt in response to unsafe conditions that arose there and the absence of sufficient commercial flights.⁴⁴⁰ These evacuations are consistent with guidance posted on the Department of State website, which provides that “[i]n more serious situations, we may recommend that U.S. citizens leave the foreign country, and, if

⁴³⁴ Possible objective factors could include, *e.g.*, the individual never had a U.S. passport or otherwise referred to U.S. status on any documents, including foreign tax returns; if the individual is an “accidental” citizen, she left at a very young age, etc.

⁴³⁵ See Office of Tax Policy, U.S. Dep’t of Treasury, *Income Tax Compliance by U.S. Citizens and U.S. Lawful Permanent Residents Residing Outside the United States and Related Issues* 38–40 (1998). In the interest of disclosure, it should be noted that the author participated in the drafting of the previously cited study while working at the Internal Revenue Service and later at the Treasury Department. See Kirsch, *supra* note 1, at 484 n.171.

⁴³⁶ See Kirsch, *supra* note 1, at 474.

⁴³⁷ Some citizen advocacy groups argue that practical limits on the voting right undermines its value for purposes of benefits-based. *But see id.* (responding to these arguments).

⁴³⁸ See *id.* at 472–73 (arguing that this benefit still retains some relevance).

⁴³⁹ See *id.* at 472; see generally U.S. Gov’t Accountability Office, *U.S. Evacuation from Lebanon*, GAO-07-893R (Jun. 7, 2007) (GAO review and analysis of the evacuation).

⁴⁴⁰ See Department of State, Press Release, *Status of U.S. Citizen Evacuations from Egypt*, Feb. 1, 2011, available at <http://www.state.gov/r/pa/prs/ps/2011/02/155819.htm>.

commercial transportation is not available, provide departure assistance, as our resources permit.”⁴⁴¹

This crisis support is generally consistent with the underlying rationale for taxing citizens abroad. However, one aspect of this support is problematic. Pursuant to Federal law,⁴⁴² these emergency evacuations are provided “on a reimbursable basis to the maximum extent practicable....”⁴⁴³ In other words, while there is no up-front charge to the evacuated citizens, they are expected to reimburse the United States for the cost of their evacuation travel, although the statute caps the reimbursement at the “reasonable commercial air fare immediately prior to the events giving rise to the evacuation.”⁴⁴⁴ The Department of State has an official form (structured as a “promissory note and loan agreement”) that the evacuating citizen is expected to complete during the evacuation process, and has issued detailed instructions to Department of State personnel to ensure that the forms are completed properly.⁴⁴⁵

This issue received media attention in 2006 with the evacuation from Lebanon. Press reports highlighted that the United States was charging its citizenship for the evacuation, while other countries—such as the United Kingdom—were not, and that “Americans in Beirut are complaining that they have been asked to sign forms agreeing in advance to pay unspecified sums to cover the cost of their evacuation.”⁴⁴⁶ After five days, the Department of State announced that it was suspending the policy of collecting promissory notes from evacuees because it was “impracticable to charge reimbursement” from evacuees “in this exceptional case.”⁴⁴⁷ The Department of State officials acknowledged that the promissory note policy had imposed instrumental costs on the evacuation process—it was viewed as having interfered with the process, and its removal may have “increased the numbers of American citizens seeking to leave.”⁴⁴⁸

More importantly for purposes of the citizenship-based taxation analysis, the reimbursement policy imposes important symbolic costs. At some level, the statute’s reimbursement requirement might be understandable—after all, a U.S.

⁴⁴¹ U.S. Dep’t of State Website, *Emergencies and Crises*, at http://www.travel.state.gov/travel/tips/tips_6086.html.

⁴⁴² See 22 U.S.C. § 2671(b)(2)(ii).

⁴⁴³ *Id.*

⁴⁴⁴ *Id.* U.S. government employees and their dependents are not required to personally reimburse the cost of their evacuation. See *id.* § 2671(b)(2)(i).

⁴⁴⁵ See 7 FOR. AFFAIRS MAN. 1800 Appx. D, *Crisis Evacuation Loans and Evacuation Documentation* (Aug. 27, 2013). The guidance provides that “if feasible, each adult private U.S. citizen evacuated on United States Government funded transportation, whether embassy commercial charter or military transport, must execute the promissory note and loan agreement on Form DS-5528 prescribed by the Department to cover the cost of transportation.” *Id.* at 1830(a) Appx. D. In this context, minor children do not “fly free,” but instead are added to the primary adult’s promissory note and loan agreement. See *id.* U.S. citizens are also entitled to receive an evacuation loan under certain circumstances. See *id.* at 1840(a) Appx. D.

⁴⁴⁶ See, e.g., Brian Whitaker, *Mass Evacuation from Beirut Underway*, THE GUARDIAN, Jul. 18, 2006 (the article also alleged that some citizens “had been told they would not be allowed to use their passports again until they paid”).

⁴⁴⁷ See U.S. Gov’t Accountability Office, *supra* note 439, Slide #25; see also *id.* at 7.

⁴⁴⁸ *Id.* at 6–7.

citizen abroad might have planned to eventually leave that country in any event, at which time she would have paid her own transportation costs. However, in the context of a crisis where lives are endangered, the government is undertaking its fundamental role to protect its citizens, and the citizens are receiving one of the fundamental benefits of citizenship. The provision of transportation is merely the most effective way to protect the citizens from danger. In analogous domestic circumstances the United States generally does not treat emergency disaster relief—*e.g.*, FEMA assistance during a hurricane—as a fee-for-service benefit. Indeed, in some circumstances FEMA reimburses individuals for certain expenses, such as short-term lodging, as a result of disasters.⁴⁴⁹

Another possible rationale for the reimbursement requirement is that the U.S. citizen, by travelling abroad, assumed unwarranted risks and therefore should be obligated to pay the related costs. Such a view, however, does not seem warranted in a modern global economy. International travel and extended residence abroad is no longer an unusual or exotic occurrence, so the mere fact that a U.S. citizen is in a foreign country does not automatically suggest that she has assumed unwarranted risks.

The treatment of search and rescue operations in the United States provides an analogy in the context of risk-taking. The National Park Service does not charge for search and rescue operations,⁴⁵⁰ although proposals have been made to charge a “special use” fee for particularly hazardous activities.⁴⁵¹ Park authorities cite utilitarian concerns similar to those observed by Department of States officials during the Lebanon evacuation—a rescue charge might discourage people in need from coming forward.⁴⁵² Most U.S. states also avoid seeking reimbursement of search and rescue costs from those who are helped. Only a few states, including Idaho, Oregon, and Maine, have laws authorizing agencies to bill for rescues, and only “when factors such as recklessness, illegal activity or false information led to the predicament.”⁴⁵³ New Hampshire has perhaps the broadest

⁴⁴⁹ See, *e.g.*, FEMA Website, *FEMA May Reimburse Short-Term Lodging Expenses*, at <http://www.fema.gov/news-release/2011/07/08/fema-may-reimburse-short-term-lodging-expenses> (describing reimbursement for certain hotel costs after severe storms and tornadoes damaged individuals' houses).

⁴⁵⁰ See Steve Fagin, *Lessons of the Mount Hood Tragedy: Who Pays for Search and Rescue?*, *The Day* (New London, CT), Dec. 19, 2009, available at <http://www.theday.com/article/20091219/INTERACT010102/912199999/0/SHANE> (noting that the costs are covered by National Park entrance fees).

⁴⁵¹ See Rone Tempest Wyofile, *Who Should Pay for Rescues in National Parks?*, *Adventure Journal*, May 25, 2011, available at <http://www.adventure-journal.com/2011/05/who-should-pay-for-rescues-in-national-parks/>.

⁴⁵² See *id.* (“if we start charging for search and rescue, people would not ask for help or would delay asking for help. We could see that it would easily drive up the cost”); see also Laura Zuckerman, *For Some Stranded U.S. Adventurers, Rescues Come at a Cost*, *CHICAGO TRIB.*, Feb. 18, 2013 (citing “objections by national search and rescue groups, who say the prospect of payment could prompt people to delay seeking needed aid, possibly making a dangerous situation worse”); see also *supra* note 447–448 and accompanying text (assertions that the evacuation fee initially inhibited some U.S. citizens in Lebanon from coming forward)

⁴⁵³ See Zuckerman, *supra* note 452.

reimbursement provision, allowing the imposition of search and rescue costs if the individual “acted negligently.”⁴⁵⁴

In this context, given that international travel should not be viewed as inherently risk-taking, Federal law should be amended so that a reimbursement requirement is not the default approach when citizens must be evacuated from a foreign country. Instead, the reimbursement requirement should either be eliminated, or should be confined to those circumstances where the U.S. citizen’s presence in the foreign country might be viewed as involving recklessness or some other elevated level of risk-taking. In order to make such an approach practicable, the standard should be tied to an objective measure. For example, the reimbursement requirement could be limited to those citizens who remain in (or enter) a country on non-official business beyond a reasonable period of time after the Department of State has ordered the departure from its embassy of non-essential personnel,⁴⁵⁵ or some other objective threat level indicating a particularly high level of risk.

It is difficult to gauge how important these “second-class” citizenship concerns are to overseas citizens’ advocates—whether they are a significant reason for opposing citizenship-based taxation, or whether they are merely an add-on argument to their more fundamental disagreement with the system. Nonetheless, given that citizenship-based taxation is justified, at least in part, on the benefits of citizenship, and given that overseas citizens do not receive immediate benefits from many Federal expenditures,⁴⁵⁶ Congress should take seriously these concerns that may be of particular interest to overseas citizens.

CONCLUSION

The recent developments in global tax enforcement and information sharing have drawn increased attention to citizenship-based taxation under U.S. tax law. While this topic had been of growing importance over the past few decades due to the increased cross-border mobility of individuals, the recent administrative developments have ratcheted up the attention even more. In an era where the IRS has new tools for collecting information, which are backed by significant penalties for non-compliance, overseas citizens must now take the tax and reporting requirements very seriously.

⁴⁵⁴ See N.H. REV. STAT. ANN. § 206:26-bb.

⁴⁵⁵ Lesser threat levels, such as “Travel Warnings,” might be too broad, given that they sometimes encompass countries to which a significant number of Americans frequently travel, such as Mexico and Israel. See U.S. Dep’t of State Website, *Current Travel Warnings*, at http://travel.state.gov/travel/cis_pa_tw/tw/tw_1764.html (listing countries).

⁴⁵⁶ While overseas citizens may not receive the immediate benefits of many Federal expenditures (e.g., Federal highways, etc.), they will benefit from the prior expenditure on these long-lived expenditures if they return to the United States. See also *supra* note (discussing benefits received as members of extended U.S. society with respect to federal expenditures on social welfare programs).

This Article concludes that the administrative developments mitigate one of the principle concerns undermining citizenship-based taxation—the ability of the IRS to enforce the law. At the same time, it suggests that proposals to shift to residence-based taxation of citizens raise significant administrative problems of their own. In addition, residence-based proposals raise more substantive concerns, particularly with respect to incentives to move abroad and the resulting impact on society's perception of the income tax and the continuing viability of the estate and gift tax.

Ultimately, the Article concludes that these administrative and substantive issues, on balance, favor the continued application of citizenship-based taxation. However, with the IRS' greater powers come greater responsibilities. The Article acknowledges that citizenship-based taxation imposes unique challenges for overseas citizens—both with respect to tax compliance and other areas—and it encourages the IRS to show more sensitivity to these concerns, consistent with the policies underlying citizenship-based taxation.