CATCH ME IF YOU CAN:[1] RELINQUISHING CITIZENSHIP FOR TAXATION PURPOSES AFTER THE 2008 HEART ACT

1. Catch Me If You Can is a 2002 motion picture loosely based on the life of Frank Abagnale Jr., a notorious conman known for his impressive skills at evading the authorities. Catch Me If You Can, http://www.dreamworks.com/catchthem/jump2.html (last visited May 1, 2009).

I. INTRODUCTION

Judge Learned Hand famously stated “there is nothing sinister in so arranging one’s affairs as to keep taxes as low as possible.”[2] Americans and their tax attorneys have always played cat-and-mouse with the Internal Revenue Service (“IRS”), going as far as legally possible to escape or minimize their tax burden.[3] One of the more controversial weapons in tax-preparers’ arsenals is outright expatriation, or relinquishment of American citizenship.[4] Ultra-wealthy citizens, particularly several high-profile ones in the 1990s,[5] have sought to escape U.S. taxation by expatriating.[6]

This comment addresses the issue of tax-driven expatriation and its effects on recent, current, and future tax policy. Part II explains the phenomenon of tax-driven expatriation from cultural and financial points of view.[7] Part III then traces the evolution of § 877 of the Internal Revenue

2. Comm’r v. Newman, 159 F.2d 848, 850-51 (2d Cir. 1947) (Hand, J., dissenting).

3. *See* David Cay Johnston, *The Way We Live Now: 12-21-03: Encounter: The Loophole Artist*, N.Y. TIMES, Dec. 21, 2003, § 6 (Magazine), at 18 (profiling Mr. Jonathan Blattmachr, one tax attorney who specializes in playing such cat-and-mouse games with the IRS).

4. *See* Andrew Walker, *The Tax Regime for Individual Expatriates: Whom to Impress?*, 58 TAX LAW. 556-58 (2005).

5. Notable escapees have included Mr. John Dorrance III (heir of the Campbell Soup fortune) and Mr. Joseph Bogdanovich (Star-Kist Foods Chairman), as well as other very wealthy individuals. Brigid McMenamin, *Home Free*, FORBES, July 26, 1999, at 110.

6. *See id.*

7. *See infra* Part II.

Code, and explains the methods which the IRS has used to close loopholes in income, estate, and gift tax areas in order to reign in what it sees as expatriate tax abuses.[8] Part III also comments on legislative initiatives after 2006, and chronicles the struggles of the newly-elected Democratic Congress in enacting changes up to and including the enactment of the Heroes Earnings Assistance and Relief Tax Act of 2008 ("HEART Act") and its mark-to-market provisions affecting potential expatriates.[9] Part IV focuses on the current state of affairs, describing the tax burdens of expatriates that departed the United States before the HEART Act, as well as after enactment of the HEART Act.[10] Part V outlines, via recent examples, the basic problem of tax-related expatriation and its underlying motive; it then attempts to explain why the tax-driven expatriation problem still exists after the enactment of the HEART Act.[11] Parts VI and VII of this comment recommend a realistic direction for the IRS to minimize exploitation while still allowing citizens to exercise their constitutional right to expatriate.[12]

II. EXPATRIATION FOR TAXATION PURPOSES: AN OVERVIEW

The United States of America, with its colonial roots, has always prided itself as a nation welcoming immigrants; similarly, it has insisted, even from the late 1800s, that emigration is a fundamental right.[13] However, relinquishment of U.S. citizenship often conveys an image of an ultra-wealthy person who, after making his fortune in the free markets found in the U.S. economy, tries to avoid paying his debt and his allegiance to the nation that made his wealth possible.[14] This image is so strongly engraved in the American psyche that when articles highlighting such practices were published in *Forbes* in 1994,[15] the resulting public outrage caused President Clinton to ask the Treasury to look into putting a stop to the practice.[16] This outrage is present despite the fact that a fairly

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8. *See infra* Part III.
9. *See id.*
10. *See infra* Part IV.
11. *See infra* Part V.
12. *See infra* Parts VI-VII.
13. Congress declared "the right of expatriation is a natural and inherent right of all people, indispensable to the enjoyment of the rights of life, liberty, and the pursuit of happiness." Act of July 27, 1868, ch. 249, 15 Stat. 223, 223 (1868).
14. *See* McMenamin, *Home Free*, *supra* note 5, at 110.
15. *See* Brigid McMenamin, *Flight Capital*, FORBES, Feb. 28, 1994, at 55. *See also* McMenamin, *Home Free*, *supra* note 5, at 110.
16. *See* Nancy Loube, *Expatriate Games: Politics Obscures Technical Issues*, 67 TAX NOTES 158, 158 ("After reading an article in Forbes magazine last fall about extremely wealthy Americans who expatriated to avoid U.S. taxation, Clinton asked Treasury for a remedy.").

significant number of people giving up U.S. citizenship do so for non-tax reasons.[17]

A. *Definition of Expatriation*

Expatriation means either abandoning the United States as a place of domicile or relinquishing the legal U.S. status of citizenship.[18] For the purposes of this comment, adopting the term's second definition is more appropriate due to the United States' system of taxation.[19] While most other countries tax their citizenry depending on where they are domiciled,[20] the United States taxes its citizens depending on their nationality status.[21]

Using a fictional example, if Mr. Mapleagle was born in the United States (and therefore was a U.S. citizen) but later in life moved to Canada and secured Canadian citizenship, he would owe taxes in both countries as long as he does not relinquish his U.S. citizenship (or even if he does relinquish his U.S. citizenship, as we shall soon learn, if he is rich enough).[22] Until recently, Mr. Mapleagle would have a hard time giving up his U.S. citizenship even if he wanted to.[23] In an age of increasing international movement of people and goods, the United States' use of nationality to determine tax status has become more difficult to enforce.[24]

B. *Tax Advantages of Expatriation*

As it stands currently, the effective tax rate for non-resident aliens is much lower than that for American citizens.[25] Because aliens "only pay

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17. *See* Doreen Carvajal, *Tax Leads Americans Abroad to Renounce U.S.*, N.Y. TIMES, Dec. 18, 2006, at A4 (quoting international tax lawyer Matthew Ledvina stating that U.S. citizens with second passports and almost no ties with the United States made up a large portion of requests for legal help on citizenship relinquishment; quoting spokesperson for London's American Embassy saying that expatriates generally "would like to simplify their lives by giving up a citizenship they are not using").

18. *See* Elise Tang, *Solving Taxpatriation: "Realizing" it Takes More than Amending the Alternative Tax*, 31 BROOK. J. INT'L L. 615, 616-19 n.7 (2006) (giving an explanation of the United States' "worldwide taxation" system).

19. *See id.*

20. *See id.* at 619.

21. *See* Walker, *supra* note 4, at 556.

22. A Wall Street Journal reporter describes a true story of an ethnic Chinese, who traveled around the world and changed nationalities multiple times for good reason, being ensnared by the IRS's worldwide taxation scheme. *See* Barry Newman, *Taxing Issue: How Do You Quit Being an American? With Great Difficulty—As Many Ruefully Find Out, Renouncing Citizenship Is Harder Than Ever—Making the 'List of Shame'*, WALL ST. J., Dec. 28, 1998, at A1.

23. *See id.* In this story a lawyer recounts a story about "an American woman who would come in every few months asking to turn her passport in [at an Embassy in Africa]. She was sent away." The American Embassy simply did not expect any "rational person [to give up] U.S. citizenship," and effectively told her that she was out of her mind. *Id.*

24. *See* Michael S. Kirsch, *The Tax Code as Nationality Law*, 43 HARV. J. ON LEGIS. 375, 432-34 (2006); *see also* Cynthia Blum & Paula N. Singer, *A Coherent Policy Proposal for U.S. Residence-Based Taxation of Individuals*, 41 VAND. J. TRANSNAT'L L. 705, 737 n.125 (2008).

25. *See* Karen DeWitt, *Some of Rich Find a Passport Lost is a Fortune Gained*, N.Y. TIMES, Apr. 12, 1995, at A1.

income taxes on selected income and gains from U.S. sources," their income tax burden is lower than that of citizens.[26] Unlike U.S. citizens, non-resident aliens can "earn unlimited capital gains on the U.S. stock markets."[27]

In addition, non-resident aliens that live in tax-shelter regimes could even, until recently, sell their stocks essentially tax-free before giving them to donees in the United States, again without incurring a tax obligation.[28] This freedom contrasts with U.S. citizens and permanent residents who will need more complex financial manipulations to minimize their estate tax burden.[29] Even though the federal estate tax is being scaled back to zero in the year 2010,[30] the maximum federal estate tax rate will hike back to 55% in 2011, its level in 2001, unless Congress takes action to make the repeal permanent.[31] The specter of facing such daunting estate taxes upon death may be a motivating factor for many tax-driven expatriates.[32]

C. *Return Visits for Expatriates*

In the past, these ex-Americans, after expatriation, were treated as non-resident aliens for both immigration and taxation purposes.[33] As recently as 2004, an expatriate could easily "visit" the United States for up to 120 days in a year and still remain a non-resident alien for tax purposes.[34] Specifically, after one year had passed from the expatriate's departure date, that expatriate would be taxed as a non-resident alien as long as he stayed in the United States for less than 120 days per year on

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26. Richard A. Westin, *Expatriation and Return: An Examination of Taxdriven Expatriation by United States Citizens, and Reform Proposals*, 20 VA. TAX REV. 75, 138 (2000); *see also* Tang, *supra* note 18, at 625.

27. Westin, *supra* note 26, at 138.

28. *See id.* at 89-90 (noting a few examples in the late 1990s where massive stock sales exploited the tax loophole). *See also* Jerry R. Dagrella, *Wealthy Americans Planning to Renounce Their Citizenship to Save on Taxes Have a New Problem to Consider: This Time Congress Means Business*, 13 TRANSNAT'L LAW. 363, 375 (2000) (giving an example where a citizen can have her entire estate "transferred to her heirs or gifted to relatives or friends with no tax liability").

29. *See* Deborah L. Jacobs, *A Little Planning Can Mean More for Heirs Later*, N.Y. TIMES, Nov. 14, 2007, at H0 (discussing estate planning options for business owners short of renouncing U.S. citizenship, including establishment of a charitable remainder trust among others).

30. *See* David E. Sanger, *President's Signature Turns Broad Tax Cut, and a Campaign Promise, Into Law*, N.Y. TIMES, June 8, 2007, at A22.

31. *See* Allan Sloan, *Doing a Big Favor for the 'Small Rich'*, NEWSWEEK, June 19, 2006, at 16.

32. *See* Westin, *supra* note 26, at 86 (suggesting a few reasons why the wealthy would rather leave the country than pay the heavy estate tax).

33. *See id.* at 174-75 (quoting the then Commissioner of the Immigration and Naturalization Service).

34. *See id.* at 175-76 (noting the scenarios for expatriates' return visits to the United States in 2000, the year of the article's publication).

average.[35] There were immigration rules that attempted to close this loophole,[36] but those rules were easily avoided with good legal advice.[37]

The addition of I.R.C. § 877(g) in 2004 significantly tightened the law with respect to the amount of days that may be spent in the United States.[38] Under that code, an ex-citizen or ex-green card holder that wished to remain non-resident for taxation purposes could visit the United States for up to 30 days per year.[39] In addition, that expatriate could spend another 30 days per year in the United States in the employ of an unrelated company.[40] While not as generous as 120 days per year, a well-advised expatriate could spend approximately two months per year in the United States, while relatives and friends will have to meet the expatriate outside the United States for the remainder of the year.[41]

In some cases, the influence of the expatriate's immense wealth over smaller governments could even bend the rules.[42] Kenneth Dart took his return visits one step further; Belize, his new host country, petitioned the United States to establish a new consulate in Mr. Dart's hometown,[43] in effect allowing Dart to expatriate without leaving the United States at all.[44] While the State Department rejected Belize's proposal, it seems at least arguably possible for a determined and resourceful expatriate to return to or visit the United States in a diplomatic capacity.

Taxation changes in 2008 freed expatriates from the I.R.C. § 877 regime.[45] Expatriates are currently considered non-residents and can return to the United States for visits as long as they do not trigger the residency conditions for falling under U.S. Federal taxation again.[46]

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35. *See* I.R.C. § 7701(b)(3)(A) (West 2008) (explaining the method by which taxpayers are determined to be residents of the United States for taxation purposes). Before I.R.C. § 877 was amended in 2004, I.R.C. § 7701 controlled the expatriate's tax burden after the first year of expatriation.

36. *See* Westin, *supra* note 26, at 105-08. Both revenue and immigration statutes have been enacted to discourage tax-driven expatriates returning to the United States. *See infra* Parts III-IV.

37. *See* Westin, *supra* note 26, at 176-77 (explaining how wealthy taxpayers could avoid the rule by not shedding citizenship outright, but rather by "taking out a new passport, taking a routine oath of allegiance and in time filing a form 1040NR evidencing an intention to terminate U.S. citizenship.").

38. *See* American Jobs Creation Act of 2004, H.R. 4520, 107th Cong. § 804(c) (2004).

39. *See* I.R.C. § 877(c)(2)(B)(iii) (West 2008).

40. *See* I.R.C. §§ 877(a)(2)(C), (c)(2)(B)(iii) (West 2008).

41. *Id.*

42. *See* Westin, *supra* note 26, at 89 (noting that Dart's daring behavior "indicates the power of great wealth over small governments").

43. *See* Art Buchwald, *Chutzpah Award*, BALTIMORE SUN, Oct. 12, 1995, at 13A (in which a syndicated columnist bestows a fictional "Chutzpah Award" for Mr. Dart's daring maneuver).

44. *See* I.R.C. § 7701(b)(5)(A)(i) (West 2008) (exempting diplomatic personnel from the physical presence test for taxation). It is unclear, given the conflicting provisions of § 7701(b)(5)(A)(i) and § 877(g), which would govern.

45. *See* I.R.C. § 877(h) (West 2008).

46. *See* STAFF OF JOINT COMM. ON TAXATION, 110TH CONG., TECHNICAL EXPLANATION OF H.R. 6081, THE "HEROES EARNINGS ASSISTANCE AND RELIEF TAX ACT OF 2008," 45 (Comm. Print 2008), *available at* http://www.jct.gov/x-44-08.pdf [herinafter TECHNICAL EXPLANATION OF H.R.

III. LEGAL HISTORY

A. *Early History: Perpetual Allegiance*

Expatriation was not an option for Americans under the common law.[47] Until the late 1800s, the United States followed a "perpetual allegiance" doctrine, meaning that "an individual had no legal right to forsake his sovereign."[48] The U.S. Supreme Court stated:

> [N]o persons [could] by any act of their own, without the consent of the government, put off their allegiance, and become aliens. If it were otherwise, then a femme alien would by her marriage become, ipso facto, a citizen, and would be dowable of the estate of her husband; which are clearly contrary to law.[49]

B. *The Expatriation Act of 1868*

The "perpetual allegiance" doctrine was not agreeable to an immigration-heavy nation like the United States.[50] In 1868, Congress passed the Expatriation Act and recognized the right of a citizen to relinquish his or her legal nationality status.[51] The Act stated that "any declaration, instruction, opinion, order, or decision of any officers of this government which denies, restricts, impairs, or questions the right of expatriation, is declared inconsistent with the fundamental principles of this government."[52] This Act enabled immigrant Americans to unilaterally renounce their nationality of origin,[53] but also opened the door to a potential escape from the U.S. tax regime.

C. *I.R.C. § 877 and the Foreign Investors Tax Act of 1966*

At the heart of the issue of taxation of expatriates is § 877 of the Internal Revenue Code, enacted in 1966.[54] Section 877 addresses

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6081] (stating that the "expatriation income tax rules under section 877 do not apply" to current expatriates).

47. *See* Dagrella, *supra* note 28, at 364.

48. *Id.* at 364-65.

49. Shanks v. Dupont, 28 U.S. 242, 246 (1830).

50. *See* Dagrella, *supra* note 28, at 368.

51. *See* Act of July 27, 1868, 15 Stat. 223, 223-24 (1868). *See also* T. Alexander Aleinikoff, *Theories of Loss of Citizenship*, 84 MICH. L. REV. 1471, 1475-76 (1986).

52. Act of July 27, 1868, 15 Stat. 223, 224 (1868).

53. *See* Afroyim v. Rusk, 387 U.S. 253, 288 (1967) (analyzing the "purposes and background of the Act," noting "repeated requests both from President Andrew Johnson and from the public that Congress assert the rights of naturalized Americans against the demands of their former countries").

54. *See* Foreign Investors Tax Act of 1966, Pub. L. No. 89-809, 103(f), 80 Stat. 1539, 1539 (1966).

expatriation to avoid tax, defining first the aliens and individuals that fall under the section,[55] then listing the alternative tax scheme that these expatriates fall under.[56]

Before 1966, if a foreign person (non-resident alien or corporation) had a permanent establishment in the United States, that non-resident alien's non business-related investment income was treated as if it was regular U.S. income, and taxed at regular U.S. tax rates.[57]

The Foreign Investors Tax Act of 1966 ("FITA") introduced the alternative tax regime that was embodied in I.R.C. § 877(a)(1), which stated that "[e]very nonresident alien individual who, within the 10-year period immediately preceding the close of the taxable year, lost U.S. citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes . . . shall be taxable for such taxable year . . . ."[58] Gains from sale of U.S. property as well as sales of stock and debt of U.S. entities were considered U.S. sourced income for § 877 purposes.[59]

It is worthy to note that § 877 only applied to expatriates who departed from the United States for the purpose of reducing their tax burden.[60] However, the FITA-enacted § 877 was a morass of administrative detail for both the IRS and the taxpayer.[61] The IRS had the burden of proof to show by a reasonable person standard that the expatriate's exit would cause a significant decrease in their U.S. income tax.[62] Also, the FITA § 877 treated expatriation for income tax evasion separately from expatriation for gift or estate tax evasion.[63] Even if the IRS could establish that a taxpayer's expatriation would substantially favor his income tax, it would need to make a separate argument over again (and would again have to meet its burden of proof first) to prove the same motive towards minimization of estate and gift tax.[64]

55. *See* I.R.C. § 877(a) (West 2008). I.R.C. § 877(a) outlines the ten year period rule that remains in effect today for individuals who expatriated before the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act) was enacted. *Id*.

56. *See* I.R.C. § 877(b) (West 2008).

57. See Eva Farkas-DiNardo, *Is the Nation of Immigrants Punishing Its Emigrants: A Critical Review of the Expatriation Rules by the American Jobs Creation Act of 2004*, 7 FLA. TAX REV. 5, 20 n.68 (2005).

58. Foreign Investors Tax Act of 1966, Pub. L. No. 89-809, sec. 103(f), § 877(a)(1), 80 Stat. 1539, 1551 (1966).

59. *Id.* at sec. 103(f), § 877(c), 80 Stat. 1539, 1552 (1996).

60. *See* Farkas-DiNardo, *supra* note 57, at 21.

61. *See id*. at 22-23 (explaining the design flaws in FITA).

62. *Id.* at 22.

63. *Id.*

64. *Id*. at 22-23.

In addition, the remaining U.S. source income that would otherwise be taxed under the U.S. tax regime could be converted or taken out of the reach of the IRS with the right tax-management advice.[65]

D. *The Health Insurance Portability and Accountability Act of 1996*

In 1996, Congress enacted the Health Insurance Portability and Accountability Act ("HIPAA"),[66] which contained significant amendments to I.R.C. § 877.[67]

HIPAA included green-card holders who relinquish their permanent residency to the list of expatriate taxpayers affected by I.R.C. § 877.[68] HIPAA also adopted an immigration-based rule in determining when expatriation occurs for taxation purposes.[69]

HIPAA added the rule that if the expatriate taxpayer met several tax liability and net worth tests, he was presumed to have expatriated for the purpose of tax avoidance and was thus subject to the alternative tax regime reserved for expatriates.[70] Expatriates could claim that their intent behind their departure was not tax-driven in order to avoid falling under that section,[71] but to do so, the expatriate would need to request a private letter ruling from the IRS.[72] What is more, expatriate citizens (not permanent residents) deemed to be tax-driven could be barred from re-entry to the United States due to separate immigration legislation that went to effect in the same timeframe as HIPAA.[73]

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65. *See id.* at 23 (explaining and giving several examples of how the pre-1966 expatriate could minimize his U.S.-source income).

66. *See* Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, sec. 511-513, § 877, 110 Stat. 1936, 2093-2102 (1996).

67. *Id.*

68. *See* Farkas-DiNardo, *supra* note 57, at 24 (explaining the addition of I.R.C. § 877(e)).

69. *Id.*

70. *See id.* at 24-25 (explaining the tax liability test, "[a]n individual was deemed to have expatriated with a principal purpose of avoiding U.S. taxes if . . . her average annual U.S. federal income tax liability for the five taxable years ending before the date of loss of U.S. citizenship or termination of U.S. residency was greater than $100,000," and the net worth test, "[the individual's] net worth as of the date of such loss or termination was $500,000 or more"). *See also* Westin, *supra* note 26, at 90. This change moved the initial burden of proof from the Government to the taxpayer, and made it more practical for IRS to enforce the provisions on possible infractions.

71. *See id.* at 91.

72. *See* Patrick W. Martin et al., *International Tax Update: American Jobs Creation Act of 2004 and Other New Developments*, 9TH ANNUAL SAN DIEGO TAX AND ACCOUNTING INSTITUTE, Nov. 3, 2005, http://www.procopio.com/publications/pdfs/ IntlTaxUpdate_AJCAct2004.pdf.

73. *See* Westin, *supra* note 26, at 176. There are harsh immigration penalties for such expatriates according to the Immigration and Naturalization Act ("INA"), but the article also notes that "[i]t is not enough that the I.R.S. consider this the case; by the terms of the INA, the Justice Department must in effect have so certified the person." *Id.* The article further notes that "[i]n reality, the [INA] rule is avoidable." *Id.*

The expatriate tax regime itself was also altered by the HIPAA changes.[74] Like the FITA-legislated code, the 1996 I.R.C. § 877 applied for a period of ten years after the taxpayer expatriated or relinquished her green card.[75] However, "the expatriate was not taxed on her foreign-source income and she was allowed to take deductions only to the extent such deductions were connected with the gross income taxable under § 877, except that no capital loss carryover was allowed."[76] Source conversion rules were also added that included a) gains on sale of property (other than stock or debt), b) gains on sale of stock issued by a U.S. corporation, c) gains on debt obligations of a U.S. person or Government, d) gains from a controlled foreign corporation where the expatriate owned ten percent or more of the voting power and fifty percent of the total value of that corporation's stock.[77]

On the estate tax front, HIPAA amended the Internal Revenue Code to state that if the expatriate taxpayer died within the ten years after he relinquished his citizenship or permanent residency, his estate would be subject to U.S. estate taxes,[78] including U.S. situs assets and stocks of controlled foreign corporations that are owned by the expatriate.[79]

The HIPAA amendments to I.R.C. § 877 were more powerful and enforceable than the original FITA version, but a few major loopholes became apparent. One was that a resourceful, wealthy taxpayer could carefully time his filing of various papers over several years surrounding his intended departure from the United States;[80] by doing so, he can effectively choose his expatriation date retroactively, up to five years or more past his actual departure date.[81]

The expatriate could, after leaving the United States, make gifts to U.S. donees in the form of shares in foreign-owned corporations.[82] Such gifts would be tax-exempt even if the foreign-owned corporation owned

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74. *See* Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, sec. 511-513, § 877, 110 Stat. 1936, 2093-2102 (1996).

75. Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, sec. 511, § 877(a)(1), 110 Stat. 1936, 2093 (1996).

76. Farkas-DiNardo, *supra* note 57, at 27.

77. *See id.*

78. *See* Westin, *supra* note 26, at 145.

79. *See* Farkas-DiNardo, *supra* note 57, at 28.

80. *See* Westin, *supra* note 26, at 108 (explaining the trick in detail: in order to obtain the convenience of claiming a range of dates for expatriation, the wealthy taxpayer would "adopt Costa Rican citizenship in year one and in year six elect to file a Form 1040NR as a nonresident alien").

81. Properly followed, the trick would allow the expatriate to argue "any number of dates for the date of expatriation." *Id.*

82. *See id*. at 170.

property in the United States.[83] The donee, of course, would have to deal with the IRS reporting requirements on his end.[84]

Another, perhaps more serious, loophole turned out to be a by-product of the presumption of tax-avoidance motive itself.[85] Although wealthy expatriates who failed the twin net-worth and tax liability tests needed to request a private letter ruling from the IRS to overcome the presumption of tax-avoidance motive,[86] in reality the IRS was quite lax in granting such rulings.[87] According to *Forbes*, about half of the 270 applications for the private letter rulings between 1997 and July 2002 received favorable responses from the IRS, and all but 11 of the remainder received neutral responses.[88] Applicants that received either favorable or neutral responses could continue with their lives with little fear from the IRS's alternative tax regime.[89] "In theory the IRS could later audit the 'neutral' [applicants] and assess a tax, but there is little evidence this happened."[90] Most telling is an admission from the U.S. Treasury that "significant numbers of wealthy citizens have continued to expatriate since the expatriation tax laws were amended in 1996."[91]

E. *The American Jobs Creation Act of 2004*

The U.S. Congress enacted the American Jobs Creation Act ("AJCA") in 2004,[92] perhaps in an attempt to close these loopholes. The AJCA made five major changes to I.R.C. § 877 and its related regulations.

1. Objective Test for Tax-driven Expatriation

A conclusive test based on the same income or net-worth bar replaced the previous presumption that an American wished to relinquish citizenship

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83. *See id.* at 169-70.

84. *See id*. at 155 (noting that "U.S. donees of large gifts from foreign donors must report their gifts on Form 3520 or face a stiff civil tax penalty," but the reporting requirements do not force the donee to disclose the identity of the donor).

85. *See* Ashlea Ebeling, *The Long Good-Bye*, FORBES, Mar. 28, 2005, at 92.

86. *See* Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, sec. 511(b)(1), § 877(c)(1)(B), 110 Stat. 1936, 2094 (1996) (stating that an exemption can be granted if "within the 1-year period beginning on the date of the loss of United States citizenship, such individual submits a ruling request for the Secretary's determination as to whether such loss has for one of its principal purposes the avoidance of taxes").

87. *See* Ebeling, *supra* note 85, at 92.

88. *Id.*

89. *See id.*

90. *Id.*

91. STAFF OF JOINT COMM. ON TAXATION, 108TH CONG., 1ST SESS., REVIEW OF THE PRESENT-LAW TAX AND IMMIGRATION TREATMENT OF RELINQUISHMENT OF CITIZENSHIP AND TERMINATION OF LONG-TERM RESIDENCY app. 26, at A-26 (Comm. Print 2003), [hereinafter REVIEW OF THE PRESENT-LAW TAX], *available at* http://www.house.gov/jct/s-2-03.pdf (a letter from the U.S. Treasury to the Joint Committee in response to questions about the effectiveness of the 1996 amendments).

92. *See* American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418.

for tax-avoidance purposes.[93] The post-AJCA test included three conditions, but only one of the conditions is required for the taxpayer to be considered a tax-motivated expatriate.[94]

Income Tax — The taxpayer's "average annual net income tax . . . for the period of 5 taxable years ending before the date of the loss of United State citizenship is greater than $124,000"[95] in 2004 dollars, adjusted for inflation in subsequent years.[96]

Net Worth — The taxpayer's net worth as of the date of the loss of U.S. citizenship is equal to or greater than two million dollars.[97]

Legal Compliance — The taxpayer does not "certify under penalty of perjury that he has met the requirements of this title for the five preceding taxable years or fails to submit such evidence of such compliance as the Secretary may require."[98]

Note that the taxpayer's intent for expatriating was no longer a relevant consideration under the post-AJCA test.[99] The taxpayer may genuinely not have tax evasion in mind when renouncing her U.S. citizenship, but if that taxpayer had a high enough income, enough money in the bank, or was remiss in filing her affidavit, then she fell under § 877 with no options to escape its scope.[100]

A small loophole remained and allowed taxpayers that enjoy dual citizenship with no substantial contacts with the United States to escape the alternative tax scheme.[101]

2. Notification Requirement to the Department of Homeland Security

Individuals, such as expatriates and permanent residents, who abandon their citizenship or residency will continue being taxed as a citizen or resident until they formally file a renunciation of citizenship or residency

93. *See* Martin, *supra* note 72.

94. American Jobs Creation Act of 2004, Pub. L. No. 108-357, sec. 804(a)(1), § 877(a)(2), 118 Stat. 1418, 1569.

95. *Id.* at sec. 804(a)(1), § 877(a)(2)(A), 118 Stat. 1418, 1569.

96. *See* Marco A. Blanco et al., *The Noose Tightens: The New Expatriation Provisions*, 106 TAX NOTES 91, 92 (Jan. 3, 2005), *available in* TAX NOTES TODAY, 2005 LEXIS TNT 2-36 [hereinafter Blanco et al., *The Noose Tightens*].

97. American Jobs Creation Act of 2004, Pub. L. No. 108-357, sec. 804(a)(1), § 877(a)(2)(B), 118 Stat. 1418, 1569.

98. *Id.* at sec. 804(a)(1), § 877(a)(2)(C), 118 Stat. 1418, 1569.

99. *See* Farkas-DiNardo, *supra* note 57, at 20-21.

100. Given the way § 877 was structured, there was even the theoretical possibility of emigrants with no income and minimum financial resources being caught in the web of the alternate taxation scheme because of a failure to certify or to produce proof of such in a timely manner. *See id*.

101. *See* Martin, *supra* note 72. However, since the loophole is very specific (involving dual citizenship at birth and some other narrow exceptions), it was not likely to be abused. *See* American Jobs Creation Act of 2004, Pub. L. No. 108-357, sec. 804(a)(2), § 877(c), 118 Stat. 1418, 1569-1570. (describing exceptions, including dual citizenship at birth).

with the Department of Homeland Security.[102] This requirement represented the attempt to force the hand of long-time permanent residents regarding their ultimate immigration intent.[103] The AJCA introduced a change in I.R.C. § 7701(n) stating that a long-term resident shall be treated as a permanent resident of the United States unless and until he formally gave "notice of . . . termination of residency (with the requisite intent to . . . terminate residency) to the . . . Secretary of Homeland Security" and provided a formal statement.[104]

The effect of the additional requirement was that permanent U.S. residents would think twice before giving up their green cards.[105] After all, these residents would need to relinquish their permanent resident status in order to be considered a non-U.S. resident for taxation purposes.[106]

As a matter of fact, the 2004 tax year was the last year that anyone could claim foreign residence under a treaty.[107]

3. Closure of the 180-Day Visitation Loophole

The 180-day visitation loophole was closed with the AJCA.[108] For the first ten years after initial expatriation, the expatriate taxpayer could only return to the United States for thirty days per year (plus another thirty days possibly for work under an unrelated employer)[109] if she did not wish to be considered a U.S. resident for that tax year for taxation purposes.[110] Thus, unless one would pursue the more far-fetched diplomatic option that Mr. Dart explored,[111] the wealthy expatriate would only be able to return to

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102. American Jobs Creation Act of 2004, Pub. L. No. 108-357, sec. 804(b), § 7701(n), 118 Stat. 1418, 1570.

103. Marco A. Blanco & John Kaufmann, *The New Section 877: Everything You Ever Wanted To Know About the Expatriation of Long-Term Permanent Residents Under the New Act but Were Afraid to Ask the Government*, 106 TAX NOTES 1, 6 (Jan. 3, 2005) [hereinafter Blanco & Kaufmann, *The New Section 877*].

104. American Jobs Creation Act of 2004, Pub. L. No. 108-357, sec. 804(b), § 7701(n), 118 Stat. 1418, 1570.

105. *See* Blanco & Kaufmann, *The New Section 877*, *supra* note 103, at 6.

106. *Id.*

107. In *The Noose Tightens*, the authors recommended that "anyone who can claim foreign residence under a treaty but has not already done so, should do so by no later than the due date for their 2004 return," in order to escape the harsher AJCA provisions. Blanco et al., *The Noose Tightens*, *supra* note 96, at 94.

108. *See* Farkas-DiNardo, *supra* note 57, at 34-35; *see also* Kirsch, *supra* note 24, at 402-03.

109. American Jobs Creation Act of 2004, Pub. L. No. 108-357, sec. 804(c), § 877(g)(2)(A), 118 Stat. 1418, 1571. The "unrelated employer" condition was further conditioned on the expatriate born, married, issuing children or the expatriate's parents being born in a foreign country, the expatriate becoming "a citizen or resident of the country," and on the expatriate becoming "fully liable for income tax in such country." American Jobs Creation Act of 2004, Pub. L. No. 108-357, sec. 804(c), § 877(g)(2)(B), 118 Stat. 1418, 1571.

110. American Jobs Creation Act of 2004, Pub. L. No. 108-357, sec. 804(c), § 877(g)(1), 118 Stat. 1418, 1570-71.

111. *See supra* text accompanying notes 42-44.

the United States for up to sixty days a year without being taxed on her worldwide assets.[112]

4. Taxation on Stock Transfers of Foreign-owned Companies with U.S. Assets

The AJCA closed the loophole in which taxpayers would give shares of such foreign-owned corporations to U.S. donees, where previously such gifts would be tax-exempt even if the foreign-owned corporation owned property in the United States. The AJCA added tax liability to gifts made of foreign-owned corporations, making these gifts taxable with the amount prorated by the U.S. asset holdings of those corporations.[113]

5. Additional Reporting Requirements and Penalties

The 2004 Act also amended § 6039G of the Internal Revenue Code.[114] This section outlined the reporting requirement for recently-expatriated American citizens.[115] While the pre-2004 law only required the taxpayer to report her foreign address and list of assets and liabilities to the IRS for the year she expatriated, the 2004 Act required the taxpayer to make the same disclosure for each year she fell under § 877,[116] under threat of a hefty $10,000 penalty.[117] The implied threat, beyond the lump-sum penalty, was that the expatriate's movements after departure could be tracked much more closely by the IRS.[118]

The 2004 changes reflected the direction that the IRS was taking in removing the incentives for the wealthy American to expatriate in order to avoid taxes.[119] While the rules were certainly more restrictive than § 877's earlier incarnations, for the ultra-wealthy these amendments only served to subtly alter the calculus the estate tax attorney performed when advising his client on minimizing her tax burden upon relinquishment of U.S.

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112. *See* American Jobs Creation Act of 2004, Pub. L. No. 108-357, sec. 804(c), § 877(g), 118 Stat. 1418, 1570-71.

113. *See* Blanco et al., *The Noose Tightens*, *supra* note 96, at 93.

114. American Jobs Creation Act of 2004, Pub. L. No. 108-357, sec. 804(e)(1), § 6039G, 118 Stat. 1418, 1572.

115. *See* Blanco et al., *The Noose Tightens*, *supra* note 96, at 92.

116. American Jobs Creation Act of 2004, Pub. L. No. 108-357, sec. 804(e)(1)-(2), § 6039G(a)-(b), 118 Stat. 1418, 1572-73.

117. *Id.* at sec. 804(e)(3), § 6039G(d), 118 Stat. 1418, 1573.

118. *See* Tang, *supra* note 18, at 634. Specifically, "information regarding the relocation activities of former citizens, as well as more information regarding income generated by assets, and any dispositions of assets that would result in the imposition of U.S. taxes" can be potentially collected. *Id.*

119. *See id.* at 638 (Stating that the AJCA "reduced the number of exceptions that allow a former citizen to escape the alternative tax regime from four to two. The increased chance of being placed in the alternative tax regime should act as a further deterrent from taxpatriating since there are fewer loopholes.").

citizenship.[120] Also, the expatriate could always borrow against her assets while she waited out the ten post-expatriation years under the alternative tax regime, since loan proceeds are not considered income;[121] estate tax-wise, she could minimize her estate tax burden by employing management techniques used by other wealthy U.S. citizens well before (and after) expatriation.[122]

F. *Legislative Actions prior to the HEART Act*

The AJCA amendments to § 877 had limited success in slowing the tide of ultra-wealthy Americans exiting to avoid U.S. taxation.[123] In terms of raw numbers,[124] there had not been a significant trend upwards or downwards in the number of expatriates renouncing ties to the United States; the number of expatriates went from 471 in 2003 and 631 in 2004 (presumably pre-AJCA), through 762 in 2005 to 279 in 2006 and 326 through three quarters of 2007.[125]

The low number of expatriates each year makes statistical analysis difficult; but if anything, the dip in 2006 could be attributed to people renouncing their U.S. ties before a tax hike passed in 2005[126] rather than any legislation aimed at tax-driven expatriates.

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120. *Cf.* Farkas-DiNardo, *supra* note 57, at 39 (discussing the various tax treatments for different sectors of the taxpaying public). One simple workaround for expatriates is to "avoid U.S. tax on certain items by refraining from any sale or exchange" in the ten years after expatriation. *Id.*

121. *See* Westin, *supra* note 26, at 152 (noting that the expatriate can borrow against his U.S. assets). *See also* Robert Lenzner, *And Don't Come Back*, FORBES, Nov. 18, 1996, at 44.

122. *See* Walker, *supra* note 4, at 562-63.

123. *See* Carvajal, *supra* note 17, at A6. With the ultra-wealthy generally keeping a low profile to avoid incurring the wrath of the IRS, it is difficult to keep tabs on any change in tax-driven expatriation of the very rich; however, the changes have certainly taken the heat off the tax-driven expatriation issue, and we have not seen the same volume of coverage on it as the mid- to late-1990s. Walker, *supra* note 4, at 556.

124. The raw numbers are available because the IRS is required to "publish in the Federal Register the name of each individual losing United States citizenship (within the meaning of section 877(a)) . . ." I.R.C. § 6039G(d) (West 2008).

125. In 2007 thus far (three out of four quarters available), 326 people were listed in the Federal Register as expatriates. 72 Fed. Reg. 63,237 (Nov. 8, 2007); 72 Fed. Reg. 44,228 (Aug. 7, 2007); 72 Fed. Reg. 26,687 (May 10, 2007). In 2006, 279 people were listed. 72 Fed. Reg. 5103 (Feb. 2, 2007); 71 Fed. Reg. 63,857 (Oct. 31, 2006); 71 Fed. Reg. 50,993 (Aug. 28, 2006); 71 Fed. Reg. 25,648 (May 1, 2006). In 2005, 762 people were listed. 71 Fed. Reg. 6312 (Feb. 7, 2006); 70 Fed. Reg. 68,511 (Nov. 10, 2005); 71 Fed. Reg. 68,901 (Nov. 28, 2006); 70 Fed. Reg. 23,295 (May 4, 2005). In 2004, 631 people were listed. 70 Fed. Reg. 5511 (Feb. 2, 2005); 69 Fed. Reg. 61,909 (Oct. 21, 2004); 69 Fed. Reg. 61,908 (Oct. 21, 2004); 69 Fed. Reg. 61,907 (Oct. 21, 2004). In 2003, 471 people were listed. 69 Fed. Reg. 61,910 (Oct. 21, 2004); 69 Fed. Reg. 61,906 (Oct. 21, 2004); 68 Fed. Reg. 44,840 (July 30, 2003); 68 Fed. Reg. 23,180 (Apr. 30, 2003).

126. The Tax Increase Prevention and Reconciliation Act of 2005 ("TIPRA") revised I.R.C. § 911 and "sharply increased" the tax burden on U.S. citizens working abroad by raising "tax rates for those with incomes of more than $82,400 a year. The legislation also increases taxes on employer-provided benefits like housing allowances." *See* Carvajal, *supra* note 17, at A6. Discussion of TIPRA's effects are outside the scope of this comment, as its effects are more sharply felt by the upper-middle class rather than the ultra-wealthy; suffice it to say that it makes dual citizenship much more expensive for U.S. citizens working or domiciled abroad.

The dubious success of I.R.C. § 877 in reducing tax-motivated expatriation had not daunted Congress.[127] Post-2004 legislative proposals to the tax expatriation picture were aimed at further curbing the practice; however, these proposals met with varying success until the HEART Act in 2008.[128]

1. Exit Tax Initiatives

a. Notable 2004 Initiatives

In 2003, the Treasury Department sent a letter to the Joint Committee on Taxation recommending a "mark-to-market" system, which was effectively an exit tax on expatriates.[129] This change would have made expatriation a realization event, as if the expatriate had cashed out all her investments and foreign assets on the day before leaving the United States. This change, if implemented, would have taxed expatriates' foreign assets and unrealized capital gains in addition to existing liquid, U.S. assets.[130] However, Congress did not follow the Treasury Department's recommendation and instead proceeded with tightening the grip of the existing I.R.C. § 877.[131]

b. Notable 2005-06 Initiatives

The Senate of the 109th Congress approved and attempted to push through an exit tax in 2005 in the form of S. 2020, added to H.R. 4297 (The Tax Relief Extension Reconciliation Act of 2005) and passed in early 2006.[132] The Senate proposed a disposition tax on wealthy expatriates,[133] with a $600,000 (for individuals) or $1.2 million (for married couples)

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127. *See infra* Part V.A.

128. Of the exit tax proposals discussed in this subsection, none have been enacted. *See infra* Part III.F.1.

129. *See* REVIEW OF THE PRESENT-LAW TAX, *supra* note 91, at A-26.

130. *See* Tang, *supra* note 18, at 637 n.157 (giving a detailed account of the IRS practice of taxing only realized gains).

131. *See* Tang, *supra* note 18, at 637. While Congress did follow the Department of Treasury's recommendations for tightening I.R.C. § 877, "Congress made [the decision to not impose a mark-to-market system] . . . despite the Treasury Department's determination that 'mere modifications' to the alternative tax system could not fully address inherent problems with the current law, and that alternative avenues of taxation would be more effective in deterring tax-motivated expatriation." *Id.* (citations omitted).

132. *See* Charles M. Bruce et al., *The Exit Tax — A Perfectly Bad Idea*, 2006 TAX NOTES INT'L, 867, 867-68 [hereinafter Bruce et al., *Bad Idea*].

133. *Cf. id.* at 871 ("The individual would continue to pay U.S. income taxes at the rates applicable to U.S. citizens following expatriation on any income generated by the . . . disposition of the property."). The expatriate would be able to "make an irrevocable election to continue to be taxed as a U.S. citizen regarding all property that otherwise is covered by the expatriation tax," but she would not be able to choose which of her assets on which the expatriate tax would apply; it would be all or nothing. *Id.*

exemption on gains.[134] Even though the language passed in the Senate and arrived at the conference committee's desk, it did not make it into the final bill signed by President Bush.[135] The exit tax provision was slipped in quietly on much larger, more popular legislation,[136] and it was removed just as quietly from the version ultimately placed on the President's desk.[137]

c. Notable 2007-08 Initiatives

In February 2007, the Senate approved the Small Business and Work Opportunity Act of 2007.[138] The Act itself contained popular initiatives such as a minimum wage hike and small business tax breaks;[139] the Senate again inserted the exit tax provisions into the bill, expecting it to be signed into law.[140]

There were alarmed parties that signaled that the exit tax may finally be enacted,[141] but the exit tax language was again removed from the bill after the House and Senate committees agreed on a final bill.[142]

In July 2007, the House proposed the Tax Collection Responsibility Act of 2007, which again contained the exit tax provisions.[143] This Act passed the House in October, but did not see movement after it was referred to the Committee on Finance in the Senate.[144]

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134. *Id.* ("US $600,000 (US $1.2 million in the case of married individuals filing a joint return, both of whom relinquish citizenship or terminate residency).")

135. H.R. 4297 eventually became TIPRA. *See* Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109-222, 120 Stat. 345 (2006).

136. *See* Bruce et al., *Bad Idea*, *supra* note 132, at 874 (noting that "[t]he provisions are buried in a large piece of legislation. They have not received much attention. There apparently are no interested parties speaking out. The administration has not stated its position on the subject.")

137. *See supra* note 135 and accompanying text. No one is able to eavesdrop on the negotiations that occur in closed committee, but the very fact that there are Tax Notes articles and analysis on the proposed legislation illustrates that there are parties involved that would like the Exit Tax removed from the bill.

138. *See* S. 349, 110th Cong. (2007). *See also* Charles M. Bruce et al., *Exit Tax: Eying the Turnstile, Again*, 12-5 BENDER'S IMMIGR. BULL. 1 (2007).

139. *See generally* S. 349, 110th Cong. §§ 101-16 (2007).

140. The exit tax provisions here were virtually the same as the suggestions made by the Treasury Department in its report to the Joint Committee on Taxation in 2003 as well as the exit tax provisions added to H.R. 4297 in 2005. *See id.* § 205.

141. *See* Baker & McKenzie, *GL – New "Exit Tax" Proposed for U.S. Expatriates*, EMPLOYMENT NEWSLETTER, Apr. 2007, http://www.bakernet.com/NR/rdonlyres/ C3A1AD9D-5CE6-4CF5-9E10-5DE7D9C0993D/0/global_employment_news_apr07.pdf (stating that "[t]his time there does seem to be a much greater likelihood that the proposal will become law").

142. The final bill presented was H.R. 2206, U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act of 2007, and was signed into law on May 25, 2007. H.R. 2206, 110th Cong. (2007).

143. *See* H.R. 3056, 110th Cong. § 5 (2007). The bill mainly concerns ending the IRS's program of private debt collection. *See id.* § 2.

144. *See* Blum & Singer, *supra* note 24, at 733 n.107 (stating that "variations between the House and Senate versions of H.R. 3997 [including H.R. 3056] were not resolved").

In late 2007, the House introduced the Heroes Earnings Assistance and Relief Tax Act of 2007.[145] This legislation passed in the Senate in December of the same year as the Defenders of Freedom Tax Relief Act of 2007 ("FTRA").[146] However, the FTRA idled and died in committee in early 2008, perhaps due to squabbling between the House and Senate regarding unrelated language in the bill.[147]

2. Effects of Initiatives

If anything, these initiatives served to alarm potential U.S. citizens; potential immigrants would think twice before stepping into the intricate web that was U.S. taxation and its ten-year post-expatriation provisions.[148]

G. *The Heroes Earnings Assistance and Relief Tax Act of 2008*

After these numerous false starts, the U.S. Congress passed the Heroes Earnings Assistance and Relief Tax Act ("HEART Act") in June 2008.[149] With that act, Congress enacted the long-expected exit tax scheme.[150] The post-HEART code is the law applied to prospective expatriates today, with the earlier AJCA alternative tax regime applying only to legacy cases.[151]

1. Defining Covered Expatriates and "Long-term Residents"

Whether a U.S. citizen or long-term resident is covered by the new I.R.C. § 877A, that is, whether that person is considered a covered expatriate in the new tax code, depends on whether that person meets any one of three factors.[152] These factors (Income Tax, Net Worth and Legal Compliance) are substantially the same as the objective, pre-HEART Act test for the AJCA alternative tax regime.[153] Notably, an expatriate, once

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145. *See* H.R. 3997, 110th Cong. (2007). Again, the main provisions of the bill contained such popular items as tax relief and protection for the military and its veterans. *See, e.g.*, *id.* §§ 101-14, 201-04. It is of academic interest that even though the HEART Act of 2007 died in Congress due to inaction, it became the vehicle for the infamous, failed $700 billion financial bailout House bill that started a Wall Street meltdown on Sept. 29, 2008. *See* H.R. 1424, 110th Cong. (2008) (for similar, Senate-backed version).

146. *See* Defenders of Freedom Tax Relief Act of 2007, S. 1593, 110th Cong. §1 (2007).

147. "Although both houses of Congress have approved the measure, it's part of a larger bill for military tax relief (H.R. 3997). And, the Senate objected to the House version of that bill because it contains a US$565 million outlay for volunteer firefighters." Mark Nestmann, *Asset Protection BLOG* (Dec. 20, 2007), http://nestmannblog.sovereignsociety.com/2007/12/index.html.

148. *See* Westin, *supra* note 26, at 92.

149. *See* Heroes Earnings Assistance and Relief Tax Act of 2008, H.R. 6081, 110th Cong. (2008).

150. *See supra* Part III.F.1.

151. *See* I.R.C. § 877(a) (West 2008).

152. *See* I.R.C. § 877A(g)(1) (West 2008).

153. *See* I.R.C. § 877A(g)(1)(A) (West 2008) (referring back to I.R.C. § 877(a)(2) for general definition of "covered expatriate").

deemed covered by I.R.C. § 877A, is covered perpetually since her covered expatriate status depended only on her finances at or around the time of her expatriation.[154]

A "long-term resident" is defined in generally the same way as in the AJCA.[155] Also, the AJCA test for determining when a long-term resident has abandoned her residency remains in I.R.C. § 877A:[156] The § 877A test is met when an individual "ceases to be a lawful permanent resident of the United States (i.e., loses his or her green card status through revocation or has been administratively or judicially determined to have abandoned such status)."[157] However, the HEART Act amends I.R.C. § 7701(b)(6) to state that an ex-green card holder will no longer be treated as a permanent resident for tax purposes if she a) begins being treated as a taxable resident of another country "under a tax treaty between the United States and such foreign country"; b) chooses not to waive the benefits for which she would otherwise qualify as resident of the foreign country under the treaty; and c) notifies the Secretary of the Internal Revenue Service "of the commencement of such treatment."[158]

On the reporting front, post-HEART Act expatriates are still governed under the same I.R.C. § 6039G rules as expatriates under the AJCA regime.[159]

2. The Exit Tax

The HEART Act enacted a mark-to-market tax, or an exit tax as the tax is more commonly known.[160] A covered expatriate who relinquishes her citizenship or permanent residency in the United States is "subject to income tax on the net unrealized gain" in her property as if she had sold it on the day before she expatriated.[161] The gains and losses from the constructive sale are calculated,[162] and any net gain beyond $600,000 in 2008 dollars is subject to the exit tax.[163] The exit tax simplifies the expatriation taxation picture significantly by no longer requiring every

154. *See* I.R.C. § 877A(g) (West 2008) (containing no mention of an expiry of the covered expatriate status).

155. *See* I.R.C. § 877A(g)(5) (West 2008) (referring back to I.R.C. § 877(e)(2) for definition of "long-term resident").

156. *See* TECHNICAL EXPLANATION OF H.R. 6081, *supra* note 46, at 40.

157. *Id.*

158. *Id.* Individuals are also excepted if they are born with dual citizenship or if they are a citizen who "relinquishes U.S. citizenship before reaching age 18 1/2." *Id.*

159. *See id.* at 46.

160. *See* Baker & McKenzie, *supra* note 141 (stating that "the Exit Tax would impose a 'mark-to-market' regime").

161. TECHNICAL EXPLANATION OF H.R. 6081, *supra* note 46, at 39.

162. *Id.* However, any "loss from the deemed sale generally is taken into account to the extent otherwise provided in the Code, except that the wash sale rules of section 1091 do not apply." *Id.*

163. *Id.* (stating that the exemption "is increased by a cost of living adjustment factor for calendar years after 2008").

covered expatriate to file (and the IRS to track) her income for ten years after expatriation.[164]

The HEART Act imposes a tax withholding requirement on all nongrantor trusts, foreign or domestic, that make taxable distributions to a covered expatriate.[165] Also, any and all tax deferrals or time extensions are treated as terminated "on the day before the expatriation date."[166] In addition, the basis of property that the covered expatriate was holding when she first became a U.S. resident, held throughout her U.S. residency for taxation purposes, and was still holding when she expatriated "will be stepped up (or down) to its fair market value on such date."[167]

Finally, there are also several other, minor exceptions to the exit tax.[168]

3. The Succession Tax

The IRS added a new section, I.R.C. § 2801, designed to govern gifts or bequests from covered expatriate donors to their U.S. donees.[169] These estate and gift tax provisions, hereinafter referred to collectively as the "succession tax,"[170] cover any "direct or indirect gift or bequest," and imposes a tax rate that is equivalent to "the highest applicable gift or estate tax rates."[171] Notably, the tax is imposed on the *donee* rather than the expatriate donor, perhaps in recognition of the difficulties of securing tax payments from an expatriate who does not reside in the United States, is no longer a U.S. citizen or permanent resident, and has no plans of crossing paths with the country again.[172]

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164. *See* I.R.C. § 877A(a)(1) (West 2008) (noting all property of the expatriate "shall be treated as sold on the day before the expatriation date for its fair market value").

165. *See* I.R.C. § 877A(f)(1)(A) (West 2008).

166. I.R.C. § 877A(h)(1)(A)-(B) (West 2008).

167. Michael G. Pfeifer, *The Final State of Expatriation?*, 2008 ALI-ABA COURSE STUDY JULY 31 – AUG. 1, 2008, INT'L TR. & EST. PLAN. 877, 889 (2008). This basis adjustment applies "solely for purposes of calculating the mark-to-market tax." *Id.* The covered expatriate can choose not to apply this basis rule; the choice, however, is irrevocable. *Id.*

168. These exceptions include deferred compensation items (including interests in "a qualified plan or other arrangement described in § 219(g)(5), . . . foreign pension" plans, and "property to be received in connection with the performance of services") as well as interests in nongrantor trusts. *Id.* at 888. However, the deferred compensation exception does not include deferred compensation that is "attributable to services performed outside the U.S. while a covered expatriate was not a U.S. citizen or resident . . . ." *Id.*

169. *See* I.R.C. § 2801(West 2008).

170. I have grouped these estate and gift tax provisions to differentiate this tax from the gift and estate tax burdens under the post-AJCA code.

171. Pfeifer, *supra* note 167, at 889. The tax is reduced, however, by the amount of gift tax or estate tax that is paid to the foreign government in order to avoid double taxation. *See id.*

172. *See* I.R.C. § 2801(b) (West 2008).

IV. Ramifications for Expatriates Now

Depending on their expatriation date, former U.S. citizens and long-term residents are subject to different tax and reporting burdens.[173] Taxpayers that expatriated before mid-2004 were grandfathered in some way or another from the alternative tax regime.[174] On the other hand, wealthy taxpayers who expatriated between June 2004 and June 2008 need to contend with the tightened alternative tax regime described in the still current I.R.C. § 877 until the tenth anniversary of their expatriation date.[175] HEART Act-covered expatriates who expatriated from June 2008 onwards are subject to the onerous, but different, exit tax and succession tax regime.[176] All expatriates that expatriated after June 2004 are also potentially affected by the Immigration and Naturalization Act ("INA").[177]

A. *Income Tax Burden under I.R.C. § 877*

Taxpayers who met the AJCA net worth and tax liability tests and expatriated prior to the HEART Act provisions are subject to taxes in addition to their existing burden under the effectively-connected income standard.[178] Additional burdens are placed on foreign-sourced income, tax-free dispositions and Controlled Foreign Corporations ("CFCs").[179]

Foreign-sourced Income — The taxpayer's "[g]ains on the sale or exchange of property (other than stock or debt obligations) located in the United States," gains on U.S.-issued financial instruments and gains "derived from stock in a foreign corporation" if the taxpayer owned such corporations would now be subject to taxation.[180]

Tax-free Exchanges — The taxpayer's property exchanges within "the 10-year period beginning on the date the individual loses U.S. citizenship"[181] would be treated as if the property was sold domestically, and any gains taxed accordingly for that tax year.[182] The taxpayer can

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173. *See infra* Part IV.A-D.

174. Some earlier expatriates were grandfathered from the HIPAA amendments to § 877. Specifically, those "who renounced their U.S. citizenship before February 1995 won't be affected by either of the two new anti-taxpatriate laws." Lenzner, *supra* note 121, at 44. Similarly, expatriates who exited the United States before June 2004 were grandfathered from the AJCA's tightening of the rules. *See* Ebeling, *supra* note 85, at 92.

175. *See* I.R.C. § 877(a)(1), (h) (West 2008).

176. *See* I.R.C. § 877(h) (West 2008); *see also* I.R.C. § 877A (West 2008).

177. Internal Revenue Service, *Expatriation Tax*, http://www.irs.gov/businesses/small/international/article/0,,id=97245,00.html (last visited May 1, 2009).

178. *See* Blanco et al., *The Noose Tightens*, *supra* note 96, at 93*; see also* Internal Revenue Service, *Effectively Connected Income (ECI)*, http://www.irs.gov/businesses/small/international/article/0,,id=96409,00.html (last visited May 1, 2009).

179. *See* I.R.C. § 877(d) (West 2008).

180. I.R.C. § 877(d)(1) (West 2008).

181. I.R.C. § 877(d)(2)(B) (West 2008).

182. *See* I.R.C. § 877(d)(2)(A) (West 2008).

exempt him/herself from this requirement if he/she "enters into a gain recognition agreement with the IRS."[183]

Controlled Foreign Corporations — The taxpayer would be directly responsible for taxes of income or gain from certain corporations if he/she "contribute[d] property during the 10-year period beginning on the date the individual loses United States citizenship,"[184] if such corporations met certain shareholder requirements above being a "controlled foreign corporation (as defined in [I.R.C. §] 957)."[185] Also, if the taxpayer sells or transfers stocks in such corporations while the corporation holds property situated in the United States, "a pro rata share of the property will be treated as disposed of by the corporation immediately before disposition of the property."[186]

B. *Estate and Gift Tax Burden under I.R.C. § 877*

In addition to the extra income tax burdens, the pre-HEART Act expatriate carries additional estate and gift tax burdens if he/she is deemed a tax-driven expatriate.[187] Some provisions for gifts and transfers of tangible property remain the same, but taxation rules for transfers of intangible property are more stringent for tax-driven expatriates than for expatriates that do not fall under the alternate regime.[188]

1. Gift Tax

The non-resident alien taxpayer can give real and tangible personal property without U.S. tax obligations if that property is not located domestically.[189] The rules for intangible property, including financial instruments such as stock and bonds, however, are significantly different for tax-driven expatriates:

Gifts of financial instruments — Unlike non-tax-driven expatriates (for AJCA § 877 purposes), who do not need to pay gift tax for gifts of financial instruments,[190] tax-driven expatriates giving those same gifts of financial instruments during the ten years after the initial expatriation date would be subject to gift tax.[191]

Gifts of Foreign Company Shares — In addition, tax-driven expatriates would have to pay gift taxes, prorated by the extent of those

183. *See* Blanco et al., *The Noose Tightens*, *supra* note 96, at 93.
184. I.R.C. § 877(d)(4)(A) (West 2008).
185. I.R.C. § 877(d)(4)(B) (West 2008).
186. *See* Blanco et al., *The Noose Tightens*, *supra* note 96, at 92-93.
187. *See id.*
188. *See* I.R.C. § 2511(West 2008).
189. *See* I.R.C. § 2511(a) (West 2008).
190. *See* I.R.C. § 2501(a)(2) (West 2008); *see also* Blanco et al., *The Noose Tightens*, *supra* note 96, at 93.
191. *See* I.R.C. § 2501(a)(3) (West 2008).

corporations' U.S. assets relative to its worldwide assets, on some transfers of shares in foreign corporations.[192]

2. Estate Tax

Under the AJCA, expatriates unaffected by I.R.C. § 877 continue to pay estate taxes on any property they own physically situated in the United States,[193] similar to the way all § 877-affected expatriates were treated before the AJCA. Note that "shares in a foreign corporation are not U.S.-situs property, even if the corporation holds U.S.-situs property,"[194] thus offering a loophole for wealthy expatriates wishing to transfer their estate to U.S. heirs.[195] However, this loophole is closed for tax-driven expatriates. An expatriate taxpayer subject to § 877 who dies within the ten year window from the expatriation date will have the "fair market value of the stock of [some] foreign corporation owned . . . included in the gross estate of such decedent" prorated by the extent of the foreign corporation's ratio of U.S. assets.[196] The foreign corporations subject to this regulation must meet both conditions of a two prong test:

Voting Stock ownership — The taxpayer must own "at the time of his death 10 percent or more of the total combined voting power of all classes of stock entitled to vote" of the corporation,[197] implying a substantial ownership stake.

Non-voting Stock ownership — The taxpayer must own more than half of either "the total combined voting power of all classes of stock entitled to vote of such corporation" or the corporation's total stock value.[198]

C. *Exit Tax Burden under I.R.C. § 877A*

Prospective expatriates today, together with expatriates with an expatriation date after June 17, 2008, are free of the HIPAA-AJCA alternative tax regime once they meet their exit tax obligations.[199] Covered expatriate status never expires, in part to ensure that expatriates do not wait

192. *See* I.R.C. § 2501(a)(5)(C)(ii) (West 2008). Taxes would be owed only if the donor owns (within the meaning of § 958(a)) at least ten percent of the voting power of all classes of stock entitled to vote of the foreign corporation and also owns (directly or through the application of either § 958(a) or 958(b)) more than fifty percent of either (i) the total combined voting power of all classes of stock of the corporation entitled to vote or (ii) the total value of the stock of the corporation. Blanco et al., *The Noose Tightens*, *supra* note 97, at 93.

193. *See* I.R.C. § 2511(b) (West 2008).

194. Blanco et al., *The Noose Tightens*, *supra* note 96, at 93.

195. *See id.*

196. I.R.C. § 2107(b) (West 2008).

197. I.R.C. § 2107(b)(1) (West 2008).

198. I.R.C. § 2107(b)(2) (West 2008).

199. *See* Pfeifer, *supra* note 167, at 879-80 (noting termination of the alternative tax regime towards expatriates who expatriate after HEART Act enactment).

out their expatriate status and escape from the exit tax.[200] However, they can choose to delay paying their exit tax on one or more of their assets until the tax due-date in the year after those assets are actually sold.[201] To take advantage of those deferrals, she must provide "adequate security" and "irrevocably waive the benefit of any U.S. tax treaty that would preclude assessment of the tax."[202] As of August 2008, Congress has not given any guidance on what action or amount constitutes "adequate security" for § 877A purposes.[203]

Both domestic and foreign trusts are required under the HEART Act to withhold taxes on their taxable distributions to a covered expatriate.[204] Regardless of whether the trustee is a U.S. person or foreign person, the part of the distribution that would have been taxable if the covered expatriate had remained a U.S. citizen or long-term resident is subject to a 30% withholding.[205] Also, if the trust distributes property to the covered expatriate, any gains are recognized as if the property was sold to her.[206]

D. *Succession Tax Burden under I.R.C. § 2801*

Post-HEART Act expatriates are covered by a different rule when they wish to transfer part of their wealth to U.S. donees: I.R.C. § 2801.[207] The succession tax described therein includes several important situations and exceptions.[208]

First, I.R.C. § 2801 affects gifts and transfers of wealth from a covered expatriate to a U.S. person.[209] The tax rate applied is the highest applicable tax rate for a gift or bequest.[210] As mentioned earlier in this article, this succession tax is levied on the donee instead of the donor, less foreign taxes already paid on the amount by the donor.[211] One possible explanation for this unusual arrangement is that the donee remains under U.S. jurisdiction regardless of the status of the covered expatriate. It is also noteworthy that the succession tax will affect all gifts and bequests made by the covered expatriate indefinitely; for example, a covered expatriate

200. *See* I.R.C. § 877A(g)(1) (West 2008) (note the absence of expiry of covered expatriate status).

201. I.R.C. § 877A(b)(1) (West 2008).

202. Pfeifer, *supra* note 167, at 887.

203. *Id.* at 890 (stating "there will have to be guidance on what constitutes 'adequate security' for purposes of electing to defer the payment of tax and whether, and on what terms, the election can apply to property disposed of in nonrecognition transactions").

204. *See* Pfeifer, *supra* note 167, at 888.

205. *See* I.R.C. § 877A(f)(1)(A) (West 2008).

206. I.R.C. § 877A(f)(1)(B) (West 2008).

207. *See* I.R.C. § 2801 (West 2008).

208. *See* I.R.C. § 2801(c)-(e) (West 2008).

209. I.R.C. § 2801(a) (West 2008).

210. I.R.C. § 2801(a)(1) (West 2008).

211. I.R.C. § 2801(d) (2002) (West 2008).

who left the United States after the HEART Act's enactment would still cause her donees to pay gift taxes on a gift that the expatriate gave fifty years later, regardless of whether that future wealth was made in the United States or in her new home country.[212]

Next, to prevent covered expatriates from gaming the system by giving to a trust instead, I.R.C. § 2801 includes a special rule that covers both donee domestic trusts and donee foreign trusts that make distributions to U.S. persons.[213] Domestic donee trusts would have to file and pay the succession tax as if it were the ultimate donee.[214] Foreign donee trusts would either have to "elect to be treated as a domestic trust solely for purposes of" I.R.C. § 2801 and pay the succession tax,[215] or pass the succession tax burden to the U.S. donee of "any distribution attributable to such gift or bequest from such trust (whether from income or corpus) . . . as if such distribution were a covered gift or bequest."[216] The calculus of determining the ultimate donee's income tax burden involves I.R.C. § 164 as well as § 2801 because the donee can deduct the amount of tax imposed under § 2801 that is attributable to gross income of the recipient but not to the capital portion of the distribution.[217]

Note that the succession tax prescribed in I.R.C. § 2801 is not levied on the first $12,000 (as of 2008) given to each U.S. donee annually.[218] Similarly, any amount given by a covered expatriate to a U.S. donee, directly or indirectly, can benefit from applicable marital or charitable deductions.[219] Finally, if the covered expatriate, or her estate, had earlier filed a timely gift or estate tax return showing the taxable transfer, then the succession tax would not apply.[220]

E. *Immigration and Other Non-Taxation Burdens*

The INA, which snares "former citizens who renounced citizenship to avoid taxation," remains in effect.[221] Because the INA is stricter than either §§ 877 or 877A in determining tax-driven motives for expatriation, it is still theoretically possible for expatriates to be classified as tax-driven by

212. Note that § 877A contains no language that would suggest that an expatriate, once deemed "covered," can ever escape from its provisions. I.R.C. § 877A(g)(1) (West 2008). However, if a covered expatriate falls under U.S. taxation as a citizen or long-term resident again, §§ 877A and 2801 no longer apply to her until she expatriates again. *See* TECHNICAL EXPLANATION OF H.R. 6081, *supra* note 46, at 41.

213. I.R.C. § 2801(e)(4) (West 2008).

214. I.R.C. § 2801(e)(4)(A) (West 2008).

215. I.R.C. § 2801(e)(4)(B)(iii) (West 2008).

216. I.R.C. § 2801(e)(4)(B)(i) (West 2008).

217. I.R.C. § 2801(e)(4)(B)(ii) (West 2008).

218. *See* I.R.C. § 2801(c) (West 2008) (referring to the annual gift exclusion in I.R.C. § 2503(b)).

219. *See* I.R.C. § 2801(e)(3) (West 2008).

220. I.R.C. § 2801(e)(2)(A) (West 2008).

221. 8 U.S.C. § 1182(a)(10)(E) (West 2008). In addition to the formal renunciation requirement, the Attorney General must make the same determination before the re-entry ban kicks in. *Id.*

the IRS but not be barred from receiving travel visas for return visits to the United States.[222] Moreover, the INS and Attorney General's office do not seem to be enforcing the INA provisions on tax-driven expatriates thus far.[223] It is entirely possible that the INA suffers from the same shortcoming that the HIPAA-amended I.R.C. § 877 had with its private-letter ruling system; putting the enforcement burden on active determination by government agencies is not as effective as bright-line, automatic rules.[224]

I.R.C. § 6039G also remains in effect for current expatriates "to whom section 877(b) applies for any taxable year."[225] This means that at a minimum, the covered expatriate must submit a statement for any taxable year in the indefinite future where she defers her exit tax or receives a distribution from a nongrantor trust.[226]

V. THE UNDERLYING PROBLEM: THE FINE LINE BETWEEN TAX MINIMIZATION AND FRAUD

A. *The Cultural Cause*

The Supreme Court stated as early as 1804, "[t]hat every man has a right to expatriate himself, is admitted by all the writers upon general law; and it is a principle peculiarly congenial to those upon which our constitutions are founded."[227] The phenomenon of tax-driven expatriation is of particular interest to the United States among developed countries because of the practice of taxing based on worldwide assets rather than domicile.[228] The legislative complexity surrounding taxation of expatriates

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222. While I.R.C. §§ 877 and 877A adopted an objective test for tax-driven expatriation, the test in the related INA statute has remained unchanged. *Id*. Westin suggests that the INA could potentially be exploited "because of the narrowness of the words 'formally renounced.'" Westin, *supra* note 26, at 176-77. The smarter approach for the expatriate who wishes to maximize his re-entry options, according to Westin, is to "avoid section 1182(a)(10)(E) by shedding citizenship by more subtle processes, such as taking out a new passport, taking a routine oath of allegiance and in time filing a form 1040NR evidencing an intention to terminate U.S. citizenship." *Id.*

223. *See* Carvajal, *supra* note 16 (Paraphrasing tax lawyer Matthew Ledvina's opinion that "in practice, the government is mainly interested in wealthier ex-citizens with a net worth of more than $2 million . . . . As for the rule barring entry to tax refugees, he said, it has not been enforced by the authorities.").

224. *See* Tang, *supra* note 18, at 636 n.157; *see also* McMenamin, *supra* note 5, at 18 (generally comparing the effectiveness of the INA and I.R.C. § 877 HIPAA amendments in terms of enforcement burden).

225. I.R.C. § 6039G(a) (West 2008).

226. *See* I.R.C. § 6039G(a) (West 2008). If § 877A is read to apply to a covered expatriate for each year the expatriate is considered covered, the expatriate will have to furnish a statement to the IRS for the rest of her life.

227. Murray v. The Schooner Charming Betsy, 6 U.S. 64, 93 (1804).

228. *See* Tang, *supra* note 18, at 619. "[The United States] utilizes the 'worldwide taxation' system, which taxes persons based on citizenship. In contrast, most other nations around the world utilize a system of 'territorial taxation,' which taxes persons based on residency." *Id.*

stems from the difficulty of enforcing the United States' system on wealthy taxpayers with enormous resources, patience and influence. There is also a great amount of cultural resistance towards tax-driven expatriates.[229] Representative Sam Gibbons of Florida called the act of expatriation for tax evasion "the despicable act of renouncing their allegiance to the United States."[230] Representative Martin Frost of Texas said, "[n]o one in my family, no matter how much money they made, would have ever renounced their American citizenship."[231] As a matter of fact, the very act of listing expatriates by name on a quarterly basis on the Federal Register as a so-called List of Shame is a social and cultural reaction to the tax-driven expatriation phenomenon.[232] These actions, while eliciting emotional reactions from the general American public, miss the point that many, if not most, expatriates renounce their U.S. Citizenship because they genuinely no longer have ties to the country.[233]

An obvious solution for the IRS, which would greatly simplify the tax code and encourage honesty, would be to switch to a domiciliary system of taxation; the domiciliary system of taxation is revenue-neutral for the United States.[234] If the IRS went in that direction, it would only have to grapple with the much simpler problem of the wealthy leaving the U.S. borders, similar to European nations like Germany.[235] By enacting the HEART Act, the United States made an important first step toward improving the enforceability of expatriation-related tax law.[236] However, doing so would appear to capitulate to the wealthy expatriates attempting to escape U.S. taxation, and the strong current of emotion running against the notion of reversing one's allegiance to the United States would make such a change very unpopular.[237]

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229. *See* Newman, *supra* note 22, at A1.

230. *Id.*

231. *Id.*

232. 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, 867 (2004).

233. *See* Newman, *supra* note 22.

234. The significance of a revenue-neutral system lies in the fact that under that system, an expatriate otherwise content to stay in the United States would not be tempted to expatriate in order to lower her taxes to the IRS. *See* Pfeifer, *supra* note 167, at 891 (stating "the law should neither serve as an inducement to leave U.S. tax solution nor as a bar to doing so").

235. *See* Carvajal, *supra* note 16 (quoting tax lawyer Ingmar Dorr with Lovells in Munich, noting that Germany "only [has] the problem that rich people who don't want to pay taxes in Germany just move to a lower-tax country in Switzerland").

236. *See* Blum & Singer, *supra* note 24, at 734 (suggesting that "there will still be significant enforcement issues, but it is more likely that mechanisms can be implemented to address them").

237. *See supra* text accompanying notes 229-31.

B. *The Human Cause*

People will always plan to minimize their taxes.[238] When the tax-driven expatriation laws designed to limit such behavior still need more definition and ease-of-enforcement,[239] the odds are against tax-driven expatriation going away on its own.

1. Genuine Expatriation and Tax Minimization

Tax minimization is popular and encouraged, as long as it remains within the bounds of the law.[240] There are also a steady number of people and families that abandon U.S. residency or citizenship because they have developed stronger ties to another country.[241] Without a probing inquiry, however, it would be impossible to differentiate tax-driven expatriates who have stronger ties to a foreign country from genuine expatriates who wish to minimize their tax exposure.[242] Regardless of the regime adopted by the IRS, there will always be tax-driven expatriates that slip through exceptions meant for genuine expatriates.

2. Interpretation Issues

Congress has not specified what constitutes "adequate security" for expatriates who choose to defer their exit tax.[243] Until the IRS or the U.S. Treasury issues some guidance as to what constitutes "adequate security" and how covered expatriates can use it to secure their deferred exit tax, covered expatriates and their agents will be confused at best and exploitative at worst. Specifically, issues like "whether, and on what terms, the election [to defer exit tax] can apply to property disposed of in nonrecognition transactions" will need to be addressed.[244]

Also, there is no maximum to the income that a covered expatriate can receive from a nongrantor trust.[245] This means that a covered expatriate can elect to be taxed at a date of her choosing by moving her wealth into a nongrantor trust before expatriation.[246] Moreover, there is no maximum to

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238. Judge Learned Hand wrote that a taxpayer "may so arrange his affairs that his taxes shall be as low as possible," and that "there is not even a patriotic duty to increase one's taxes." Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934).

239. *See* Blum & Singer, *supra* note 24, at 734.

240. *See* Comm'r v. Newman, 159 F.2d 848, 850-51 (2d Cir. 1947) (Hand, J., dissenting).

241. *See generally* Carvajal, *supra* note 16 (citing examples of everyday expatriates relinquishing citizenship).

242. *See id.* (stating that "motivations for renunciation are mixed and complex, involving social concerns, political displeasure with their government and other reasons," but that "taxation plays a large role for many, even though few are willing to admit that").

243. Pfeifer, *supra* note 167, at 890.

244. *Id.*

245. *Id.*

246. This loophole runs against "the fundamental precept of the mark-to-market tax . . . that a covered expatriate is taxed on his wealth at the date of expatriation." *Id.*

the succession tax levied on U.S. donees, which could allow the covered expatriate to time her gifts or distribute them to a larger group of individuals to fall under the $12,000 per-annum (as of 2008) gift tax exemption.[247]

3. Enforcement Issues

Even if Congress clarifies the HEART Act sections to close the loopholes as much as realistically possible, there remain stubborn enforcement problems that defy a solution. First, it is difficult to track the movements of a covered expatriate after she leaves the United States.[248] Under the AJCA regime, the expatriate had to report to the IRS annually for ten years;[249] under the HEART Act, the expatriate may be subject to even more onerous reporting requirements.[250] However, the United States has very little leverage for enforcing these provisions against someone who is essentially a foreigner living in a foreign country.[251] The United States can resort to diplomatic channels for enforcement, especially with countries with which the United States has friendly relations.[252] However, the United States can do little against a wayward expatriate in a tax haven without treaty ties to the U.S., particularly if the expatriate has no plans to return.[253]

There is also an honesty issue for such covered expatriates; they and their agents are responsible for honestly reporting their worldwide assets for exit tax determination.[254] It is impractical for the IRS to track all potential expatriates for their worldwide assets, and impossible for the IRS to discover all cases where the expatriate hides the ball by transferring assets away before she relinquishes her citizenship.[255]

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247. *See* I.R.C. § 2801(c) (West 2008); I.R.C. § 2503(b) (West 2008). While there is an annual limit in I.R.C. § 2503(b), the limit is applied per donee, not per donor. *See* I.R.C. § 2503(b) (West 2008).

248. *See* Blum & Singer, *supra* note 24, at 713-14 n.32.

249. *See* TECHNICAL EXPLANATION OF H.R. 6081, *supra* note 46, at 39.

250. The procedural details are still unclear as of the time of this writing, other than the fact that § 6039G still applies to HEART Act covered expatriates. *See* I.R.C. § 6039G(a) (West 2008). However, Pfeifer has noted that "new guidance [is needed] on information reporting by covered expatriates, as existing Form 8854 will no longer be sufficient." Pfeifer, *supra* note 168, at 890.

251. *See* Pfeifer, *supra* note 169, at 892 (noting that "even in an increasingly transparent financial world with greater cross-border cooperation amongst national tax administrations, it will be difficult to impose and collect tax on foreign income and assets from individuals who are no longer generally within the U.S. jurisdiction").

252. *See* Westin, *supra* note 26, at 125 (explaining that "there is extensive information-gathering activity under Tax Treaties and Information Exchange Agreements," but that "these agreements only apply on an ad hoc, country-by-country basis").

253. *See id.* at 133 (answering the rhetorical question by saying "not if you plan it right and go to a country that will resist expatriation [sic] by the U.S. government").

254. *See id.* at 124. The taxpayer faces federal prosecution if he commits fraud; but "if the information is never revealed, the criminal will never be prosecuted." *Id.*

255. *See* Blum & Singer, *supra* note 24, at 713 n.32.

Even for more honest expatriates living in a U.S.-friendly territory, there is still the problem of determining the correct foreign tax credit to be applied. Because the I.R.C. § 2801 succession tax is levied on the donee less any foreign succession taxes,[256] the IRS must cross-reference each donee with her expatriate donor and keep track of the taxes due and proper tax credits; this oversight burden can be even more onerous than tracking the expatriate's movements under the AJCA regime.[257]

There are also cases in which foreigners inadvertently fall under the HEART Act definition of covered expatriate and where enforcing the exit tax or succession tax will be counter-productive for the IRS. Take, for example, a temporary worker in the United States who brings her spouse with her from her home country. The spouse may meet the criteria for long-term residency, or obtain a green card, over the span of time he accompanies his spouse in the United States, but once his long-term residency is established for tax purposes, if his spouse finishes her stint in the United States and wishes to return to her home country, he falls under the exit tax regime.[258] A situation like this almost certainly argues against enforcement of the exit tax on the hapless spouse.[259]

VI. A REALISTIC DIRECTION

Congress has repeatedly signaled its desire to make taxation of covered expatriates a tax-neutral regime.[260] This desire likely grows from the long-held belief in the United States that people should be free to immigrate to and emigrate from the United States.[261] Our expatriation tax regime should aspire toward this goal.

The IRS has concentrated its efforts since 1966 to close the income tax evasion loophole for wealthy Americans wishing to depart from the United States for the purposes of minimizing their tax exposure.[262] Its efforts have had mixed results: a major loophole existed before 2008, in that estate and gift taxes were not covered under § 877, and wealthy citizens were inadvertently encouraged to expatriate and gift their assets

256. *See* I.R.C. § 2801(d) (West 2008).

257. *See* Pfeifer, *supra* note 167, at 892 (noting that "additional IRS resources likely will be required to efficiently administer and try to enforce the tax").

258. *See* Blum & Singer, *supra* note 24, at 713 (explaining an analogous situation where citizen children of non-citizen foreigners face tax obligations as "accidental citizens"). In such cases, faced with the onerous tasks of returning to tax compliance, it is highly likely that the spouse would simply choose not to remedy his non-compliance.

259. *See id.*

260. *See* Pfeifer, *supra* note 167, at 891.

261. *See* Act of July 27, 1868, ch. 249, 40th Cong., 15 Stat. 223, 223-24 (1868) (reformed and enacted as 8 U.S.C. § 1481).

262. *See* Blanco et al., *The Noose Tightens*, *supra* note 96, at 94 (claiming more severe effects on long term residents).

back to the United States.[263] Wealthy, patient expatriates could also delay gains realization for the first ten years after expatriation.[264] After the HEART Act was enacted in 2008, expatriation became a realization event and an exit tax was put in place; however, a separate set of interpretation and enforcement issues surfaced, which encouraged covered expatriates to play a different game to minimize their taxes.

A. *Exit Tax Considerations*

The exit tax is levied when a citizen relinquishes her citizenship.[265] This tax helped to close the loophole in the prior code where no tax was due upon expatriation.[266] However, Congress is also using this provision as a revenue-raiser.[267] This action pits the IRS against the wits and will of the expatriate who desires tax minimization. The covered expatriate can escape or defer her exit tax indefinitely by either transferring her assets to an offshore nongrantor trust in a tax haven long before expatriation or by borrowing against her holdings.[268] The former strategy is likely fraudulent, while the latter is technically legal, but the motivation for such gyrations lies in the expatriate's observation that it is financially advantageous for her to undertake such tax strategies.

B. *Succession Tax Considerations*

Compared to the exit tax in I.R.C. § 877A, the succession tax of § 2801 is much tougher to swallow for covered expatriates.[269] A cash gift that a good-faith expatriate wishes to give to a U.S. donee will be taxed twice, once by the exit tax regime and once by the succession tax.[270] On

263. *See* Westin, *supra* note 26, at 91-94 (explaining opposition to the estate tax in general because it reaches from the ultra-wealthy to the upper-middle class, affecting its public perception and thus popularity).

264. The Health Insurance Portability & Accountability Act claims the right to tax expatriates for ten years from the time at which they renounce their citizenship. *See* Lenzner, *supra* note 121, at 44.

265. *See* TECHNICAL EXPLANATION OF H.R. 6081, *supra* note 46, at 39.

266. *See* Tang, *supra* note 18, at 641 (concluding that "[t]he principal benefits of taxpatriation are the non-taxation of unrealized gains on foreign assets and the lower tax rate afforded to nonresident noncitizens of U.S. assets").

267. The third title of the HEART Act is entitled "Revenue Provisions," suggesting Congress' intent to use it as a revenue-raiser. *See* TECHNICAL EXPLANATION OF H.R. 6081, *supra* note 46, at 36 (noting that the title of the HEART Act provisions that became I.R.C. §§ 877A and 2801 state plainly, "REVENUE PROVISIONS").

268. This is possible because loan proceeds are not taxable as long as it is considered a good-faith loan and not a gift in disguise. *See* I.R.C. § 61 (West 2008) (defining gross income, which does not include loan proceeds); *see also* United States v. Swallow, 511 F.2d 514, 519 (10th Cir. 1975) (stating the doctrine that "loans obtained in bad faith and without an intent to repay them" are considered income).

269. *See* Pfeifer, *supra* note 167, at 881 n.12.

270. The succession tax is technically a transfer tax and thus a different beast from the exit tax. The succession tax is also levied on the donee, while the exit tax is levied on the expatriate. However, to a lay person who sees her wealth subject to taxation twice, this may be an academic argument.

the other hand, shifting the tax burden to the donee should yield similar benefits to treating succession wealth transfers as income.[271] The succession tax should also make the covered expatriate less willing to give cash to a U.S. donee because the expatriate's estate finances would have to be exposed.[272]

However, the ultra-wealthy expatriate's donees can still avoid the succession tax in a variety of ways. One obvious, although illegal, avenue is that the expatriate donor can give to the donee through a web of intermediaries, thus allowing the donee to escape from under I.R.C. § 2801 and claim her gift as coming from a non-covered foreigner.[273]

If not committed egregiously,[274] such offenses against I.R.C. § 2801 may not be detected since these transfers put a comparable burden of tracking expatriate movement on the IRS as the AJCA code did.[275] If the covered expatriate's spouse keeps her U.S. residency or citizenship, the expatriate's transfers can also be made to the spouse first in order to escape the succession tax.[276] The spouse can then make further distributions or loans to the eventual donee, perhaps pay for their tuition or medical expenses, to further evade taxation.[277]

C. *A Revenue-Neutral Solution*

Again and again, the same ultimate issue appears to be one of motivation versus revenue; as the expatriate is driven by her desire to minimize taxes to game the succession tax regime, a desire that would be absent if the expatriation tax regime was revenue-neutral. The IRS is likewise required to resort to extensive, and likely expensive, monitoring,

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271. Westin suggested in his pre-AJCA treatise that the estate and gift taxes could be replaced by the simple treatment of inheritance and gifts as income. Westin, *supra* note 26, at 184. "One goal of such a change would be simplification of the law. [I]t would repeal many sections of the Internal Revenue Code. Some amendment in the income tax law probably would be necessary." *Id.*

272. An estate tax placed on the expatriate can be maneuvered around, but a tax on the donee would require disclosure of the source of the donee's gift. *See* Westin, *supra* note 26, at 185.

273. The covered expatriate, or her agents, can even pay the donee's expenses directly, such as tuition and medical care, and be able to escape the donee's reporting requirement completely, provided that the non-expenses part of the gift does not exceed $13,561 (as of 2008). *See* I.R.C. §§ 2503(e), 6039F(a) (West 2008).

274. The IRS does have powerful weapons in its arsenal against questionable bank transfers that occur within the United States; the Bank Secrecy Act and its subsequent amendments require national banks to report to the IRS any suspicious deposits and financial activity. *See* 12 C.F.R. § 21.11(c) (2008). The Act also forbids these banks from notifying the account holders of the disclosures. *See* 31 U.S.C. § 5318(g)(2) (West 2008).

275. Pfeifer thinks the burden under the HEART Act may even exceed that under the AJCA. *See* Pfeifer, *supra* note 167, at 892. Blum and Singer suggest that enforcement of any exit tax would be almost impossible. *See* Blum & Singer, *supra* note 24, at 737 n.125. However, they also suggest utilizing the Department of Homeland Security's entry-exit system to help keep track of expatriate movement. *Id.* at 737.

276. *See* I.R.C. § 2801(e)(3) (West 2008). The gift is still governed by a less restrictive limit for spouses. *See* I.R.C. § 2523 (West 2008).

277. *See* I.R.C. § 2523(e) (West 2008).

tracking and investigating in order to effectively enforce its regulations against these motivated wealthy expatriates.

The natural solution to this issue is to adjust the expatriation tax regime so that it does not offer expatriates a financial incentive either to remain in the United States or to leave the country. The exit tax of I.R.C. § 877A should be simplified further, and the "adequate security" provision behind exit tax deferral should be clarified and codified, to minimize the burden the current discretionary rules place on the IRS. Because covered expatriates can effectively adjust the time their assets are taxed by using distributions from nongrantor trusts, an income cap should be placed on the distribution amounts from these trusts so that we can move closer to the exit tax's ideal intent of making expatriation a realization event of all assets on the day before expatriation.

The succession tax of I.R.C. § 2801 was added to raise revenue, which seems fundamentally unfair even to good-faith expatriates who wish to give back to the United States. The provision also presents enforcement difficulties for the IRS, because the agency will have to keep track of and investigate every gift tax return that any U.S. donee files. This daunting task is required to ensure that the received amounts claimed truly came from an *uncovered* expatriate, that the foreign taxes claimed actually were paid if the donee claimed a gift from a *covered* expatriate, and that any income from a trust is not an attempt by a covered expatriate to skirt the succession tax.[278] The practical recommendation is to scale back or remove the succession tax altogether, to increase the fairness of the exit tax regime to potential expatriates, and to rid the tax code of a provision that promises large revenue gains but may yield little actual gain because the revenue is offset by the increased cost of enforcement. At the very least, there should be a clarification as to the mechanism the covered expatriate can claim on the foreign tax credits and a bright-line rule that divides the filing burden between the expatriate donor and the domestic donee.[279]

VII. CONCLUSION

Wealthy Americans have tried, are trying, and will continue to try to minimize their tax exposure. There is nothing wrong with trying to do so.[280] However, the IRS has a vested interest in closing any tax-evasion loopholes it finds, so as to capture lost revenue from Americans who try to expatriate to lessen their taxes, and, ultimately, to discourage the practice completely.[281] It is the author's opinion that this tussle will not end until potential tax-driven expatriates see that there is no longer any financial

278. *See* Pfeifer, *supra* note 167, at 892 (predicting the increased burden of enforcement).

279. *See id.* at 890 ("Clearly, . . . there will have to be guidance on foreign tax credit issues that are bound to arise.").

280. *See* Comm'r v. Newman, 159 F.2d 848, 851 (2d Cir. 1947) (Hand, J., dissenting).

281. *See supra* Part III.

incentive for them to relinquish their U.S. citizenship or long-term residency. The only reliable way to remove the incentive to the expatriates is to adjust the expatriation tax regime so that it is revenue neutral.

The author does not harbor the illusion that closing the tax-driven expatriation loophole using the recommendations given herein will eliminate the practice completely. Ingenious tax attorneys and accountants will always find ways around and over any revenue code changes that are not advantageous to their clients. But the hope remains that with a good combination of scaling back the succession tax and fine-tuning the exit tax, the main motivation behind tax planners' use of expatriation for disingenuous purposes would be taken away.

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