WRITTEN TESTIMONY
OF THE STAFF OF THE JOINT COMMITTEE ON TAXATION
REGARDING ISSUES RELATING TO PROPOSALS TO MODIFY
THE TAXATION OF INDIVIDUALS WHO RELINQUISH
U.S. CITIZENSHIP OR RESIDENCY

FOR A HEARING
OF THE
SENATE COMMITTEE ON FINANCE
ON
JULY 11, 1995

PRESENTED
BY
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JOINT COMMITTEE ON TAXATION
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I. INTRODUCTION

My name is Ken Kies. I am the Chief of Staff of the Joint Committee on Taxation. It is my pleasure to present the testimony of the Joint Committee at this hearing on the tax treatment of individuals who relinquish their U.S. citizenship or residency.

The President's fiscal year 1996 budget proposals submitted on February 6, 1995, included a proposal to impose income tax on unrealized gains of U.S. citizens who relinquish their U.S. citizenship and certain long-term residents of the United States who relinquish their U.S. residency. This proposal was included as section 201 of S. 453 (introduced by Senators Daschle and Moynihan on February 16, 1995).

On March 15, 1995, the Committee on Finance approved an amendment to H.R. 831 to adopt a modified version of the Administration proposal with respect to the taxation of U.S. citizens who relinquish their citizenship. The Senate amendment was not included in the bill as enacted; rather, the enacted legislation included a requirement that the staff of the Joint Committee on Taxation complete a study on expatriation tax issues by June 1, 1995.

On April 6, 1995, Senator Moynihan introduced a bill (S. 700) that further modified the Administration proposal with respect to the taxation of U.S. citizens and residents who relinquish their citizenship or residency.[1]

On June 9, 1995, following the completion of the Joint Committee staff's study on expatriation tax issues, Representative Archer and Representative Johnson of Connecticut introduced a bill (H.R. 1812) that would expand and strengthen the present-law expatriation tax provisions. The House Committee on Ways and Means approved two amendments to H.R. 1812 on June 13, 1995.

First, this testimony describes the present-law tax treatment of U.S. citizens, residents, and nonresident aliens, including the tax treatment of U.S. citizens who relinquish their citizenship. Second, a summary of the findings of the Joint Committee staff's study on expatriation tax issues is provided. Third, the proposals with respect to the taxation of individuals who relinquish their U.S. citizenship or residency are described in detail. Finally, the testimony discusses the revenue estimates with respect to such proposals and explains the estimating methodology of the Joint Committee staff.

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[1] Representative Gibbons introduced an identical bill (H.R. 1535) on May 2, 1995.

II. PRESENT LAW

A. Taxation of United States Citizens, Residents, and Nonresidents

1. Individual income taxation

a. Income taxation of U.S. citizens and residents

In general

A United States citizen generally is subject to the U.S. individual income tax on his or her worldwide taxable income.[2] All income earned by a U.S. citizen, whether from sources inside or outside the United States, is taxable, whether or not the individual lives within the United States. A non-U.S. citizen who resides in the United States generally is taxed in the same manner as a U.S. citizen if the individual meets the definition of a "resident alien," described below.

The taxable income of a U.S. citizen or resident is equal to the taxpayer's total income less certain exclusions, exemptions, and deductions. The appropriate tax rates are then applied to a taxpayer's taxable income to determine his or her individual income tax liability. A taxpayer may reduce his or her income tax liability by any applicable tax credits. When an individual disposes of property, any gain or loss on the disposition is determined by reference to the taxpayer's cost basis in the property, regardless of whether the property was acquired during the period in which the taxpayer was a citizen or resident of the United States.

If a U.S. citizen or resident earns income from sources outside the United States, and that income is subject to foreign income taxes, the individual generally is permitted a foreign tax credit against his or her U.S. income tax liability to the extent of foreign income taxes paid on that income.[3] In addition, a United States citizen who lives and works in a foreign country generally is permitted to exclude up to $70,000 of annual compensation from being subject to U.S. income taxes, and is permitted an exclusion or deduction for certain housing expenses.[4]

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[2] The determination of who is a U.S. citizen for tax purposes, and when such citizenship is lost, is governed by the provisions of the Immigration and Nationality Act, 8 U.S.C. section 1401, et seq. See Treas. Reg. section 1.1-1(c).

[3] See Internal Revenue Code sections ("sections") 901-907.

[4] Section 911.

Resident aliens

In general, a non-U.S. citizen is considered a resident of the United States if the individual (1) has entered the United States as a lawful permanent U.S. resident (the "green card test"); or (2) is present in the United States for 31 or more days during the current calendar year and has been present in the United States for a substantial period of time--183 or more days during a 3-year period weighted toward the present year (the "substantial presence test").[5]

If an individual is present in the United States for fewer than 183 days during the calendar year, and if the individual establishes that he or she has a closer connection with a foreign country than with the United States and has a tax home in that country for the year, the individual generally is not subject to U.S. tax as a resident on account of the substantial presence test. If an individual is present for as many as 183 days during a calendar year, this closer connections/tax home exception is not available. An alien who has an application pending to change his or her status to permanent resident or who has taken other steps to apply for status as a lawful permanent U.S. resident is not eligible for the closer connections/tax home exception.

For purposes of applying the substantial presence test, any days that an individual is present as an "exempt individual" are not counted. Exempt individuals include certain foreign government-related individuals, teachers, trainees, students, and professional athletes temporarily in the United States to compete in charitable sports events. In addition, the substantial presence test does not count days of presence of an individual who is physically unable to leave the United States because of a medical condition that arose while he or she was present in the United States, if the individual can establish to the satisfaction of the Secretary of the Treasury that he or she qualifies for this special medical exception.

In some circumstances, an individual who meets the definition of a U.S. resident (as described above) could also be defined as a resident of another country under the internal laws of that country. In order to avoid the double taxation of such individuals, most income tax treaties include a set of "tie-breaker" rules to determine the individual's country of residence for income tax purposes. In general, a dual resident is deemed to be a resident of the country in which such person has a permanent home. If the individual has a permanent home available in both countries, the individual's residence is deemed to be the country with which his or her personal and economic relations are closer, i.e., the "center of vital interests." If the country in which such individual has his or her center of vital interests cannot be determined, or if such individual does not have a permanent home available in either country, he or she is deemed to be a resident of the country in which he or she has an habitual abode. If the individual has an habitual abode in both

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[5] The definitions of resident and nonresident aliens are set forth in section 7701(b). The substantial presence test compares 183 days to the sum of (1) the days present during the current calendar year, (2) one-third of the days present during the preceding calendar year, and (3) one-sixth of the days present during the second preceding calendar year. Presence for 122 days (or more) per year over the 3-year period would be sufficient to trigger the test.

countries or in neither of them, he or she is deemed to be a resident of the country of which he or she is a citizen. If each country considers the person to be its citizen or if he or she is a citizen of neither of them, the competent authorities of the countries are to settle the question of residence by mutual agreement.

b. Income taxation of nonresident aliens

Non-U.S. citizens who do not meet the definition of "resident aliens" are considered to be nonresident aliens for tax purposes. Nonresident aliens are subject to U.S. tax only to the extent their income is from U.S. sources or is effectively connected with the conduct of a trade or business within the United States. Bilateral income tax treaties may modify the U.S. taxation of a nonresident alien.

A nonresident alien is taxed at regular graduated rates on net profits derived from a U.S. business.[6] Nonresident aliens also are taxed at a flat rate of 30 percent on certain types of passive income derived from U.S. sources, although a lower treaty rate may be provided (e.g., dividends are frequently taxed at a reduced rate of 15 percent). Such passive income includes interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits and income. There is no U.S. tax imposed, however, on interest earned by nonresident aliens with respect to deposits with U.S. banks and certain types of portfolio debt investments.[7] Gains on the sale of stocks or securities issued by U.S. persons generally are not taxable to a nonresident alien because they are considered to be foreign source income.[8]

Nonresident aliens are subject to U.S. income taxation on any gain recognized on the disposition of an interest in U.S. real property.[9] Such gains generally are subject to tax at the

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[6] Section 871.

[7] See sections 871(h) and 871(i)(3).

[8] Section 865(a).

[9] Sections 897, 1445, 6039C, and 6652(f), known as the Foreign Investment in Real Property Tax Act ("FIRPTA"). Under the FIRPTA provisions, tax is imposed on gains from the disposition of an interest (other than an interest solely as a creditor) in real property (including an interest in a mine, well, or other natural deposit) located in the United States or the U.S. Virgin Islands. Also included in the definition of a U.S. real property interest is any interest (other than an interest solely as a creditor) in any domestic corporation unless the taxpayer establishes that the corporation was not a U.S. real property holding corporation ("USRPHC") at any time during the five-year period ending on the date of the disposition of the interest (sec. 897(c)(1)(A)(ii)). A USRPHC is any corporation, the fair market value of whose U.S. real property interests equals or exceeds 50 percent of the sum of the fair market values of (1) its U.S. real property interests, (2)

same rates that apply to similar income received by U.S. persons. If a U.S. real property interest is acquired from a foreign person, the purchaser generally is required to withhold 10 percent of the amount realized (gross sales price). Alternatively, either party may request that the Internal Revenue Service ("IRS") determine the transferor's maximum tax liability and issue a certificate prescribing a reduced amount of withholding (not to exceed the transferor's maximum tax liability).[10]

2. Estate and gift taxation

The United States imposes a gift tax on any transfer of property by gift made by a U.S. citizen or resident,[11] whether made directly or indirectly and whether made in trust or otherwise. Nonresident aliens are subject to the gift tax with respect to transfers of tangible real or personal property where the property is located in the United States at the time of the gift. No gift tax is imposed, however, on gifts made by nonresident aliens of intangible property having a situs within the United States (e.g., stocks and bonds).[12]

The United States also imposes an estate tax on the worldwide "gross estate" of any person who was a citizen or resident of the United States at the time of death, and on certain property belonging to a nonresident of the United States that is located in the United States at the time of death.[13]

Since 1976, the gift tax and the estate tax have been unified so that a single graduated rate schedule applies to cumulative taxable transfers made by a U.S. citizen or resident during his or her lifetime and at death. Under this rate schedule, the unified estate and gift tax rates begin at 18 percent on the first $10,000 in cumulative taxable transfers and reach 55 percent on cumulative taxable transfers over $3 million.[14] A unified credit of $192,800 is available with respect to taxable transfers by gift and at death. The unified credit effectively exempts a total of $600,000 in cumulative taxable transfers from the estate and gift tax.

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its interests in foreign real property, plus (3) any other of its assets which are used or held for use in a trade or business (sec. 897(c)(2)).

[10] Section 1445.

[11] Section 2501.

[12] Section 2501(a)(2).

[13] Sections 2001, 2031, 2101, and 2103.

[14] Section 2001(c).

Residency for purposes of estate and gift taxation is determined under different rules than those applicable for income tax purposes. In general, an individual is considered to be a resident of the United States for estate and gift tax purposes if the individual is "domiciled" in the United States. An individual is domiciled in the United States if the individual (a) is living in the United States and has the intention to remain in the United States indefinitely; or (b) has lived in the United States with such an intention and has not formed the intention to remain indefinitely in another country. In the case of a U.S. citizen who resided in a U.S. possession at the time of death, if the individual acquired U.S. citizenship solely on account of his birth or residence in a U.S. possession, that individual is not treated as a U.S. citizen or resident for estate tax purposes.[15]

In addition to the estate and gift taxes, a separate transfer tax is imposed on certain "generation-skipping" transfers.

3. Special tax rules with respect to the movement of persons and property into or out of the United States

a. Individuals who relinquish U.S. citizenship with a principal purpose of avoiding U.S. tax

An individual who relinquishes his or her U.S. citizenship with a principal purpose of avoiding U.S. taxes is subject to an alternative method of income taxation for 10 years after expatriation under section 877.[16] Under this provision, if the Treasury Department establishes that it is reasonable to believe that the expatriate's loss of U.S. citizenship would, but for the application of this provision, result in a substantial reduction in U.S. tax based on the expatriate's probable income for the taxable year, then the expatriate has the burden of proving that the loss of citizenship did not have as one of its principal purposes the avoidance of U.S. income, estate or gift taxes. Section 877 does not apply to resident aliens who terminate their U.S. residency.

The alternative method modifies the rules generally applicable to the taxation of nonresident aliens in two ways. First, the expatriate is subject to tax on his or her U.S. source income at the rates applicable to U.S. citizens rather than the rates applicable to other nonresident

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[15] Section 2209.

[16] Treasury regulations provide that an individual's citizenship status is governed by the provisions of the Immigration and Nationality Act, specifically referring to the "rules governing loss of citizenship [set forth in] sections 349 to 357, inclusive, of such Act (8 U.S.C. 1481-1489)." Treas. Reg. section 1.1-1(c). Under the Immigration and Nationality Act, an individual is generally considered to lose U.S. citizenship on the date that an expatriating act is committed. The present-law rules governing the loss of citizenship, and a description of the types of expatriating acts that lead to a loss of citizenship, are discussed more fully below.

aliens. (Unlike U.S. citizens, however, individuals subject to section 877 are not taxed on any foreign source income.) Second, the scope of items treated as U.S. source income for section 877 purposes is broader than those items generally considered to be U.S. source income under the Code. For example, gains on the sale of personal property located in the United States, and gains on the sale or exchange of stocks and securities issued by U.S. persons, generally are not considered to be U.S. source income under the Code. However, if an individual is subject to the alternative taxing method of section 877, such gains are treated as U.S. source income with respect to that individual. The alternative method applies only if it results in a higher U.S. tax liability than would otherwise be determined if the individual were taxed as a nonresident alien.

Because section 877 alters the sourcing rules generally used to determine the country having primary taxing jurisdiction over certain items of income, there is an increased potential for such items to be subject to double taxation. For example, a former U.S. citizen subject to the section 877 rules may have capital gains derived from stock in a U.S. corporation. Under section 877, such gains are treated as U.S. source income, and are, therefore, subject to U.S. tax. Under the internal laws of the individual's new country of residence, however, that country may provide that all capital gains realized by a resident of that country are subject to taxation in that country, and thus the individual's gain from the sale of U.S. stock also would be taxable in his or her country of residence. If the individual's new country of residence has an income tax treaty with the United States, the treaty may provide for the amelioration of this potential double tax.

Similar rules apply in the context of estate and gift taxation if the transferor relinquished U.S. citizenship with a principal purpose of avoiding U.S. taxes within the 10-year period ending on the date of the transfer. A special rule is applied to the estate tax treatment of any decedent who relinquished his or her U.S. citizenship within 10 years of death, if the decedent's loss of U.S. citizenship had as one of its principal purposes a tax avoidance motive.[17] Once the Secretary of the Treasury establishes a reasonable belief that the expatriate's loss of U.S. citizenship would result in a substantial reduction in estate, inheritance, legacy and succession taxes, the burden of proving that one of the principal purposes of the loss of U.S. citizenship was not avoidance of U.S. income or estate tax is on the executor of the decedent's estate.

In general, the estates of such individuals are taxed in accordance with the rules generally applicable to the estates of nonresident aliens (i.e., the gross estate includes all U.S.-situs property held by the decedent at death, is subject to U.S. estate tax at the rates generally applicable to the estates of U.S. citizens, and is allowed a unified credit of $13,000, as well as credits for State death taxes, gift taxes, and prior transfers). However, a special rule provides that the individual's gross estate also includes his or her pro-rata share of any U.S.-situs property held through a foreign corporation in which the decedent had a 10-percent or greater voting interest, provided that the decedent and related parties together owned more than 50 percent of the voting power of the corporation. Similarly, gifts of intangible property having a situs within the United States (e.g., stocks and bonds) made by a nonresident alien who relinquished his or her U.S.

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[17] Section 2107.

citizenship within the 10-year period ending on the date of transfer are subject to U.S. gift tax, if the loss of U.S. citizenship had as one of its principal purposes a tax avoidance motive.[18]

b. Aliens having a break in residency status

A special rule applies in the case of an individual who has been treated as a resident of the United States for at least three consecutive years, if the individual becomes a nonresident but regains residency status within a three-year period.[19] In such cases, the individual is subject to U.S. tax for all intermediate years under the section 877 rules described above (i.e., the individual is taxed in the same manner as a U.S. citizen who renounced U.S. citizenship with a principal purpose of avoiding U.S. taxes). The special rule for a break in residency status applies regardless of the subjective intent of the individual.

c. Transfers to foreign corporations

Certain transfers of property by shareholders to a controlled corporation are generally tax-free if the persons transferring the property own at least 80 percent of the corporation after the transfer.[20] Also, in certain corporate reorganizations, including qualifying acquisitions and dispositions, shareholders of one corporation may exchange their stock or securities for stock or securities of another corporation that is a party to the reorganization without a taxable event except to the extent they receive cash or other property that is not permitted stock or securities. In these cases, a corporation may also transfer property to another corporation that is a party to the reorganization, without a taxable event except to the extent of certain non-permitted consideration.[21] A liquidation of an 80-percent owned corporate subsidiary into its parent corporation is also generally tax-free.[22]

Under the rules applicable to these types of transfers, property transferred to a corporation retains its basis, to the extent the transfer was tax-free, so that any appreciation (i.e., built-in gain) will be subject to tax if the property is subsequently sold by the recipient corporation. Similarly, a shareholder who exchanges stock of one corporation for stock of another retains his or her original basis so that a subsequent sale of the acquired stock can produce a taxable gain.

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[18] Section 2501(a)(3).

[19] Section 7701(b)(10).

[20] Section 351.

[21] Sections 368, 354, 356, and 361. (See also sec. 355.)

[22] Section 332.

Section 367 applies special rules, however, if property is transferred by a U.S. person to a foreign corporation in a transaction that would otherwise be tax-free under these provisions. These special rules are generally directed at situations where property is transferred to a foreign corporation, outside of the U.S. taxing jurisdiction, so that a subsequent sale by that corporation could escape U.S. tax notwithstanding the carryover basis of the asset. In some instances, such a transfer causes an immediate taxable event so that the generally applicable tax-free rules are overridden. In other instances, the taxpayer may escape immediate tax by entering a gain recognition agreement ("GRA") obligating the taxpayer to pay tax if the property is disposed of within a specified time period after the transfer. The GRA rules generally require the taxpayer to agree to file an amended return for the year of the original transfer if the property is disposed of by the transferee (including payment of interest from the due date of the return for the year of the original transfer to the time the additional tax under the agreement is actually paid following the disposition).

Section 367 also imposes rules directed at situations where a U.S. person has an interest in a foreign corporation, such as a controlled foreign corporation ("CFC") meeting specific U.S. shareholder ownership requirements, that could result in the U.S. person being taxed on its share of certain foreign corporate earnings. These rules are designed to prevent the avoidance of tax in circumstances where a reorganization or other nonrecognition transaction restructures the stock or asset ownership of the foreign corporation so that the technical requirements for imposition of U.S. tax on foreign earnings under the CFC or other rules are no longer met, which would result in potential for removing the earnings of the original CFC from current or future U.S. tax or changing the character of the earnings for U.S. tax purposes (e.g., from dividend to capital gain).

The rules of section 367 do not generally apply unless there is a transfer by a U.S. person to a foreign corporation, or unless a foreign corporation of which a U.S. person is a shareholder engages in certain transactions. Because an individual who expatriates is no longer a U.S. person, section 367 has no effect on actions taken by such individuals after expatriation. The Treasury Department has considerable regulatory authority under section 367 to address situations that may result in U.S. tax avoidance. For example, section 367(b) provides that any of certain tax-free corporate transactions that do not involve a transfer of property from a U.S. person (described in section 367(a)(1)) can be recharacterized as taxable "to the extent provided in regulations prescribed by the Secretary which are necessary or appropriate to prevent the avoidance of Federal income taxes." The legislative history of this provision suggests that it was directed principally at situations involving avoidance of U.S. tax on foreign earnings and profits;[23] however the statutory language is quite broad and was provided in conjunction with the general rules taxing certain transfers by U.S. persons. Under the existing section 367 regulations and the relevant expatriation sections of the Code, a U.S. person who expatriates, even for a principal purpose of avoiding U.S. tax, may subsequently engage in transactions that involve the transfer of

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[23] See, e.g., H.Rept. No. 94-658, pp. 239-248 (94th Cong. 1st Sess, 1975); S.Rept. No. 94-938, pp. 261-271 (94th Cong., 2d Sess, 1976); H. Rept. No. 94-1515, p. 463 (94th Cong., 2d Sess., 1976)

property to a foreign corporation without any adverse consequences under section 367, since expatriation (even for a principal purpose of tax avoidance) is not an event covered by section 367 or the current regulations under that section. Similarly, a U.S. person who has expatriated would not be considered a U.S. shareholder for purposes of applying the rules that address restructurings of foreign corporations with U.S. shareholders. By engaging in such a transaction, a taxpayer that has expatriated could transfer assets that would otherwise generate income which would be subject to tax under section 877 into a foreign corporation, thus transforming the income into non-U.S. source income not subject to tax under section 877. For example, under section 877, if a principal purpose of tax avoidance existed, an expatriate would be taxed for 10 years on any sale of U.S. corporate stock. However, after expatriation, the person would no longer be a U.S. person for purposes of section 367, and thus could transfer U.S. corporate stock to a foreign corporation controlled by the expatriate under section 351 without any section 367 effect. The foreign corporation could then sell the U.S. corporate stock within the 10-year period, but the gain would not be subject to U.S. tax.

In addition, the IRS or the Treasury Department might encounter difficulties enforcing a gain recognition agreement if a U.S. person who has entered into such an agreement to pay tax on a later disposition of an asset subject to the agreement and then expatriates. The GRA regulations contain provisions requiring security arrangements if a U.S. natural person who has entered an agreement dies (or if a U.S. entity goes out of existence) but these provisions do not apply if a U.S. natural person expatriates. [24]

Even if an individual is subject to the alternative taxing method of section 877 (because the person expatriated with a principal purpose of avoiding U.S. tax), section 877 does not impose a tax on foreign source income. Thus, such an individual could expatriate and subsequently transfer appreciated property to a foreign corporation or other entity beyond the U.S. taxing jurisdiction, without any U.S. tax being imposed on the appreciation under section 877.

Similar issues exist under section 1491. Section 1491 imposes a 35-percent tax on otherwise untaxed appreciation when appreciated property is transferred by a U.S. citizen or resident, or by a domestic corporation, partnership, estate or trust, to certain foreign entities in a transaction not covered by section 367. In some cases, taxpayers may elect to enter into a gain recognition agreement (rather than pay immediate tax) pursuant to section 1492.[25] As in the case of section 367, an individual who has expatriated is no longer a U.S. citizen and may also no longer be a U.S. resident, thus a transfer by such a person would be unaffected by section 1491.

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[24] See, e.g., Temp. Treas. Reg. section 1.367(a)-3T(g)(9) and (10); Notice 87-85, 1987-2 C.B. 395.

[25] See, e.g., PLR 9103033.

B. Requirements for United States Citizenship, Immigration, and Visas

1. United States citizenship

An individual may acquire U.S. citizenship in one of three ways: (1) being born within the geographical boundaries of the United States; (2) being born outside the United States to at least one U.S. citizen parent (as long as that parent had previously been resident in the United States for a requisite period of time); or (3) through the naturalization process. All U.S. citizens are required to pay U.S. income taxes on their worldwide income. The State Department estimates that there are approximately 3 million U.S. citizens living abroad, although thousands of these individuals may not even know that they are U.S. citizens.

A U.S. citizen may voluntarily give up his or her U.S. citizenship at any time by performing one of the following acts ("expatriating acts") with the intention of relinquishing U.S. nationality: (1) becoming naturalized in another country; (2) formally declaring allegiance to another country; (3) serving in a foreign army; (4) serving in certain types of foreign government employment; (5) making a formal renunciation of nationality before a U.S. diplomatic or consular officer in a foreign country; (6) making a formal renunciation of nationality in the United States during a time of war; or, (7) committing an act of treason.[26] An individual who wishes to formally renounce citizenship (item (5), above), must execute an Oath of Renunciation before a consular officer, and the individual's loss of citizenship is effective on the date the oath is executed. In all other cases, the loss of citizenship is effective on the date that the expatriating act is committed, even though the loss may not be documented until a later date. The State Department generally documents loss in such cases when the individual acknowledges to a consular officer that the act was taken with the requisite intent. In all cases, the consular officer abroad submits a certificate of loss of nationality ("CLN") to the State Department in Washington, D.C. for approval.[27] Upon approval, a copy of the CLN is issued to the affected individual. The date upon which the CLN is approved is not the effective date for loss of citizenship.

Before a CLN is issued, the State Department reviews the individual's files to confirm that: (1) the individual was a U.S. citizen; (2) an expatriating act has been committed; (3) the act was undertaken voluntarily; and (4) the individual had the intent of relinquishing citizenship when the expatriating act was committed. If the expatriating act involved an action of a foreign government (for example, if the individual was naturalized in a foreign country or joined a foreign army), the State Department will not issue a CLN until it has obtained an official statement from the foreign government confirming the expatriating act. If a CLN is not issued because the State Department does not believe that an expatriating act has occurred (for example, if the requisite intent appears to be lacking), the issue is likely to be resolved through litigation. Whenever the loss of U.S. nationality is put in issue, the burden of proof is on the person or party claiming that a

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[26] 8 U.S.C. section 1481.

[27] 8 U.S.C. section 1501.

loss of citizenship has occurred to establish, by a preponderance of the evidence, that the loss occurred.[28] Similarly, if a CLN has been issued, but the State Department later discovers that such issuance was improper (for example, because fraudulent documentation was submitted, or the requisite intent appears to be lacking), the State Department could initiate proceedings to revoke the CLN. If the recipient is unable to establish beyond a preponderance of the evidence that citizenship was lost on the date claimed, the CLN would be revoked. To the extent that the IRS believes a CLN was improperly issued, the IRS could present such evidence to the State Department and request that revocation proceedings be commenced. If it is determined that the individual has indeed committed an expatriating act, the date for loss of citizenship will be the date of the expatriating act.

A child under the age of 18 cannot lose U.S. citizenship by naturalizing in a foreign state or by taking an oath of allegiance to a foreign state. A child under 18 can, however, lose U.S. citizenship by serving in a foreign military or by formally renouncing citizenship, but such individuals may regain their citizenship by asserting a claim of citizenship before reaching the age of eighteen years and six months.

A naturalized U.S. citizen can have his or her citizenship involuntarily revoked if a U.S. court determines that the certificate of naturalization was illegally procured, or was procured by concealment of a material fact or by willful misrepresentation (for example, if the individual concealed the fact that he served as a concentration camp guard during World War II).[29] In such cases, the individual's certificate of naturalization is cancelled, effective as of the original date of the certificate; in other words, it is as if the individual were never a U.S. citizen at all.

2. United States immigration and visas

In general, a non-U.S. citizen who enters the United States is required to obtain a visa.[30] An immigrant visa (also known as a "green card") is issued to an individual who intends to relocate to the United States permanently. Various types of nonimmigrant visas are issued to individuals who come to the United States on a temporary basis and intend to return home after a certain period of time. The type of nonimmigrant visa issued to such individuals is dependent upon the purpose of the visit and its duration. An individual holding a nonimmigrant visa is

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[28] 8 U.S.C. sec. 1481(b).

[29] See section 340(a) of the Immigration and Nationality Act, 8 U.S.C. section 1451(a). See also, U.S. v. Demjanjuk, 680 F.2d 32, cert. denied, 459 U.S. 1036 (1982).

[30] Under the Visa Waiver Pilot Program, nationals of most European countries are not required to obtain a visa to enter the United States if they are coming as tourists and staying a maximum of 90 days. Also, citizens of Canada, Mexico, and certain islands in close proximity to the United States do not need visas to enter the United States, although other types of travel documents may be required.

prohibited from engaging in activities that are inconsistent with the purpose of the visa (for example, an individual holding a tourist visa is not permitted to obtain employment in the United States).

Foreign business people and investors often obtain "E" visas to come into the United States. Generally, an "E" visa is initially granted for a one-year period, but it can be routinely extended for additional two-year periods. There is no overall limit on the amount of time an individual may retain an "E" visa. There are two types of "E" visas: an "E-1" visa, for "treaty traders" and an "E-2" visa, for "treaty investors". To qualify for an "E-1" visa, an individual must be a national of a country that has a treaty of trade with the United States, and must be coming to the United States solely to engage in substantial trade principally between a U.S. entity and a foreign-based company (i.e., over 50 percent of the individual's business must be between the United States and the foreign country). Trade includes the import and export of goods or services. At least 50 percent of the foreign-based company must be owned by nationals of that country, and at least 50 percent of the shareholders must either live abroad, or have an "E-1" visa and live in the United States (thus, an individual holding a "green card" would not be counted). To qualify for an "E-2" visa, an individual (and, if the individual is not himself making the investment, the major shareholders of the company of which he is an executive, manager, or essential employee) must be a national of a country that has a treaty investor agreement with the United States, and the individual (or the company) must be coming to the United States solely to develop and direct the operations of an enterprise in which the individual (or the company) has invested, or is actively in the process of investing, a substantial amount of capital.

3. Relinquishment of green cards

There are several ways in which a green card can be relinquished. First, an individual who wishes to terminate his or her permanent residency may simply mail his or her green card back to the INS. Second, an individual may be involuntarily deported from the United States (through a judicial or administrative proceeding), and the green card must be relinquished at that time. Third, a green card holder who leaves the United States and attempts to re-enter more than a year later may have his or her green card taken away by the INS border examiner, although the individual may appeal to an immigration judge to have the green card reinstated. A green-card holder may permanently leave the United States without relinquishing his or her green card, although such individuals would continue to be taxed as U.S. residents.[31]

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[31] Section 7701(b)(6)(B) provides that an individual who has obtained the status of residing permanently in the United States as an immigrant (i.e., an individual who has obtained a green card) will continue to be taxed as a lawful permanent resident of the United States until such status is revoked, or is administratively or judicially determined to have been abandoned.

III. SUMMARY OF THE JOINT COMMITTEE ON TAXATION STUDY OF EXPATRIATION TAX ISSUES

In the course of analyzing the Administration and other proposals relating to the tax treatment of U.S. citizens who relinquish their citizenship and long-term U.S. residents who give up their U. S. residency, the Joint Committee staff reached the following findings and conclusions in its June 1, 1995 report:

- Since 1980, an average of 781 U.S. citizens expatriated each year. Since 1962, the average number of U.S. citizens expatriating each year has been 1,146. In 1994, 858 U.S. citizens expatriated. Although there is some anecdotal evidence that a small number of U.S. citizens may be expatriating to avoid continuing to pay U.S. tax and the amount of potential tax liability involved in any individual case could be significant, the Joint Committee staff found no evidence that the problem is either widespread or growing. However, certain practitioners have indicated that they believe that present law is not a significant impediment to expatriation even if minimizing U.S. taxes is a purpose of such expatriation. Certain changes could be made to present law to strengthen its impact on those expatriating for tax avoidance purposes without also negatively impacting those Americans who expatriate for nontax reasons.

- Present-law section 877 imposes U.S. income tax on the U.S. assets of U.S. citizens who expatriate for tax avoidance purposes. The Joint Committee staff has identified certain problems with the present-law provisions, including the following:

  - There are legal methods to avoid some or all taxation under section 877 through proper tax planning.

  - Section 877 is ineffective with respect to individuals who relocate to certain countries with which the United States has a tax treaty because these treaties may not permit the United States to impose a tax on its former citizens who are residents in such other countries.

  - Section 877 only applies to U.S.-source assets and careful tax planning can be used to relocate appreciated assets outside the United States and, therefore, outside the scope of section 877.

- The Administration believes that section 877 is unadministrable because it is difficult to demonstrate that tax avoidance is a principal reason for expatriation. However, it appears that neither the current Administration nor past administrations has ever undertaken any systematic effort to enforce the provisions of section 877. No regulations have been issued under section 877 since its enactment in 1966. The IRS has litigated the tax avoidance motive issue under section 877 in only two cases and has won one of those cases.

- The Administration proposal would eliminate the intent test currently applicable under section 877 and would apply an objective test that would impose tax on U.S. citizens who expatriate as if the expatriating individual had sold all of his or her assets.

- The Administration proposal to impose a new tax regime of much broader scope than present-law section 877 raises a number of issues, including the following:

  - The Administration proposal affects more individuals than intended. The Administration proposal has been justified on two grounds. First, the Administration has stated that it is appropriate to collect U.S. tax with respect to those individuals who have enjoyed the benefits of U.S. citizenship (e.g., traveling on a U.S. passport) or with respect to U.S. citizens and long-term residents whose assets have enjoyed the protection of being within U.S. borders. Second, some have argued that certain U.S. citizens are relinquishing their citizenship, but are maintaining a significant continuing relationship with the United States. However, the Administration proposal would affect U.S. citizens who have lived abroad their entire lives and have very tenuous ties to the United States. In addition, it would affect expatriates who sever all ties with the United States.

  - The Administration proposal would require all U.S. citizens to pay a tax on unrealized gains on their assets upon expatriation. Gains would be taxed to the extent they are in excess of $600,000 ($1.2 million in the case of married individuals filing a joint return, both of whom expatriate). This tax on unrealized gains is inconsistent with the normative U.S. income tax system of imposing tax only on recognized gains. Although the Administration has stated that the tax would be imposed generally in the case of U.S. citizens with assets in excess of $5 million, the key determinant of whether the tax is imposed is the amount of the taxpayer's unrealized gains; thus, taxpayers with low-basis assets would pay the tax even if their total assets are well below $5 million, while taxpayers with high basis assets may pay little or no tax even though they own assets worth substantially more than $5 million.

  - The Administration proposal would impose tax on all expatriates and long-term residents who relinquish their U.S. residence without regard to a taxpayer's motivation. Thus, the Administration proposal would impose tax on U.S. citizens or residents who (1) are expatriating for purely nontax reasons, (2) have long-term dual citizenship with another country (e.g., their country of birth or ancestry) to which they are returning, or (3) have tenuous ties to the United States (e.g., an individual who did not even realize that he or she was a U.S. citizen).

  - The Administration proposal would apply to long-term U.S. residents who relinquish their U.S. residence. It will be difficult to determine when U.S.

residence is relinquished because there are no specific acts that must be taken to give up U.S. residency status.

- A number of practical problems are raised by the Administration proposal to tax unrealized gains (i.e., effectively to mark to market interests in property) upon expatriation. These issues may be summarized as (1) identifying the owner of the interest in property (identity problems), (2) raising sufficient funds from the interests in property to pay the tax (liquidity problems), and (3) valuing the interests in property (valuation problems). The problems are often related -- something that makes it difficult to determine who owns an interest in property often makes that interest very illiquid, which, in turn, may make valuing the interest more difficult. These problems are especially difficult in the case of interests held through trusts because expatriating beneficiaries would be subject to a tax liability determined by reference to the unrealized appreciation in value of the trust's assets notwithstanding the fact that the beneficiary has no access to the assets of the trust. This particular aspect of the proposal raises potential constitutional issues at least under certain circumstances. Moreover, under certain circumstances, the tax might inappropriately interfere with the right to expatriate which is recognized by U.S. and international law.

- The Administration proposal may retroactively impose tax on former U.S. citizens who lost their citizenship years ago. U.S. citizenship is lost by performing certain acts of expatriation (for example, by formally renouncing U.S. citizenship or by being naturalized in a foreign country). These acts of expatriation may have occurred many years prior to announcement of the Administration proposal, but the individual might have never gone through the process of recording that loss with the U.S. government through acquisition of a certificate of loss of nationality from the State Department. If such an individual were to apply for a certificate of loss of nationality on or after February 6, 1995, the Administration proposal would subject such an individual to the proposed tax. It is unclear whether the United States would have any legal basis for attempting to collect tax in such a case since the individual has lost all rights and responsibilities of U.S. citizenship many years earlier.

- The Administration proposal would have a retroactive effect on U.S. long-term residents who have been in the United States for more than 8 years and who have had no notice that they would be taxed on unrealized gains upon departure from the United States.

- The Administration proposal may subject to tax assets that have no relationship with the United States. For example, the proposal would subject to tax assets held by long-term residents of the United States that were acquired outside the United States and were never brought into the United States. Under the Administration

proposal, the tax imposed not only would apply to the appreciation in value of an asset during the period of U.S. residence, but could also apply to all appreciation in value. (The proposal does permit an individual to elect for all assets to use fair market value on the date an individual became a resident of the United States solely for purposes of determining gain upon the deemed disposition of such assets.)

- Enactment of the Administration proposal may create an incentive to expatriate which does not exist under current law for individuals who either have recently inherited wealth or who expect to inherit wealth in the near future, because the basis of inherited assets is stepped up to the fair market value of the assets on the date of the decedent's death, and thus there would be little or no expatriation tax imposed on such assets. At the same time, the long-term tax savings from eliminating exposure to the U.S. tax system could be extraordinary. This problem may be particularly significant because certain anecdotal evidence suggests that the limited class of wealthy U.S. citizens who may have expatriated for tax avoidance purposes involves, in large part, second and third generation wealth.

- The Senate amendment to H.R. 831 and the bills introduced by Senator Moynihan (S. 700) and Representative Gibbons (H.R. 1535) address some, but not all, of the issues raised by the Administration proposal.

- If the Congress determines that present-law section 877 should be modified, there are alternatives to the Administration proposal that may be more appropriate. In evaluating such alternatives, the following issues should be considered:

    - What is the underlying rationale for the proposal? In other words, is the proposal intended to collect U.S. taxes that would otherwise be paid by individuals who do not really sever their ties with the United States? If so, is it intended to collect the equivalent amount of income taxes, estate taxes, or both? Or, is the proposal intended to impose a tax to recoup the benefits of U.S. citizenship or residence?

    - What is the appropriate class of individuals to whom the proposal should be applied given the rationale for the proposal?

    - How can the proposal be structured so as not to impose a new tax regime retroactively on individuals who structured their holdings of assets in reliance upon present law?

- Does the proposal impose a tax that is fair in relation to its goals? Is the tax imposed consistent with the U.S. normative system of taxation or is it an extraordinary tax? If it is an extraordinary tax, are there alternatives that would be more consistent with the way in which the United States taxes it citizens and residents?

- Can a modification to present law be structured so as to not create an incentive to expatriate for those with recently inherited wealth?

In the course of studying the issue of the appropriate tax treatment of U.S. citizens and long-term residents who relinquish citizenship or residence, the Joint Committee staff also obtained information from the IRS on the tax return filings of U.S. citizens who reside outside the United States. It is estimated that there are currently 2.5 million U.S. citizens (not including U.S. government employees and U.S. military personnel and their families) who reside outside the United States. The most recent figures indicate that only approximately 1 million taxpayers annually file Form 1040 (U.S. Individual Income Tax Return) and included in this 1 million figure are U.S. government and military personnel residing abroad. Although many U.S. citizens residing outside the United States may be entitled to foreign tax credits that would reduce the amount of U.S. income taxes owed, it appears that the failure of these taxpayers to file annual income tax returns represents a continuing compliance problem that should be explored further.

IV. PROPOSALS TO MODIFY TAX TREATMENT OF U.S. CITIZENS AND RESIDENTS WHO RELINQUISH CITIZENSHIP OR RESIDENCE

A. Administration's Fiscal Year 1996 Budget Proposal (H.R. 981 and S. 453)

In general

The Administration proposal to modify the tax treatment of U.S. citizens and residents who relinquish their U.S. citizenship or residence was transmitted to the Congress in conceptual form in the President's fiscal year 1996 budget proposal on February 6, 1995. The statutory language of the proposal was included in the revenue provisions of the Administration's fiscal year 1996 budget proposal that was introduced (by request) in the House (in H.R. 981) and the Senate (in S. 453) on February 16, 1995. Under the Administration proposal, U.S. citizens who relinquish their U.S. citizenship and certain long-term resident aliens who terminate their U.S. residency generally would be treated as having sold all of their property at fair market value immediately prior to the expatriation or cessation of residence. Gain or loss from the deemed sale would be recognized at that time, generally without regard to other provisions of the Code.[32] Any net gain on the deemed sale would be recognized to the extent it exceeds $600,000 ($1.2 million in the case of married individuals filing a joint return, both of whom expatriate).

Property taken into account

Assets within the scope of the proposal generally would include all property interests that would be included in the individual's gross estate under the Federal estate tax if such individual were to have died on the day of the deemed sale, plus any interest the individual holds as a beneficiary of a foreign or domestic trust that is not otherwise included in the gross estate (see "Interests in trusts", below), and other interests that could be specified by the Treasury Department to carry out the purposes of the provision. U.S. real property interests, which remain subject to U.S. taxing jurisdiction in the hands of nonresident aliens, generally would be excepted from the proposal.[33] An exception would apply to interests in qualified retirement plans and, subject to a limit of $500,000, interests in certain foreign pension plans. The IRS would be authorized to allow a taxpayer to defer, for a period of no more than five years, payment of the tax attributable to the deemed sale of a closely-held business interest (as defined in present-law sec. 6166(b)).

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[32] See the discussion of the application of the Code's income exclusions under "Other special rules" below.

[33] The exception would apply to all U.S. real property interests, as defined in section 897(c)(1), except the stock of a United States real property holding company that does not satisfy the requirements of section 897(c)(2) on the date of the deemed sale.

Interests in trusts

Under the Administration proposal, any trust interest held by an expatriating individual would be deemed to be sold immediately prior to the expatriation. This provision would require that trust interests be valued specifically for this purpose. For example, a trust instrument may provide that one individual (the "income beneficiary") is entitled to receive the income from the trust assets for the next 10 years, at which time the trust will terminate and another individual (the "remainderman") will be entitled to receive the assets. If either the income beneficiary or the remainderman expatriates, a value would need to be placed on their respective interests, and the expatriate would be subject to tax on the value of the expatriate's interest. It is unclear in this context what value would be placed on a nontransferable interest in a trust (e.g., a "spendthrift" trust that prohibits the trust beneficiary from assigning or transferring the trust interest). If nontransferable interests were to be valued at zero (because they cannot be sold), they would not be taxed under the proposal, thus rendering the proposal inapplicable with respect to such interests. An additional issue is raised by the fact that the trust instrument is not likely to provide the beneficiaries with access to the trust assets in order to pay the tax. Therefore, in many cases, the resulting tax liability could exceed the assets available to the beneficiary to pay the tax.

A beneficiary's interest in a trust would be determined on the basis of all facts and circumstances. These include the terms of the trust instrument itself, any letter of wishes or similar document, historical patterns of trust distributions, the role of any trust protector or similar advisor, and anything else of relevance. Under the Administration proposal, the Treasury Department would be expected to issue regulations providing guidance as to the determination of trust interests for purposes of the expatriation tax, and such regulations would be expected to disregard de minimis interests in trusts, such as an interest of less than a certain percentage of the trust as determined on an actuarial basis, or a contingent remainder interest that has less than a specified likelihood of occurrence. In the event that any beneficiaries' interests in the trust could not be determined on the basis of the facts and circumstances, the beneficiary with the closest degree of family relationship to the settlor would be presumed to hold the remaining interests in the trust. Each beneficiary would be required to disclose on his or her tax return the methodology used to determine that beneficiary's interest in the trust, and whether that beneficiary knows (or has reason to know) that any other beneficiary of the trust uses a different method.

For purposes of this provision, grantor trusts would continue to be treated as under present law---the grantor of the trust would be treated as the owner of the trust assets for tax purposes. Therefore, a grantor who expatriates would be treated as selling the assets held by the trust for purposes of computing the tax on expatriation. Correspondingly, a beneficiary of a grantor trust who is not treated as an owner of the trust (or any portion thereof) under the grantor trust rules would not be considered to hold an interest in the trust for purposes of the expatriation tax.

Date of relinquishment of citizenship

Under the Administration proposal, a U.S. citizen would be treated as having relinquished his citizenship on the date that the State Department issues a CLN, even though the individual may have ceased to be a U.S. citizen at a substantially earlier date. In cases where a naturalized U.S. citizen has his or her naturalization revoked (e.g., where the naturalization was obtained illegally, through the concealment of a material fact, or by willful misrepresentation), the individual would be treated as relinquishing citizenship on the date that a U.S. court cancels the certificate of naturalization, even though, for all other purposes, the individual would not be considered to have ever been a U.S. citizen. These new definitions of when citizenship is deemed to be relinquished for tax purposes would also apply in determining when an expatriating individual ceases to be taxed as a U.S. citizen. Under the Administration proposal, an expatriating individual would be subject to U.S. tax as a citizen of the United States until a CLN is issued or a certificate of naturalization is revoked, regardless of when citizenship has actually been lost through the commission of an expatriating act.[34]

Long-term residents who terminate their U.S. residency

Under the Administration proposal, the tax on expatriation would apply to certain "long-term residents" who terminate their residency in the United States. A long-term resident would be any individual who has been a lawful permanent resident of the United States (i.e., a "green card" holder) in at least 10 of the prior 15 taxable years.[35] For this purpose, any year in which the individual was taxed as a resident of another country under a treaty tie-breaker rule would not be considered.[36] The proposal would not apply to individuals who were treated as U.S. residents under the "substantial presence" test, regardless of the amount of time the individual was present in the United States.

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[34] As drafted, there is some uncertainty as to how the Administration proposal would affect an individual who had committed an expatriating act prior to February 6, 1995, but who never applies for a CLN. To the extent the State Department eventually does issue a CLN with respect to the individual (whether upon the State Department's initiative or upon the individual's request), the individual clearly would be covered by the new provisions.

[35] If a long-term resident surrenders his green card, such a person may still be treated as a resident for U.S. income tax purposes if he has a "substantial presence" within the United States. (See sec. 7701(b)(3).) The proposal would not apply so long as such a person continues to be treated as a tax resident under the substantial-presence test.

[36] Most treaties include "tie-breaker" rules for determining the residency of an individual who would otherwise be considered to be a resident of both the U.S. and the treaty partner under the internal laws of each country. In general, these tie-breaker rules provide that an individual will be taxed as a resident of only one country, based on factors such as the country in which the individual has a permanent home or closer personal and economic ties.

Solely for purposes of this provision of the Administration proposal, a special election would permit long-term residents to determine the tax basis of certain assets using their fair market value at the time the individual became a U.S. resident, rather than their historical cost. The election, if made, would apply to all assets within the scope of the proposal that were held on the date the individual first became a U.S. resident and the fair market value would be determined as of such date.

A long-term resident who terminates his or her U.S. residency would be subject to the Administration proposal at the time the individual ceases to be taxed as a resident of the United States (as determined under present law).

Other special rules

Under the Administration proposal, the tax on expatriation generally would apply notwithstanding other provisions of the Code. For example, gain that would be eligible for nonrecognition treatment if the property were actually sold would be treated as recognized for purposes of the tax on expatriation. Also, the exclusions from gross income generally provided to bona fide residents of U.S. possessions or commonwealths (e.g., secs. 931 and 933) would not be applicable for purposes of calculating the expatriation tax.[37]

Other special rules of the Code would affect the characterization of amounts treated as realized under the Administration proposal. For example, in the case of stock in a foreign corporation that was a CFC at any time during the five-year period ending on the date of the deemed sale, the gain recognized on the deemed sale would be included in the shareholder's income as a dividend to the extent of certain earnings of the foreign corporation.[38]

Under the Administration proposal, any period during which recognition of income or gain generally is deferred would terminate on the date of the relinquishment, causing any deferred U.S. tax to become due and payable. For example, where an individual has disposed of certain property in a transaction for which deferral is conditioned on the purchase of certain replacement property (e.g., property that qualifies for like-kind exchange treatment under sec. 1031 or that qualifies as a principal residence under sec. 1034), but has not yet acquired the replacement property, the relevant period in which to acquire any replacement property would be deemed to terminate upon expatriation and the individual would be taxed on the gain from the original sale.

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[37] Native-born residents of U.S. territories and possessions are citizens of the United States, thus it was not intended that the provision be "mirrored" for application in the U.S. territories and possessions that employ the mirror code. However, a rule could be provided to extend the Administration proposal to long-term residents of U.S. territories or possessions who are not citizens of the United States.

[38] See section 1248.

Under the Administration proposal, the present-law provisions with respect to individuals who expatriate with a principal purpose of avoiding tax (sec. 877) and certain aliens who have a break in residency status (sec. 7701(b)(10)) would not apply to any individual who is subject to the new expatriation tax provisions. The special estate and gift tax provisions with respect to individuals who expatriate with a principal purpose of avoiding tax (secs. 2107 and 2501(a)(3)), however, would continue to apply.

The Administration proposal authorizes the Treasury Department to issue regulations necessary to carry out the purposes of the provision.

Effective date

The Administration proposal would be effective for U.S. citizens who obtain a CLN, or have a certificate of naturalization cancelled, on or after February 6, 1995 (regardless of when the individual actually lost his or her U.S. citizenship), and for long-term residents who terminate their U.S. residency on or after February 6, 1995. Present law would continue to apply to U.S. citizens who obtained a CLN prior to February 6, 1995, and to long-term residents who terminated their residency prior to February 6, 1995.

B. Senate Amendment to H.R. 831

In general

The Senate amendment to H.R. 831 ("the Senate bill") adopted a modified version of the Administration proposal with respect to the taxation of U.S. citizens and residents who relinquish their citizenship or residency.[39] The Senate bill modified the Administration proposal in several ways. First, the Senate bill applies the expatriation tax only to U.S. citizens who relinquish their U.S. citizenship, not to long-term resident aliens who terminate their U.S. residency. Second, the Senate bill modifies the date when an expatriating citizen is treated as relinquishing U.S. citizenship, such that most expatriating citizens are treated as relinquishing their citizenship at an earlier date than under the Administration proposal. The Senate bill also makes some technical modifications to the Administration proposal, including a provision to prevent double taxation in the case of certain property that remains subject to U.S. tax jurisdiction.

Property taken into account; Interests in trusts

The types of property that would be taken into account in determining the tax liability of an expatriate under the Senate bill generally are the same as under the Administration proposal.

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[39] The Senate amendment to H.R. 831 was not included in the conference agreement on H.R. 831, nor as the bill was enacted (P.L. 104-7, signed by the President on April 11, 1995). Instead, the enacted legislation included a requirement that the staff of the Joint Committee on Taxation complete a study of the expatriation tax issues by June 1, 1995.

The rules with respect to interests in trusts, however, are modified in the Senate bill. Under the Administration proposal, an individual holding an interest in a trust would be deemed to have sold that trust interest immediately prior to expatriation. Under the Senate bill, a beneficiary's interest in a trust would be determined in the same manner as under the Administration proposal. However, a trust beneficiary would be deemed to be the sole beneficiary of a separate trust consisting of the assets allocable to his or her share of the trust, in accordance with his or her interest in the trust. The separate trust would be treated as selling its assets for fair market value immediately before the beneficiary relinquishes his or her citizenship, and distributing all resulting income and corpus to the beneficiary. The beneficiary would be treated as subsequently recontributing the assets to the trust. Consequently, the separate trust's basis in the assets would be stepped up and all assets held by the separate trust would be treated as corpus. The Senate bill also adds a constructive ownership rule with respect to a trust beneficiary that is a corporation, partnership, trust or estate. In such cases, the shareholders, partners or beneficiaries of the entity that is the trust beneficiary would be deemed to be the direct beneficiaries of the trust for purposes of applying these provisions.

Date of relinquishment of citizenship

Under the Administration proposal, an individual would be deemed to have lost U.S. citizenship on the date that a CLN is issued by the State Department or a certificate of naturalization is canceled by a court. The Senate bill would modify these rules to treat an individual as relinquishing his or her citizenship on an earlier date, specifically, the date that the individual first presents himself or herself to a diplomatic or consular officer of the United States as having voluntarily relinquished citizenship through the performance of an expatriating act. Under the Senate bill, a U.S. citizen who relinquishes citizenship by formally renouncing his or her U.S. nationality before a diplomatic or consular officer of the United States[40] would be treated as having relinquished citizenship on that date, provided that the renunciation is later confirmed by the issuance of a CLN. (For these individuals, the date on which the individual would be deemed to lose his or her citizenship for tax purposes is the same as the date on which the individual has actually lost such citizenship under existing U.S. law.) A U.S. citizen who furnishes to the State Department a signed statement of voluntary relinquishment of U.S. nationality confirming the performance of an expatriating act[41] would be treated as having relinquished his or her citizenship on the date the statement is so furnished (regardless of the date of performance of the expatriating act that caused the actual loss of U.S. citizenship to occur), provided that the voluntary relinquishment is later confirmed by the issuance of a CLN. If neither of these circumstances exist, the individual would be treated as having relinquished citizenship on the date the CLN is

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[40] Section 349(a)(5) of the Immigration and Nationality Act (8 U.S.C. sec. 1481(a)(5)) provides for the relinquishment of citizenship through renunciation.

[41] The Senate bill would apply to any expatriating act specified in section 349(a)(1) - (4) of the Immigration and Nationality Act (8 U.S.C. sec. 1481(a)(1) - (4)).

issued, or a certificate of naturalization is cancelled, regardless of when the individual actually lost U.S. citizenship.[42]

Under the Senate bill, it is anticipated that an individual who has formally renounced his or her citizenship or furnished a signed statement of voluntary relinquishment (but has not received a CLN from the State Department by the date on which he or she is required to file a tax return covering the year of expatriation) would file his or her U.S. tax return as if he or she had expatriated.

Administrative requirements

Under the Senate bill, an expatriating individual subject to the expatriation tax would be required to pay a tentative tax equal to the amount of tax that would have been due for a hypothetical short tax year ending on the date the individual is deemed to have relinquished his citizenship.[43] The tentative tax would be due on the 90th day after the date of the deemed relinquishment. The individual also would be required to file a tax return for the entire tax year during which he or she expatriated reporting all of his or her taxable income for the year, including gain attributable to the deemed sale of assets on the date of expatriation. The individual's U.S. Federal income tax liability for such year would be reduced by the tentative tax paid with the filing of the hypothetical short-year return.

The Senate bill provides that the time for the payment of the tax on expatriation could be extended for up to 10 years at the request of the taxpayer, using the rules applicable to estate tax payments provided by section 6161.[44] It is expected that a taxpayer's interest in non-liquid assets, such as an interest in a closely-held business interest (as defined in section 6166(b)), would be taken into account in determining reasonable cause for the extension of time to pay the tax on expatriation.

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[42] As under the Administration proposal, there is some uncertainty as to how the Senate bill would affect an individual who committed an expatriating act prior to February 6, 1995, but who never executed a formal renunciation of citizenship, signed a statement of voluntary relinquishment, or obtained a CLN.

[43] Thus, the tentative tax is based on all the income, gain, deductions, loss and credits of the individual for the year through the date of the deemed relinquishment, including amounts realized from the deemed sale of property. The tentative tax is deemed to be imposed immediately before the individual is deemed to have relinquished citizenship.

[44] Under these rules, if reasonable cause is shown, the IRS may grant an extension for the payment of estate taxes for a reasonable period, not to exceed 10 years, from the date the payment is due. If such an extension is granted, interest continues to run, but there would be no penalties imposed for late payment. Section 6166 further provides that the estate tax attributable to certain closely-held business interests may be paid over a 14-year period.

If the expatriating individual and the Treasury Department agree to defer payment of the tax on expatriation for a period that extends beyond the filing date for the full-year tax return for the year of expatriation, the individual would not be required to pay a tentative tax. The entire gain on the deemed sale of property on the date of expatriation would be included in the individual's full-year tax return for that year, and would be paid in accordance with the provisions of the deferred-tax agreement under section 6161. It is expected that the Treasury Department would not agree to defer payment of the tax on expatriation unless the taxpayer provides adequate assurance that all amounts due under the agreement will be paid.

Other special rules

The "other special rules" included in the Administration proposal are also included in the Senate bill. In addition, the Senate bill clarifies that any portions of a gain that would qualify for the specific income exclusions of sections 101-137 (Subtitle A, Chapter 1B, Part III) of the Code would not be treated as realized under the provisions of the expatriation tax. In addition to giving the Treasury Department general regulatory authority, the Senate bill also provides specific authority to issue regulations to permit a taxpayer to allocate the taxable gain on the deemed sale (net of any applicable exclusion) to the basis of the assets taxed under this provision, thereby preventing double taxation if the assets remain subject to U.S. tax jurisdiction.

Effective date

The provision in the Senate bill would be effective for U.S. citizens who are deemed to have relinquished their U.S. citizenship on or after February 6, 1995 (i.e., individuals who first made their loss of U.S. citizenship known to a U.S. government or consular official after this date). The tentative tax would not be required to be paid until 90 days after the date of enactment of the bill.

Present law would continue to apply to U.S. citizens who are deemed to have relinquished their citizenship prior to February 6, 1995 (i.e., individuals who first made their loss of U.S. citizenship known to a U.S. government or consular official prior to this date).

C. Modified Bills Introduced by Senator Moynihan (S. 700) and Representative Gibbons (H.R. 1535)

Senator Moynihan introduced S. 700 on April 6, 1995. Representative Gibbons introduced an identical bill, H.R. 1535, on May 2, 1995. These bills (the "modified bills") make several changes to the Administration proposal as incorporated in the Senate amendment to H.R. 831.

Long-term residents who terminate their U.S. residency

The modified bills would apply the tax on expatriation to "long-term residents" who terminate their residency in a manner similar to the provision included in the Administration proposal. Under the modified bills, a long-term resident is an individual who has been a lawful permanent resident of the United States (i.e., a green-card holder) in at least 8 of the prior 15 taxable years. (In contrast, the Administration proposal defines a long-term resident as one who had been a lawful permanent resident for at least 10 of the prior 15 taxable years.) As under the Administration proposal, for purposes of satisfying the 8-year threshold, taxable years for which an individual was a resident of another country under a treaty tie-breaker rule would be disregarded. The tax on expatriation would apply to a long-term resident when (1) the individual is no longer treated as a lawful permanent resident of the United States as that term is defined in section 7701(b)(6), or (2) the individual is treated as a resident of another country under the tie-breaking provisions of a U.S. income tax treaty (and the individual does not elect to waive treaty benefits). Long-term residents who terminate their residency status would be treated as "expatriates" for purposes of applying the tax on expatriation.

Fair market value basis adjustment

Under the modified bills, a nonresident alien individual who becomes a citizen or resident of the United States would be required to utilize a fair market value basis, rather than an historical cost basis, in determining any subsequent gain or loss on the disposition of any property held on the date the individual became a U.S. citizen or resident. The fair market value basis would be equal to the fair market value of the property on the earlier of: (1) the date the individual first became a U.S. citizen or resident, or (2) the date the property first became subject to U.S. tax because it was used in a U.S. trade or business or was a U.S. real property interest. The fair market value basis would apply for all purposes of computing gain or loss on actual or deemed dispositions (not just for purposes of the tax on expatriation), but would not apply for purposes of computing depreciation. This provision would apply only to individuals; it would not apply to a foreign trust that becomes a domestic trust.

An individual would be able to make an irrevocable election not to have the fair market value provision apply to any specified property, solely for purposes of determining gain with respect to that property. Thus, for any property with respect to which the election is made, the taxpayer's gain upon disposition would be determined based on the historical cost of the property. This election would not be available to claim a loss on the disposition of the property. These rules could produce anomalous results. For example, assume that an individual purchased a nondepreciable asset for $100, and that when the individual first became a U.S. resident, the fair market value of the asset was $50. If the asset is later sold for $90, the individual would be required to recognize a gain of $40, since the historical cost election cannot be used to claim a loss. If the asset is instead sold for $101, however, the individual could make the historical cost election and recognize a gain of only $1.

Election for expatriate to be treated as a U.S. citizen

The modified bills would allow an expatriating individual to irrevocably elect, on an asset-by-asset basis, to continue to be taxed as a U.S. citizen with respect to such assets. Under such election, the expatriate would continue to pay U.S. income taxes following expatriation on any income generated by the asset and on any gain realized on the disposition of the asset, as well as any excise tax imposed with respect to the asset (see, e.g., sec. 1491). In addition, the asset would continue to be subject to U.S. gift, estate, and generation-skipping transfer taxes. However, the amount of any transfer tax so imposed would be limited to the amount of income tax that would have been due if the property had been sold for its fair market value immediately before the transfer or death, taking into account any remaining portion of the expatriate's $600,000 exclusion. To make this election, the taxpayer would be required to waive treaty benefits with respect to the specified assets. If an individual elects to be subject to U.S. taxes after expatriation with respect to certain assets, a double taxation issue could arise if the expatriate's new country of residence also imposes a tax on income realized from those assets; however, in most cases there would be no double taxation because the individual would be entitled to a foreign tax credit with respect to the taxes imposed by the non-source country. An expatriating individual would be required to provide security to ensure payment of the tax under this election in such form, manner, and amount as the Secretary of the Treasury would require.

Interests in trusts

In general, the modified bills use the same rules with respect to determining interests in trusts as those provided in the Senate amendment to H.R. 831. However, the bills would modify the special rule for determining the ownership of an interest in a trust where ownership cannot be determined based on the general facts and circumstances test. In such cases, any remaining interests would be allocated to the grantor, if the grantor is a beneficiary of the trust. Otherwise, the ownership of the trust interest would be based on the rules of intestate succession. (The Administration proposal and the Senate bill provided that, in cases where the beneficiaries' interests could not be determined based on the facts and circumstances test, they would be determined based on the beneficiary's degree of family relationship to the settlor.)

Other special rules

Relinquishment of citizenship by certain minors

Under the modified bills, the tax on expatriation would not apply to an individual who relinquishes U.S. citizenship before attaining the age of 18-1/2 years, if the individual lived in the United States for less than five taxable years (as defined under the substantial presence test of sec. 7701(b)(1)(A)(ii)) before the date of relinquishment.

Deferral of tax on expatriation where estate taxes would be deferred

The modified bills provide that the time for the payment of the tax on expatriation could be deferred to the same extent, and in the same manner, as any estate taxes may be deferred under the present-law provisions of section 6161 (without regard to the 10-year limitation of that section). In addition, the tax on expatriation could be deferred on interests in closely-held businesses as provided in present law section 6166. Moreover, the tax on expatriation could be deferred for reversionary or remainder interests in property as provided in section 6153. Finally, payment of tax liability could be deferred under section 6159 to facilitate the collection of tax liabilities.

Method of providing security

The modified bills provide that, if a taxpayer is required to provide security under the expatriation tax provisions, the Secretary of the Treasury could consider the rules with respect to qualified domestic trusts set forth in section 2056A (requiring that assets be contributed to a trust with a responsible U.S. trustee). If an expatriating individual is a beneficiary of a trust, and the beneficiary elects to defer payment of the tax on expatriation with respect to the trust interest, a U.S. trustee of that trust would be required to provide security if the beneficiary provides actual notice of such requirement to the domestic trustee.

Coordination with estate and gift tax imposed upon certain expatriations

Under the modified bills, the tax on expatriation would be allowed as a credit against any U.S. estate or gift taxes subsequently imposed on the same property solely by reason of the special rules imposing an estate or gift tax on property transferred by an individual who relinquished his U.S. citizenship with a principal purpose of avoiding U.S. taxes within 10 years prior to the transfer (i.e., the tax imposed under present-law secs. 2107 and 2501(a)(3)).

"Sailing permits"

The modified bills would repeal the current "sailing permit" requirement of section 6851(d).

Effective date

The effective dates of the modified bills are identical to the effective date of the Senate amendment. The provisions in the modified bills would be effective for U.S. citizens who are deemed to have relinquished their U.S. citizenship on or after February 6, 1995 (i.e., individuals who first made their loss of U.S. citizenship known to a U.S. government or consular official after this date). The tentative tax would not be required to be paid until 90 days after the date of enactment of the bill.

Present law would continue to apply to U.S. citizens who are deemed to have relinquished their citizenship prior to February 6, 1995 (i.e., individuals who first made their loss of U.S. citizenship known to a U.S. government or consular official prior to this date).

The fair market value basis election would apply to any deemed dispositions of property resulting from expatriations occurring on or after February 6, 1995, and any actual dispositions of property after the enactment date, regardless of when the property was acquired.

D. Ways and Means Committee bill (H.R. 1812)

In general

The Ways and Means Committee bill (H.R. 1812) reflects an approach to the taxation of expatriates that is different from the approach of the Administration proposal and the other proposals. The Ways and Means Committee bill would expand and substantially strengthen in several ways the present-law provisions that subject U.S. citizens who lose their citizenship for tax avoidance purposes to special tax rules for 10 years after such loss of citizenship (secs. 877, 2107, and 2501(a)(3)). First, the bill would extend the expatriation tax provisions to apply not only to U.S. citizens who lose their citizenship but also to certain long-term residents of the United States whose U.S. residency is terminated. Second, the bill generally would subject individuals to the expatriation tax provisions without inquiry as to their motive for losing their U.S. citizenship or residency, but would allow certain categories of citizens to show an absence of tax-avoidance motives if they request a ruling from the Secretary of the Treasury as to whether the loss of citizenship had a principal purpose of tax avoidance. Third, the bill would expand the categories of income and gains that are treated as U.S. source income (and therefore subject to U.S. income tax under section 877) if earned by an individual who is subject to the expatriation tax provisions and would eliminate the ability to engage in certain transactions that under current law partially or completely circumvent the 10-year reach of section 877. Further, the bill would provide relief from double taxation in circumstances where another country imposes tax on items that would be subject to U.S. tax under the expatriation tax provisions.

The Ways and Means Committee bill also contains provisions to enhance compliance with the expatriation tax provisions. The bill would impose information reporting obligations on U.S. citizens who lose their citizenship and long-term residents whose U.S. residency is terminated at the time of expatriation. In addition, the bill would direct the Treasury Department to undertake a study regarding compliance by individuals living abroad with their U.S. tax reporting obligations and to make recommendations with respect to improving such compliance.

Individuals covered

The present-law expatriation tax provisions apply only to certain U.S. citizens who lose their citizenship. The Ways and Means Committee bill would extend these expatriation tax provisions to apply also to long-term residents of the United States whose U.S. residency is

terminated. For this purpose, a long-term resident would be any individual who was a lawful permanent resident of the United States for at least 8 out of the 15 taxable years ending with the year in which such termination occurs. In applying this 8-year test, an individual would not be considered to be a lawful permanent resident for any year in which the individual is taxed as a resident of another country under a treaty tie-breaker rule. An individual's U.S. residency would be considered to be terminated when either the individual ceases to be a lawful permanent resident pursuant to section 7701(b)(6) (i.e., the individual loses his or her green-card status) or the individual is treated as a resident of another country under a tie-breaker provision of a tax treaty (and the individual does not elect to waive the benefits of such treaty). Furthermore, a long-term resident could elect to use the fair market value basis of property on the date the individual became a U.S. resident (rather than the property's historical basis) to determine the amount of gain subject to the expatriation tax provisions if the asset is sold within the 10-year period.

Under present law, the expatriation provisions of the income, estate and gift tax regimes are applicable to a U.S. citizen who loses his or her citizenship unless such loss did not have as a principal purpose the avoidance of taxes. Under the Ways and Means Committee bill, for purposes of such income, estate and gift tax provisions, U.S. citizens who lose their citizenship and long-term residents whose U.S. residency is terminated generally would be treated as having lost such citizenship or terminated such residency with a principal purpose of the avoidance of taxes if either: (1) the individual's average annual U.S. Federal income tax liability for the 5 taxable years ending before the date of such loss or termination is greater than $100,000 (the "tax liability test"), or (2) the individual's net worth as of the date of such loss or termination is $500,000 or more (the "net worth test"). The dollar amount thresholds contained in the tax liability test and the net worth test would be indexed for inflation in the case of a loss of citizenship or termination of residency occurring in any calendar year after 1996. An individual who falls below the thresholds specified in both the tax liability test and the net worth test would be subject to the expatriation tax provisions unless the individual's loss of citizenship or termination of residency did not have as a principal purpose the avoidance of tax (as under present law in the case of U.S. citizens).

A U.S. citizen, who loses his or her citizenship and who satisfies either the tax liability test or the net worth test, would not be subject to the expatriation tax provisions if such individual could demonstrate that he or she did not have a principal purpose of tax avoidance and the individual is within one of the following categories: (1) the individual was born with dual citizenship and retains only the non-U.S. citizenship; (2) the individual becomes a citizen of the country in which the individual, the individual's spouse, or one of the individual's parents, was born; (3) the individual was present in the United States for no more than 30 days during any year in the 10-year period immediately preceding the date of his or her loss of citizenship; (4) the individual relinquishes his or her citizenship before reaching age 18-1/2; or (5) any other category of individuals prescribed by Treasury regulations. In all of these situations, the individual would have been subject to tax on his or her worldwide income (as are all U.S. citizens) until the time of expatriation. In order to qualify for one of these exceptions, the former U.S. citizen would be required, within one year from the date of loss of citizenship, to submit a ruling request for a

determination by the Secretary of the Treasury as to whether such loss had as one of its principal purposes the avoidance of taxes. A former U.S. citizen who submits such a ruling request would be entitled to challenge an adverse determination by the Secretary of the Treasury. However, a former U.S. citizen who fails to submit a timely ruling request would not be eligible for these exceptions. It is expected that in making a determination as to the presence of a principal purpose of tax avoidance, the Secretary of the Treasury would take into account factors such as the substantiality of the former citizen's ties to the United States (including ownership of U.S. assets) prior to expatriation, the retention of U.S. citizenship by the former citizen's spouse, and the extent to which the former citizen resides in a country that imposes little or no tax.[45]

The foregoing exceptions would not be available for long-term residents whose U.S. residency is terminated. However, the bill would authorize the Secretary of the Treasury to prescribe regulations to exempt certain categories of long-term residents from the bill's provisions.

Items subject to section 877

Under section 877, an individual covered by the expatriation tax provisions is subject to tax on U.S. source income and gains for a 10-year period after expatriation at the graduated rates

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[45] The Ways and Means Committee bill has been criticized as inappropriately providing exceptions from the expatriate tax provisions for certain categories of individuals who establish that tax avoidance was not a motive for expatriation. The categories to which these exceptions would apply are individuals who have significant connections to another jurisdiction. Under the bill, an individual who becomes a citizen of the country in which the individual, the individual's spouse or one of the individual's parents was born would not be subject to the expatriation tax provisions if the individual did not have a tax avoidance motive for expatriating. Such an individual must submit a ruling request for a determination as to motive in order to qualify for this exception. While, as pointed out by the critics, such an individual could reside in a tax-haven country rather than the foreign country of citizenship, that fact would be a significant factor strongly weighing in favor of a determination that tax avoidance was a principal purpose for the individual's expatriation.

The bill would provide a similar exclusion for individuals who are long-term foreign residents prior to expatriation. Such an individual would have foregone many of the benefits of U.S. citizenship during his or her extended absence from the United States, but nevertheless would have been subject to U.S. tax as a citizen during such period. Moreover, such an individual would be subject to the expatriation tax provisions of the bill unless he or she demonstrates that tax avoidance was not a principal purpose for his or her expatriation.

applicable to U.S. citizens.[46] The tax under section 877 applies to U.S. source income and gains of the individual for the 10-year period, without regard to whether the property giving rise to such income or gains was acquired before or after the date the individual became subject to the expatriation tax provisions. For example, a U.S. citizen who inherits an appreciated asset immediately before losing citizenship and disposes of the asset immediately after such loss would not recognize any taxable gain on such disposition (because of the date of death fair market value basis accorded to inherited assets), but the individual would continue to be subject to tax under section 877 on the income or gain derived from any U.S. property acquired with the proceeds from such disposition.

In addition, section 877 currently recharacterizes as U.S. source income certain gains of individuals who are subject to the expatriation tax provisions, thereby subjecting such individuals to U.S. income tax on such gains. Under this rule, gain on the sale or exchange of stock of a U.S. corporation or debt of a U.S. person is treated as U.S. source income. In this regard, under current law, the substitution of a foreign obligor for a U.S. obligor is generally treated as a taxable exchange of the debt instrument and, therefore, any gain on such an exchange would be subject to tax under section 877. The Ways and Means Committee bill would extend this recharacterization to income and gains derived from property obtained in certain transactions on which gain or loss is not recognized under present law. An individual covered by section 877 who exchanges property that would produce U.S. source income for property that would produce foreign source income would be required to recognize immediately as U.S. source income any gain on such exchange (determined as if the property had been sold for its fair market value on such date). To the extent gain is recognized under this provision, the property would be accorded the step-up in basis provided under current law. This rule requiring immediate gain recognition would not apply if the individual enters into an agreement with the Secretary of the Treasury specifying that any income or gains derived from the property received in the exchange during the 10-year period after the loss of citizenship (or termination of U.S. residency, as applicable) would be treated as U.S. source income. Such a gain recognition agreement would terminate if the property transferred in the exchange is disposed of by the acquiror, and any gain that had not been recognized by reason of such agreement would be recognized as U.S. source as of such date. It is expected that a gain recognition agreement would be entered into not later than the due date for the tax return for the year of the exchange. In this regard, the Secretary of the Treasury would be authorized to issue regulations providing similar treatment for nonrecognition transactions that

[46] Under present law, all nonresident aliens (including expatriates) are subject to U.S. income tax at graduated rates on certain types of income. Such income includes income effectively connected with a U.S. trade or business and gains from the disposition of interests in U.S. real property. For example, compensation (including deferred compensation) paid with respect to services performed in the United States is subject to such tax. Thus, under current law, a U.S. citizen who earns a stock option while employed in the United States and delays the exercise of such option until after such individual loses his or her citizenship would be subject to U.S. tax on the compensation income recognized upon exercise of the stock option (even if the stock received upon the exercise is stock in a foreign corporation).

occur within 5 years immediately prior to the date of loss of citizenship (or termination of U.S. residency, as applicable).

The Secretary of Treasury would be authorized to issue regulations to treat removal of tangible personal property from the United States, and other circumstances that result in a conversion of U.S. source income to foreign source income without recognition of any unrealized gain, as exchanges for purposes of computing gain subject to section 877. The taxpayer could defer the recognition of the gain if he or she enters into a gain recognition agreement as described above. For example, a former citizen who removes appreciated artwork that he or she owns from the United States could be subject to immediate tax on the appreciation under this provision unless the individual enters into a gain recognition agreement.

The foregoing rules regarding the treatment under section 877 of nonrecognition transactions are illustrated by the following examples: Ms. A loses her U.S. citizenship on January 1, 1996, and is subject to section 877. On June 30, 1997, Ms. A transfers the stock she owns in a U.S. corporation, USCo, to a wholly-owned foreign corporation, FCo, in a transaction that qualifies for tax-free treatment under section 351. At the time of such transfer, A's basis in the stock of USCo is $100,000 and the fair market value of the stock is $150,000. Under present law, Ms. A. would not be subject to U.S. tax on the $50,000 of gain realized on the exchange. Moreover, Ms. A would not be subject to U.S. tax on any distribution of the proceeds from a subsequent disposition of the USCo stock by FCo. Under the Ways and Means Committee bill, if Ms. A does not enter into a gain recognition agreement with the Secretary of the Treasury, Ms. A would be deemed to have sold the USCo stock for $150,000 on the date of the transfer, and would be subject to U.S. tax in 1997 on the $50,000 of gain realized. Alternatively, if Ms. A enters into a gain recognition agreement, she would not be required to recognize for U.S. tax purposes in 1997 the $50,000 of gain realized upon the transfer of the USCo stock to FCo. However, under the gain recognition agreement, for the 10-year period ending on December 31, 2005, any income (e.g., dividends) or gain with respect to the FCo stock would be treated as U.S. source, and therefore Ms. A would be subject to tax on such income or gain under section 877. Because any future appreciation in the USCo stock would be reflected in an increase in the value of the FCo stock, such appreciation would potentially be subject to tax under section 877. If FCo disposes of the USCo stock on January 1, 2002, Ms. A's gain recognition agreement would terminate on such date, and Ms. A would be required to recognize as U.S. source income at that time the $50,000 of gain that she previously deferred under the gain recognition agreement. (The amount of gain required to be recognized by Ms. A in this situation would not be affected by any changes in the value of the USCo stock since her June 30, 1997 transfer of such stock to FCo.)

The Ways and Means Committee bill also would extend the recharacterization rules of section 877 to treat as U.S. source any income and gains derived from stock in a foreign corporation if the individual losing citizenship or terminating residency owns, directly or indirectly, more than 50 percent of the vote or value of the stock of the corporation on the date of such loss or termination or at any time during the 2 years preceding such date. Such income and gains would be recharacterized as U.S. source only to the extent of the amount of earnings and

profits attributable to such stock earned or accumulated prior to the date of loss of citizenship (or termination of residency, as applicable) and while such ownership requirement is satisfied.

The following example illustrates this rule: Mr. B loses his U.S. citizenship on July 1, 1996, and is subject to section 877. Mr. B has owned all of the stock of a foreign corporation, FCo, since its incorporation in 1991. As of FCo's December 31, 1995, year-end, FCo has accumulated earnings and profits of $500,000. FCo has earnings and profits of $100,000 for 1996 and does not have any subpart F income (as defined in sec. 952). FCo makes a $100,000 distribution to Mr. B in each of 1997 and 1998. On January 1, 1999, Mr. B disposes of all his stock of FCo and realizes $400,000 of gain. Under present law, neither the distributions from FCo nor the gain on the disposition of the FCo stock would be subject to U.S. tax. Under the Ways and Means Committee bill, the distributions from FCo and the gain on the sale of the stock of FCo would be treated as U.S. source income and would be taxed to Mr. B under section 877, subject to the earnings and profits limitation. For this purpose, the amount of FCo's earnings and profits for 1996 is prorated based on the number of days during 1996 that Mr. B is a U.S. citizen. Thus, the amount of FCo's earnings and profits earned or accumulated before Mr. B's loss of citizenship is $550,000. Accordingly, the $100,000 distributions from FCo in 1997 and 1998 would be treated as U.S. source income taxable to Mr. B under section 877 in such years. In addition, $350,000 of the gain realized from the sale of the stock of FCo in 1999 would be treated as U.S. source income taxable to Mr. B under section 877 in that year.

Section 877 applies to income and gains for the 10-year period following the loss of citizenship (or termination of residency, as applicable). For purposes of applying section 877, the Ways and Means Committee bill would suspend this 10-year period for gains derived from a particular property during any period in which the individual's risk of loss with respect to such property is substantially diminished. For example, Ms. C loses her citizenship on January 1, 1996, and is subject to section 877. On that date Ms. C owns 10,000 shares of stock of a U.S. corporation, USCo, with a value of $1 million. On the same date Ms. C enters into an equity swap with respect to such USCo stock with a 5-year term. Under the transaction, Ms. C will transfer to the counter-party an amount equal to the dividends on the USCo stock and any increase in the value of the USCo stock for the 5-year period. The counter-party will transfer to Ms. C an amount equal to a market rate of interest on $1 million and any decrease in the value of the USCo stock for the same period. Ms. C's risk of loss with respect to the USCo stock is substantially diminished during the 5-year period in which the equity swap is in effect, and therefore, under the Ways and Means Committee bill, the 10-year period under section 877 is suspended during such period. Accordingly, under the bill, if Ms. C sells her USCo stock for a gain on January 1, 2010, such gain would be treated as U.S. source income taxable to Ms. C under section 877. Such gain would not be subject to U.S. tax under present law.

The Ways and Means Committee bill has been criticized as continuing to permit expatriates to avoid the expatriation tax provisions by converting U.S. source income and gain to foreign source income and gain and by entering into hedging transactions. As a preliminary matter, it should be noted that complete exit from the U.S. capital markets in order to avoid the

application of the expatriation tax provisions may be neither attractive nor feasible. In particular, many wealthy individuals who hold significant interests in family-controlled businesses may be unwilling to divest of such interests and cede control of the businesses despite the U.S. tax cost of continued ownership after expatriation. Moreover, under the bill, in order to avoid the reach of the expatriation tax provisions, an expatriate would have to remain out of the U.S. capital markets for the entire ten-year post-expatriation period. Under the Administration proposal, however, an expatriate would have access to the U.S. capital markets immediately after expatriation without being subject to any special U.S. tax regime with respect to the income so earned.

The Ways and Means Committee bill contains specific provisions aimed at eliminating the tax-avoidance opportunities through conversion or hedging that are potentially available under the expatriation tax provisions of present law. First, under the bill, immediate gain recognition generally would be required if an expatriate converts U.S. property into foreign property in a transaction or other occurrence that would otherwise not be a recognition event; no such gain recognition would be required if the expatriate enters into an agreement to treat all income and gains from the foreign property as U.S. source income that is subject to tax under section 877. This gain recognition agreement would terminate (and the deferred gain would be recognized) upon a disposition of the U.S. property that was transferred in the conversion transaction. Second, under the bill, the ten-year period for application of section 877 would be suspended with respect to gains from an asset during any period in which the expatriate's risk of loss with respect to the asset is substantially diminished through a hedge, swap or any other transaction. An expatriate could avoid tax on gains under these provisions only by holding the acquired foreign asset completely unhedged until the expiration of the ten-year post-expatriation period (and ensuring that the recipient of the U.S. asset disposed of by the expatriate in the conversion transaction holds such asset for the same period). Ten years is a long period to hold an asset and be at risk with respect to such asset. Moreover, the expatriate would be subject to tax under section 877 on any income generated by the foreign asset during the ten-year period.

Double tax relief

In order to avoid the double taxation of individuals subject to the expatriation tax provisions, the Ways and Means Committee bill would provide a credit against the U.S. tax imposed under such provisions for any foreign income, gift, estate or similar taxes paid with respect to the items subject to such taxation. This credit would be available only against the tax imposed solely as a result of the expatriation tax provisions, and would not be available to be used to offset any other U.S. tax liability. For example, Mr. D loses his citizenship on January 1, 1996 and is subject to section 877. Mr. D becomes a resident of Country X. During 1996, Mr. D recognizes a $100,000 gain upon the sale of stock a U.S. corporation, USCo. Country X imposes $20,000 tax on this capital gain. But for the double tax relief provision, Mr. D would be subject to tax of $28,000 on this gain under section 877. However, under the Ways and Means Committee bill, Mr. D 's U.S. tax under section 877 would be reduced by the $20,000 of foreign tax paid, and Mr. D 's resulting U.S. tax on this gain would be $8,000.

Effect on tax treaties

The Ways and Means Committee found that the expatriation tax provisions, as amended by its bill, would be generally consistent with the underlying principles of income tax treaties to the extent the bill would provide a foreign tax credit for items taxed by another country, but intended that the purpose of the expatriation tax provisions, as amended, not be defeated by any treaty provision. The Treasury Department would be expected to review all outstanding treaties to determine whether the expatriation tax provisions, as revised, potentially conflict with treaty provisions and to eliminate any such potential conflicts through renegotiation of the affected treaties as necessary. Beginning on the tenth anniversary of the enactment of the Ways and Means Committee bill, any conflicting treaty provisions that remain in force would take precedence over the expatriation tax provisions as revised.

Critics of the Ways and Means Committee bill have objected to this override of any contrary treaty provisions. However, it is believed that the provisions of the bill are generally consistent with treaty obligations to the extent that the bill provides a foreign tax credit for items that are taxed both by the expatriation tax provisions and by a foreign country. Moreover, in light of the small number of individuals who expatriate to any given treaty partner coupled with the foreign tax credit provision that cedes primary taxing jurisdiction over such individuals to the treaty partner, it is unlikely that any of our treaty partners will have strong objections to the provisions contained in the bill. In addition, it should be noted that the Administration proposal would also raise issues regarding potential conflicts with treaty provisions because it would tax former citizens and residents of the United States; furthermore, unlike the Ways and Means Committee bill, the Administration proposal does not include a foreign tax credit that would mitigate any such conflicts.

Required information reporting and sharing

In order to facilitate the administration of the expatriation tax provisions, under the Ways and Means Committee bill, a U.S. citizen who loses his or her citizenship would be required to provide a statement to the State Department (or other designated government entity) which includes the individual's social security number, forwarding foreign address, new country of residence and citizenship and, in the case of individuals with a net worth of at least $500,000, a balance sheet. The entity to which such statement is to be provided would be required to provide to the Secretary of the Treasury copies of all statements received and the names of individuals who refuse to provide such statements. A long-term resident whose U.S. residency is terminated would be required to attach a similar statement to his or her U.S. income tax return for the year of such termination. An individual's failure to provide the required statement would result in the imposition of a penalty for each year the failure continues equal to the greater of (1) 5 percent of the individual's expatriation tax liability for such year, or (2) $1,000.

The Ways and Means Committee bill would require the State Department to provide the Secretary of the Treasury with a copy of each CLN approved by the State Department. Similarly,

the bill would require the agency administering the immigration laws to provide the Secretary of the Treasury with the name of each individual whose status as a lawful permanent resident has been revoked or has been determined to have been abandoned.

Further, the Ways and Means Committee bill would require the Secretary of the Treasury to publish in the Federal Register the names of all former U.S. citizens from whom it receives the required statements or whose names it receives under the foregoing information-sharing provisions.

The Ways and Means Committee bill has been criticized as unadministrable because it would rely on voluntary compliance. However, the entire U.S. tax system is based on voluntary compliance. The burden of administration of the expatriation tax provisions would be eased under the bill because of the elimination in many cases of the requirement that tax-avoidance motives for expatriation be proven and the institution in other cases of a ruling request process to determine the motive for expatriation. Under present law, a wealthy individual could take the position that he had not expatriated for tax avoidance purposes and therefore is not subject to the expatriation tax provisions. Under the bill, wealthy individuals who do not establish their eligibility for an exception would be subject to the expatriation tax provisions without regard to the motive for expatriation. For such an individual, failure to pay the expatriation tax no longer would be a matter of an aggressive interpretation of the applicability of the expatriation tax provisions but instead would be a violation of the U.S. tax laws. This change from present law is significant, particularly in light of the evidence of the reluctance of high-profile, wealthy individuals to break the law. In addition, the bill provides for information sharing between the State Department (and other governmental agencies with information regarding expatriates) and the Treasury Department which would facilitate policing of the expatriation tax provisions. Finally, it should be noted that the Administration proposal would impose on expatriates a tax liability to be paid after expatriation, and thus would similarly require voluntary compliance after expatriation. There is no practical mechanism for avoiding reliance on voluntary compliance.

Treasury report on tax compliance by U.S. citizens and residents living abroad

In order to address the compliance issues raised during the course of the Joint Committee staff study on the taxation of expatriates, the Treasury Department would be directed to undertake a study on the tax compliance of U.S. citizens and green-card holders residing outside the United States and to make recommendations regarding the improvement of such compliance. The findings of such study and such recommendations would be required to be reported to the House Committee on Ways and Means and the Senate Committee on Finance within 90 days of the date of enactment.

During the course of the Joint Committee staff study, a specific issue was identified regarding the difficulty in determining when a U.S. citizen has committed an expatriating act with the requisite intent, and thus no longer has the obligation to continue to pay U.S. taxes on his or her worldwide income due to the fact that the individual is no longer a U.S. citizen. Neither the

Immigration and Nationality Act nor any other Federal law requires an individual to request a CLN within a specified amount of time after an expatriating act has been committed, even though the expatriating act terminates the status of the individual as a U.S. citizen for all purposes, including the status of being subject to U.S. tax on worldwide income. Accordingly, the Ways and Means Committee anticipated that the Treasury report, in evaluating whether improved coordination between executive branch agencies could improve compliance with the requirements of the Internal Revenue Code, would review the process through which the State Department determines when citizenship has been lost, and make recommendations regarding changes to such process to recognize the importance of such date for tax purposes. In particular, the Committee anticipated that the Treasury Department would explore ways of working with the State Department to insure that the State Department would not issue a CLN confirming the commission of an expatriating act with the requisite intent necessary to terminate citizenship in the absence of adequate evidence of both the occurrence of the expatriating act (e.g., the joining of a foreign army) and the existence of the requisite intent.

Effective date

The expatriation tax provisions as modified by the Ways and Means Committee bill generally would apply to any individual who loses U.S. citizenship on or after February 6, 1995, and any long-term residents whose U.S. residency is terminated on or after June 13, 1995. For citizens, the determination of the date of loss of citizenship would remain the same as under present law (i.e., the date of loss of citizenship would be the date of the expatriating act). However, a special transition rule would apply to individuals who committed an expatriating act within one year prior to February 6, 1995, but had not applied for a CLN as of such date. Such an individual would be subject to the expatriation tax provisions as amended by the bill as of the date of application for the CLN, but would not be retroactively liable for U.S. income taxes on his or her worldwide income. In order to qualify for the exceptions provided for individuals who fall within one of the specified categories, such individual would be required to submit a ruling request within 1 year after the date of enactment of the bill.

The special transition rule is illustrated by the following example. Mr. E joined a foreign army on October 1, 1994 with the intent to relinquish his U.S. citizenship, but Mr. E does not apply for a CLN until October 1, 1995. Under the Ways and Means Committee bill, Mr. E would be subject to the expatriation tax provisions (as amended) for the 10-year period beginning on October 1, 1995. Moreover, if Mr. E falls within one of the specified categories (i.e., Mr. E is age 18 when he joins the foreign army), in order to qualify for the exception provided for such individuals, Mr. E would be required to submit his ruling request within 1 year after the date of enactment of the bill. Mr. E would not, however, be liable for U.S. income taxes on his worldwide income for any period after October 1, 1994.

The information reporting provisions under the Ways and Means Committee bill would apply to U.S. citizens who lose their citizenship and long-term residents whose U.S. residency is terminated after the date of enactment.

V. REVENUE ESTIMATES AND ESTIMATING METHODOLOGY

In general

Estimating the revenue effects of proposed legislation to modify the tax treatment of U.S. citizens and long-term residents who relinquish their citizenship or residence ("expatriates") is inherently difficult, particularly in cases in which the decision to relinquish citizenship or residence is made, at least in part, for tax reasons. Depending upon the proposal, there may be both income and estate tax consequences to the act of relinquishing citizenship or residence. The consequences may be significantly affected by whether the assets of the citizen or resident are U.S. or foreign situs and by whether the assets are held in trust.

Under all of the proposals that have been reported, it is necessary to estimate the number of individuals who will expatriate. Under some proposals, it is necessary to estimate the number of citizens who expatriate for tax avoidance purposes. Under all of the proposals, it is necessary to estimate the behavioral effect that will occur as a result of the proposal. In addition, it is necessary under certain proposals to estimate the unrealized appreciation of assets held by potential expatriates.

The current levels of expatriation are well documented by the State Department. However, the current levels of expatriation for tax avoidance purposes cannot be determined with precision because it is impossible to infer taxpayers' intent in expatriating. Thus, the revenue estimates of the various proposals ultimately are based upon the best judgment of the Joint Committee staff using anecdotal evidence that is available publicly, plus tax return information obtained from the IRS, expatriation data obtained from the State Department, and other data and information available to the Joint Committee staff.

Calculating a baseline

Revenue estimates measure the anticipated changes in Federal receipts that result from proposed legislative changes to the Internal Revenue Code or related statutes. The reference point for a revenue estimate is the revenue baseline, which projects Federal receipts assuming that present law remains unchanged. Thus, in its simplest form, a revenue estimate measures projected Federal receipts under a proposed change in law minus the projected Federal receipts under present law. If this formula yields a negative result, the proposal is a revenue loser. If the formula yields a positive result, the proposal is a revenue raiser.

In order to determine the present-law baseline with respect to proposals to alter the tax treatment of expatriation, the Joint Committee staff received information from the State Department relating to the number of U.S. citizens who relinquish citizenship each year and the number of long-term U.S. residents who change their residence.

More difficult determinations that are relevant for calculating the baseline include the levels of income, unrealized appreciation of assets, location of assets (i.e., U.S. or foreign), the wealth of those who are expatriating under present law, the tax effects of expatriation, and the reasons for expatriation. Individuals may receive any of several tax benefits from expatriation, assuming they relocate to a low-tax environment. First, they remove some or all of their entrepreneurial and investment income from current U.S. taxation. Second, they are able to recognize some or all of their unrealized gains at relatively low cost. Third, they largely insulate themselves from U.S. estate tax liability.

Shortly after release of the Administration's Fiscal Year 1996 Budget, the Joint Committee staff received information from the staff of the Treasury Department concerning U.S. citizens or lawful permanent residents who had relinquished, or appeared to be in the process of relinquishing, citizenship or residence. This information was updated by subsequent information provided by the IRS and the Treasury Department. The subsequent information provided by the Treasury Department contained tax liability information for individuals who had expatriated in 1993 or 1994 according to State Department information and whose names could be matched to the IRS Individual Income Tax Return Master File. Of the 697 individuals who expatriated in 1993, the Treasury Department was able to match 13 names to the Individual Income Tax Return Master File with tax liability information for certain of the years 1989-1992. Of these 13 matches, seven had tax liability in any year less than $10,000. The total tax liability for all years matched was approximately $20 million. The information matched to those who had expatriated in 1994 showed a higher total tax liability for all years matched. However, it is unclear how the information that was matched would relate to information for all individuals who had expatriated during the 1993-1994 period. In addition, the information relating to tax liability provides no information as to an individual's wealth and, to the extent only one or two years of tax liability is shown, may show no information as to what an expatriating individual's tax liability would be if the individual did not expatriate. The Joint Committee staff found the Treasury Department information useful, but not determinative, in analyzing the potential effect of any of the proposals on fiscal year budget receipts.

In addition, the Joint Committee staff asked the State Department to match names appearing on the Forbes 400 list of the wealthiest people in the United States with (1) the names of people who had been publicly reported to have expatriated and (2) State Department data on individuals who had actually relinquished U.S. citizenship during 1994 and 1995. The Forbes 400 list was utilized because it was the only information of which the Joint Committee staff was aware that provided a measure of the net wealth of individuals. In addition, a number of the individuals listed in the Forbes 400 list have been identified publicly as having expatriated or being in the process of expatriating and the Joint Committee staff wanted to verify the extent to which the reported information was accurate.

A present-law baseline was formed by extrapolating available information on expatriation to fiscal years 1995-2005. This extrapolation included judgments about the representativeness of the tax information, the potential numbers of expatriates, and the application of present law.

Expatriation is assumed to be cyclical, affected by numerous factors, and the number of potential expatriates is limited. In addition, potential erosion of U.S. estate tax liabilities was omitted from consideration because of the inherent difficulty in predicting mortality and estate tax consequences.

The published reports of expatriation allegedly for tax avoidance purposes that predated the Administration proposal, the Administration proposal itself, and the reports (and in some cases solicitations) that ensued have altered the individual and institutional (e.g., State Department and IRS) awareness of expatriation, regardless of whether the Administration proposal or something similar is enacted. The Joint Committee staff made the assumption that such publicity has not altered the present-law baseline because it is not clear how the parties involved will react. Some potential expatriates may be wary of the personal and professional stigma that may be attached to expatriation given the greater publicity of the issue in recent months. Others may use the recent publicity as a road map to expatriation. The Joint Committee staff also assumed that the IRS would make no additional efforts to enforce present law with regard to expatriation.

Behavioral effects

One of the most significant elements of the estimates of revenue effects of modifications to the tax treatment of expatriation is the assumed effect of the proposal on taxpayer behavior. For those individuals who it is assumed would expatriate during the budget period under present law, there are two possible reactions to a modification to the tax treatment of expatriation.

First, the individual may decide not to expatriate and, therefore, would remain a U.S. citizen or resident. In this case, the individual would continue to pay U.S. income and estate (if applicable) taxes. In evaluating how many of the individuals who are assumed in the present-law baseline to be likely to expatriate during the budget period but would not do so as a result of the proposal, it was necessary to evaluate the tax consequences of remaining a U.S. citizen or resident relative to the tax consequences of expatriating. For example, because the Administration proposal would impose tax on unrealized gains of assets held upon expatriation, individuals with low-basis assets might be deterred from expatriating. Similarly, the potential double taxation that could occur as a result of the Administration proposal might deter an individual from expatriating.

Second, the individual may decide to expatriate in any event and pay whatever taxes are owed as a result of the expatriation. Individuals who will fall into this category would include those whose expatriation is for nontax purposes in the first place. Also, under the Administration proposal, individuals with high-basis assets might conclude that the cost of expatriation is small relative to the potential exposure to U.S. estate taxes. Some have suggested that the Administration proposal might encourage some individuals who had not previously considered expatriation to do so.

A factor that may also determine whether the decision to expatriate (and the revenue consequences of any proposal) is the age of the individual and the likelihood of death occurring during the period shortly after expatriation. However, as indicated earlier, this element has not been incorporated into the estimates of the present-law baseline or of the effects of any of the proposals because of the inherent difficulty in predicting mortality, wealth, and the estate tax consequences for a particular group of individuals.

Potential macroeconomic effects

The estimates of proposals to alter the tax treatment of expatriation do not include any changes in aggregate macroeconomic variables such as domestic investment. This assumption is consistent with the macroeconomic baseline required to be used for estimating purposes by the Joint Committee staff. It also comports with the Joint Committee staff's judgment that a proposal like the Administration's affecting a relatively small number of individuals, regardless of their wealth, would not cause a noticeable change in the overall U.S. economy.

Estimates of the proposals

Administration proposal

The Joint Committee staff estimates that the Administration proposal would have the following effect on fiscal year budget receipts:

Fiscal Years
[Billions of Dollars]

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	95-05	96-00
Administration proposal	*	*	0.1	0.1	0.2	0.2	0.2	0.2	0.3	0.3	0.3	1.9	0.6

* Gain of less than $50 million.

This estimate differs from the estimate provided to the Congress during consideration of H.R. 831. In conjunction with its study of expatriation tax issues, the Joint Committee staff acquired additional information on the number and tax status of recent expatriates. In addition, the Joint Committee staff learned more about the decision required of the heterogeneous pool of potential expatriates, under this and other proposals discussed in the study.

The Administration proposal would increase revenue by imposing a tax on appreciation which is effectively absent or delayed under present law. This tax is high enough to delay or deter some expatriation. Potential expatriates with sizable appreciation in self-created assets, such as businesses they started up, would find expatriation more costly under the Administration proposal. As a result, the entrepreneurial and investment income they generate on an ongoing basis would be subject to U.S. income tax. Some potential expatriates may adjust their economic

activities to avoid the tax imposed under the Administration proposal, but this adjustment may be difficult to make, particularly for individuals who run their own businesses. In the longer term, four or five years after the proposal is enacted, individuals planning to expatriate at that time would have had enough of a warning to prepare properly for expatriation, so growth in revenue attributable to the Administration proposal drops off significantly. As under present law, the effect of the Administration proposal on estate tax receipts was excluded.

The Administration proposal also may cause some new and accelerated expatriation. Individuals with high-basis assets but no immediate concern about the U.S. estate tax may expatriate in response to the Administration's proposal. Some of these individuals would accelerate expatriation that would have occurred in any event under present law. Others who would not have expatriated under present law may expatriate because of the Administration proposal. Individuals falling into this latter group include those who would not expatriate under present law because with the passage of time they would find it difficult for various reasons to surrender citizenship or permanent residence, but the Administration proposal stimulates them to take advantage of a high-basis "window" to expatriate at a time that they are relatively unencumbered. Individuals in this category include individuals who have recently inherited wealth or who expect to inherit wealth in the near future and individuals who have recently sold their businesses in a taxable transactions.

Individuals who would expatriate in the budget window because of the Administration proposal precipitate two tax effects. These expatriates would be taxed on unrealized capital gain at the time of expatriation. Secondly, U.S. tax base would be eroded by these expatriating individuals because: (1) they would be removing subsequent capital gain they would have realized under present law from the U.S. tax base; (2) they may qualify for reduced U.S. taxation on other income because of a tax treaty; and (3) they would remove themselves from potential U.S. estate tax consequences. In the Joint Committee staff's ten-year estimate of the Administration proposal, these two countervailing effects, the tax on unrealized capital gain and the tax base erosion, largely cancel each other out. In the longer run, stimulated expatriation will reduce the revenue raised by the Administration proposal as the tax base erosion factor outweighs the revenue gain from the tax on capital gain at the time of expatriation.

Senate amendment to H.R. 831

The estimate of the revenue effects of the Senate amendment to H.R. 831 is as follows:

Fiscal Years
[Billions of Dollars]

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	95-05	96-00
Senate Amendment	*	*	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	1.6	0.5

* Gain of less than $50 million.

The estimated revenue effects of the Senate amendment to H.R. 831 are lower than those for the Administration proposal to reflect the fact that the Senate amendment would not apply to long-term residents of the United States. In addition, the Senate amendment effective date would delay the effective date for payment of the tax to 90 days after the date of enactment. However, this lower revenue gain would be partially offset by the fact that the Senate amendment would, in certain circumstances, deem the loss of citizenship to occur at a date earlier than the Administration proposal, which would apply the tax on expatriation to more individuals and at an earlier date than would the Administration proposal.

S. 700 (Senator Moynihan) and H.R. 1535 (Representative Gibbons)

The estimated effects of the modified bills (S. 700 and H.R. 1535) on Federal fiscal year budget receipts are as follows:

Fiscal Years
[Billions of Dollars]

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	95-05	96-00
S.700 and H.R. 1535	*	*	*	*	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.8	0.2

* Gain of less than $50 million.

Under S. 700 and H.R. 1535, the expatriation tax would apply both to U.S. citizens who expatriate and to long-term U.S. residents who relinquish their residence. Thus, the estimated revenue gain takes into account the potential tax imposed on both groups. Under the bills, an expatriating individual could elect to continue to be taxed as a U.S. citizen, rather than being subject to the tax on expatriation. It is anticipated that individuals would only make this election if the effect would be to reduce the total taxes owed. Thus, the election is assumed to reduce the revenue gain that otherwise might be raised under the bills.

The bills would provide a basis step up with respect to assets held by a nonresident alien individual who becomes a citizen or resident of the United States. Thus, under the bills, the amount of gain on sale of such assets that would be subject to U.S. tax would be the gain during the period the individual was a citizen or resident of the United States. Because this treatment is more favorable to the taxpayer than the treatment accorded under present law (i.e., that all appreciation is subject to tax without regard to whether it accrued during the time of U.S. citizenship or residence), this provision produces a revenue loss relative to present law.

The bills would provide an exception to the expatriation tax with respect to certain individuals who relinquish U.S. citizenship before the age of 18-1/2, which would also be expected to reduce the revenue gain relative to the Administration proposal.

The effective dates of S. 700 and H.R. 1535 are the same as the effective date in the Senate amendment to H.R. 831; therefore, the bills have the potential to subject individuals to the expatriation tax at a time earlier than under the Administration proposal.

Ways and Means Committee bill (H.R. 1812)

The estimate of the revenue effects of the Ways and Means Committee bill (H.R. 1812) is as follows:

Fiscal Years
[Billions of Dollars]

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	95-05	96-00
Ways and Means Committee bill	*	0.1	0.1	0.1	0.2	0.3	0.3	0.3	0.3	0.3	0.4	2.4	0.8

* Gain of less than $50 million.

The Ways and Means Committee bill (H.R. 1812) would subject individuals to U.S. income and estate taxes with regard to U.S.-sourced items for ten years after U.S. citizenship or long-term residence is relinquished. Among other things, the bill includes changes in the provisions covering the transfer or conversion of assets. As described in the following section, the Joint Committee staff estimated that H.R. 1812 would deter some individuals from expatriating while causing others to pay additional U.S. income taxes.

Variations between Joint Committee on Taxation estimates and Treasury Department estimates

There are disparties between the revenue estimates of the various expatriation tax proposals provided by the Treasury Department and the estimates provided by the Joint Committee staff. As recently as the markup of H.R. 1812 by the Committee on Ways and Means, the Treasury Department estimated that the Administration proposal would raise Federal budget receipts by $2.2 billion over the fiscal year 1995-2000 period, while the Joint Committee staff estimated an increase of $0.6 billion over the same window. With regard to the Ways and Means Committee bill (H.R. 1812), the Treasury Department estimated an increase of $0.1 billion, while the Joint Committee staff estimated an increase of $0.8 billion. The modified bills (S. 700 and H.R. 1535) have been estimated to raise $1.7 billion by the Treasury Department, while the Joint Committee staff has estimated that these bills would raise $0.2 billion.

One principle guiding the Joint Committee staff revenue estimates with respect to the expatriation proposals is that potential expatriates are heterogeneous. A second principle is that an individual who desires to sever direct economic ties to the United States would be able to circumvent all of the expatriation proposals advanced to this date. The final principle is that there will be no enforcement of present law section 877 in the current budget baseline.

The Joint Committee staff evaluated the income tax effects of all the expatriation proposals in light of these principles. The staff did not account for estate tax effects of any of the proposals because of the lack of reliable data on expatriate wealth, the inaccuracy inherent in applying general mortality tables to a small group of expatriates, and the complexity of forecasting the outcomes of estate settlements (e.g., marital exclusions, philanthropic giving). It is the understanding of the Joint Committee staff that the estimates made by the Treasury Department do incorporate changes in estate and gift tax receipts caused by the expatriation proposals.

Although the Joint Committee staff's revenue estimates do not take into account estate tax effects, it should be noted that the estate tax provisions for expatriates are different under the Administration proposal and the Ways and Means Committee bill. Under the Administration proposal, a former U.S. citizen would be subject to the estate tax provisions for expatriates only if tax avoidance was a principal purpose for the individual's loss of citizenship. Under the Ways and Means Committee bill, former citizens who meet the specified income or net worth threshold generally would be subject to the estate tax provisions for expatriates without regard to their motive for expatriating. Accordingly, a wealthy expatriate who transfers all of his or her assets to a foreign corporation he or she controls and who dies within ten years of expatriation would pay no estate tax under the Administration proposal (unless a tax-avoidance purpose is established) but generally would be subject to the estate tax under the Ways and Means Committee bill.

The "target" expatriate, that is, the individual who the Joint Committee staff believes would be affected by the expatriation proposals, is an individual who wants to maintain a substantial economic presence in the United States after expatriation. This presence might take the form of personal economic activity such as running a business, or might involve a more indirect presence such as substantial holdings of U.S. corporate stock. The target expatriate is assumed to retain at least some U.S. assets, even though this may not result in overall short-term tax minimization. The motive for the target's expatriation could be concern about high income tax rates or possible imposition of estate taxes.

The Administration proposal and the modified bills both impose tax on unrealized gain at the time of expatriation. The Joint Committee staff estimated that the Administration proposal would deter target expatriates with substantial unrealized gains, or would extract significant tax payments in the event expatriation occurs. Taxpayers with low unrealized gains, who under present law would be in no hurry to make an expatriation decision, might find expatriation attractive given their current low-gain status. Expatriates who have low unrealized gains could find it advantageous to expatriate sooner under the Administration proposal, or any other proposal that would impose a toll charge on unrealized gains at time of departure.

The modified bills (S. 700 and H.R. 1535), allow an asset-by-asset election. Under this election, taxpayers would be able to treat high-gain assets throwing off little current income as taxable by the United States following expatriation, while they could treat low-gain assets throwing off substantial income as subject only to the U.S. tax on unrealized gains at the time of expatriation.

The Ways and Means Committee bill imposes a ten-year income and estate tax requirement on expatriates. The Joint Committee staff considers ten years to be a significant obstacle to a potential expatriate who wants to avoid capital gains or estate taxes. The bill does not subject foreign source income to U.S. taxation after expatriation (with some exceptions), but the U.S. tax on foreign source income is contingent on foreign tax credits and accurate reporting. An individual receiving a significant amount of low-tax foreign income would seem to have little incentive to subject himself to U.S. taxation in any event, with or without a change in the tax treatment of expatriates.

With regard to expatriation motivations, the Ways and Means Committee bill also impedes a potential group of expatriates who are not significantly restrained by the other proposals. The ten-year requirement of the Ways and Means Committee bill would reduce the incentive to expatriate when death is pending.