

July 2015

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## Recommended Citation

Cantley, Beckett G. (2013) "Taxation Expatriation: Will the Fast Act Stop Wealthy Americans From Leaving the United States?," *Akron Law Review*: Vol. 36 : Iss. 2 , Article 1.

Available at: <http://ideaexchange.uakron.edu/akronlawreview/vol36/iss2/1>

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## TAXATION EXPATRIATION: WILL THE FAST ACT STOP WEALTHY AMERICANS FROM LEAVING THE UNITED STATES?

*Beckett G. Cantley\**

### I. INTRODUCTION

In the wake of September 11, 2001,<sup>1</sup> several influential lawmakers have sought to pass tax legislation that would reduce the tax benefits that may result from an American citizen expatriating to a foreign nation. According to these congressional critics, certain wealthy American citizens are willing to relinquish their United States citizenship to save taxes (“tax expatriates”). The last major attempt to prevent tax expatriation was undertaken in 1995 when Internal Revenue Code (“I.R.C.”) § 877 was enacted. Several congressional critics have charged that I.R.C. § 877 is being easily circumvented by tax expatriates and their advisors.<sup>2</sup> To stem the tide of tax expatriation, the Senate

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1. Warren Rojas, *Senate Taxwriters Adopt Military Tax Package with New Expatriation Curb*, 27 TAX NOTES INT’L 1485, Sept. 23, 2002, at 1485. The tax changes were added as offsets on the one year anniversary of the September 11, 2001 attacks. *Id.* “This bill pays respect to the men and women making sacrifices and, in some cases, risking their lives to protect and defend freedom . . . [t]he full Senate should pass the bill before the session ends this fall.” *Id.* at 1486.

2. Brigid McMenamin, *Home Free*, FORBES, July 26, 1999, at 110 (stating it “ain’t working,” concerning the Expatriation Act). This article further stated examples of the previous Expatriation Act for the high profile expatriation of Tara Getty (Paul Getty’s grandchild), Jacob Stolt-Nielson, Jr. (son of shipping magnate Jacob Stolt-Neilson) and Joseph J. Bogdanovich, Jr. (heir to the Star-Tuna fortune). *Id.* See also, Martin A. Sullivan, *News Analysis: Democrats Revisit Expatriate Tax: With Neutrality & Justice for All*, 19 TAX NOTES INT’L 1705, Nov. 1, 1999, at 1705 (quoting Democrats Charles B. Rangel of New York and Robert Matsui of California). Sullivan quotes them as saying, “1996 legislation that claimed to close loopholes allowing wealthy U.S. citizens to avoid taxes by renouncing their citizenship has failed.” *Id.* See also, Ryan J. Donmoyer & Heidi Glen, *U.S. Democrats Gun for Expatriate Cheats*, WORLD WIDE TAX DAILY, Oct. 1, 1999, at 190-96.

Finance Committee has added certain tax provisions to the Foreign and Armed Services Tax Fairness Act (Draft Fast Act)<sup>3</sup> that would bolster the provisions existing under I.R.C. § 877. Under the Draft Fast Act, two of the ways<sup>4</sup> tax expatriates would be punished are by: (1) treating all of the tax expatriate's holdings as if they had been sold the day before expatriation, thereby triggering all inherent capital gains on the holdings<sup>5</sup> and (2) requiring that estate taxes due from the death of a tax expatriate be collected against a domestic heir of the tax expatriate, rather than the tax expatriate's estate.<sup>6</sup> Currently, the Draft Fast Act is awaiting a floor vote in the Senate. As such, the time is ripe to analyze the Draft Fast Act and determine whether it will prevent tax expatriation.

## II. CURRENT TAX CONSEQUENCES OF EXPATRIATION

### A. Non-Tax Expatriation

#### 1. Income Tax

In general, U.S. taxpayers are taxable on their worldwide<sup>7</sup> income.<sup>8</sup>

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3. Armed Forces Tax Fairness Act of 2002, H.R. 5063, 107th Cong. (2002) (discussing how the proposed changes to the Armed Forces Tax Fairness Act of 2002 would dramatically affect the tax liability of individuals who expatriate for tax motivated purposes such as imposing the Mark-to-Market tax on expatriating individuals).

4. S. REP. NO. 107-283, at 11 (2002). Other than the two penalties discussed above the Act would also impose other penalties for expatriates who leave the U.S. for tax avoidance purposes. *Id.* First, the scope of items treated as U.S. source income for § 877 purposes is broader than those items generally considered to be U.S. source income under the code. *Id.* For example, gains on the sale or exchange of personal property located in the U.S. and gains on the sale or exchange of stocks and securities issued by the U.S. are generally not considered to be U.S. source income under the code. *Id.* Thus, such gains would not be taxable to a nonresident non-citizen. *Id.* However, if an individual is subject to the alternative regime under § 877, such gains are treated as U.S. source income. *Id.* Second, any tax credit that might be used to offset U.S. tax liability is now only available against the tax imposed solely as a result of the expatriation tax provision and is not available to be used to offset any other tax liability. *Id.* Third, investments in retirement plans and trusts will be included in gross income and taxed. *Id.* Fourth, any individual who expatriates for tax avoidance purposes will be denied re-entry into the United States, even if the entry is for a visit only. *Id.*

5. S. REP. NO. 107-283, at 10-11 (discussing the Mark-to-Market provision of the Act which provides that all property of a covered expatriate shall be treated as sold on the day before the expatriation date for its fair market value).

6. *Id.* at 12 (discussing estate tax rules with respect to expatriates).

7. *Id.* at 13. The Senate Report provides in pertinent part:

The expatriation tax provisions permit 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 is available only against the tax imposed solely

An individual who relinquishes his or her U.S. citizenship<sup>9</sup> and does not have a tax purpose for the expatriation ceases to be taxed as a U.S. citizen for U.S. income tax purposes.<sup>10</sup> Provided that such expatriated individual also ceases to reside in the U.S.,<sup>11</sup> the expatriated individual

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as a result of the expatriation tax provisions and is not available to be used to offset any other U.S. tax liability.

*Id.*

8. I.R.C. § 11 (2002) (providing that “[a] tax is hereby imposed for each taxable year on the *taxable income* of every corporation”) (emphasis added). I.R.C. § 63(a) (2002) (providing that (a) “[e]xcept as provided in subsection (b), for purposes of this subtitle, the term ‘taxable income’ means *gross income* minus the deductions allowed by this chapter (other than the standard deduction”) (emphasis added). I.R.C. § 61(a) (2002) (providing that “[e]xcept as otherwise provided in this subtitle, gross income means *all income from whatever source derived*”) (emphasis added). As such, “gross income” includes all worldwide income. *Id.*

9. S. REP. NO. 107-283 (2002), at 14. The Senate Report provides in pertinent part:

A U.S. citizen who loses his or her citizenship is required to provide a statement to the State Department (or other designated government entity) that includes the individual’s social security number, forwarding address, new country of residence and citizenship, a balance sheet in the case of individuals with a net worth of at least \$500,000, and such other information as the Secretary may prescribe. This information statement must be provided no later than the earliest day on which the individual (1) renounces the individual’s U.S. nationality before a diplomatic or consular officer of the United States, (2) furnishes to the U.S. Department of State a statement of voluntary relinquishment of U.S. nationality confirming an act of expatriation, (3) is issued a certificate of loss of U.S. nationality by the U.S. Department of State, or (4) loses U.S. nationality because the individual’s certificate of naturalization is canceled by a U.S. court. The entity to which such statement is to be provided is 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 is required to attach similar statements to his or her U.S. income tax return for the year of such termination. An individual’s failure to provide the required statement results in the imposition of a penalty for each year the failure continues equal to the greater of (1) five percent of the individual’s expatriation tax liability for such year, or (2) \$1,000.

*Id.*

10. See I.R.C. § 2107 (2002). If a person’s expatriation was not motivated by tax avoidance, then under the estate tax rules, the decedent’s estate includes the proportion of the decedent’s stock in a foreign corporation that the fair market value of the U.S. situs assets owned by the corporation bears to the total assets of the corporation. This rule applies only if (1) the decedent owned directly, at death 10 percent or more of the combined voting power of all voting stock of the corporation and (2) the decedent owned, directly or indirectly, at death more than 50 percent of the total voting stock of the corporation or more than 50 percent of the total value of all stock of the corporation.

S. REP. NO. 107-283, at 11.

11. *Id.* at 10. Residency is defined as:

[A]ny individual who was a lawful permanent resident of the United States for at least eight of the fifteen taxable years ending in the year in which such termination occurs. In applying the eight year test, an individual is not considered to be a lawful permanent resident for any year in which the individual is not considered to be a resident of another country under a treaty tie-breaker rule.

*Id.*

would thereafter only be taxed on: (1) certain types of passive income<sup>12</sup> derived from U.S. sources<sup>13</sup> at a flat rate of thirty percent<sup>14</sup> and (2) on net profits<sup>15</sup> derived from U.S. businesses<sup>16</sup> at certain graduated rates.<sup>17</sup>

12. Joint Committee on Taxation, *JCT Describes Tax Relief for Military Personnel*, 2002 TAX NOTES TODAY 171-21, Sept. 4, 2002. The Joint Committee provides:

Trusts, inheritances, gifts and stocks are all forms of passive income that even if not derived from the United States that an expatriate can be taxed on. Specifically the proposed bill refers to retirement plans and interest in trusts. For retirement plans and similar arrangements this refers to all property interest held by the individual at the time of relinquishment of citizenship or termination of residency. Accordingly, such property includes compensation arrangements, as well as, any interest in an individual retirement account or annuity. However, the proposed bill contains a special rule for an interest in a "qualified retirement plan." A qualified retirement plan includes an employer-sponsored qualified plan (see section 410(a)), a qualified annuity (see section 403(a)), a tax shelter annuity (see section 403(b)) and eligible deferred compensation plan of a governmental employer (see section 457(b)) or an IRS (see section 408).

For interest in trusts detailed rules apply to trust interests held by an individual at the time of relinquishment of citizenship or termination of residency. The treatment of trust interest depends on whether the trust is a qualified trust. A trust is a qualified trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust.

*Id.*

13. I.R.C. § 877. "U.S. source income" includes gains from the sales or exchange of property (other than stock or debt obligations) located in the United States and gains on the sales or exchanges of stock of a domestic corporation and debt obligations of U.S. persons, including the federal, state, and local governments. I.R.C. § 877 (d)(A)-(B). "U.S. source income" also includes income or gain derived from stock held in certain foreign corporations. I.R.C. § 877 (d)(1)(C). This source rule applies to corporations in which the individual who terminates citizenship or residency owns more than fifty percent of the corporation (by vote or by value) at any time within the two year period ending on the date of termination of citizenship or residency. *Id.* The source rule only applies to the extent of earnings and profits earned and accumulated before the termination of citizenship or residency and during any period in which the individual meets the ownership tests. *Id.* *E.g.*, Edna Fitzgerald loses her U.S. citizenship on July 1, 2001, and is subject to the expatriation tax provisions. Fitzgerald has owned all of the stock of a foreign corporation, Fitzgerald Industries, since 1993. As of its December 31, 2000 tax year-end, the corporation had accumulated earnings and profits of \$500,000. For 2001, the corporation had earnings and profits of \$100,000 and had no subpart F income. Fitzgerald receives a \$100,000 distribution from the corporation in 2002 and realizes a \$500,000 gain on the sale of all her stock in 2003. The distribution and the gain are treated as U.S. source income to the extent of the corporation's earnings and profits earned or accumulated during periods in which Fitzgerald owned more than 50 percent of the corporation and before her loss of citizenship. The amount of earnings and profits treated as earned or accumulated in 2001 is prorated based on the number of days that Fitzgerald was a citizen. Consequently, on July 1, 2001, the corporation had earned or accumulated earnings and profits of \$550,000. Accordingly, the \$100,000 distribution and \$450,000 of the gain realized on the sale of stock are treated as U.S.-source income taxable to Fitzgerald.

14. Joint Committee on Taxation, *supra* note 12.

15. *Id.* at 320. The Joint Committee provides:

U.S. citizens and residents generally are subject to U.S. income taxation on their worldwide income. The U.S. tax may be reduced or offset by a credit allowed for foreign income taxes paid with respect to foreign-source income. Nonresidents who are not U.S.

## 2. Estate Tax

An individual who relinquishes his or her U.S. citizenship<sup>18</sup> and does not have a tax purpose for the expatriation is only subject to limited estate taxation<sup>19</sup> with respect to transfers of U.S. based property<sup>20</sup> at

citizens are taxed at a flat rate of 30 percent (or lower treaty rate) on certain types of passive income derived from U.S. sources, and at regular graduated rates on net profits derived from a U.S. business.

*Id.*

16. I.R.C. § 877(d)(1)-(d)(1)(C)(II) (2002) (describing what is considered income from U.S. sources). The Code Section provides:

(d) Special rules for source, etc. For purposes of subsection (b)—

(1) Source rules. The following items of gross income shall be treated as income from sources within the United States:

(A) Sale of property. Gains on the sale or exchange of property (other than stock or debt obligations) located in the United States.

(B) Stock or debt obligations. Gains on the sale or exchange of stock issued by a domestic corporation or debt obligations of United States persons or of the United States, a State or political subdivision thereof, or the District of Columbia.

(C) Income or gain derived from controlled foreign corporation. Any income or gain derived from stock in a foreign corporation but only—

(i) if the individual losing United States citizenship owned (within the meaning of section 958(a)), or is considered as owning (by applying the ownership rules of section 958(b)), at any time during the 2-year period ending on the date of the loss of United States citizenship, more than 50 percent of—

(I) the total combined voting power of all classes of stock entitled to vote of such corporation, or

(II) the total value of the stock of such corporation, and

(ii) to the extent such income or gain does not exceed the earnings and profits attributable to such stock which were earned or accumulated before the loss of citizenship and during periods that the ownership requirements of clause (i) are met.

17. *Id.*

18. S. REP. NO. 107-283, *supra* note 9.

19. *Id.* at 11 (discussing the estate tax provisions for expatriates). The Senate Report provides that: Nonresident non-citizens generally are subject to estate tax on certain transfers of U.S. situated property at death. *Id.* Such property includes real estate and tangible property located within the United States. *Id.* Moreover, for estate tax purposes, stock held by nonresident non-citizens is treated as U.S. situated if issued by a U.S. corporation. *Id.* Special rules apply to U.S. citizens who relinquish their citizenship and long term residents who terminate their U.S. residency within the ten years prior to the date of death unless the loss of status did not have as one of its principle purpose the avoidance of tax. I.R.C. § 2107. Under these rules, the decedent's estate includes the proportion of the decedent's stock in a foreign corporation that the fair market value of the U.S. situs assets owned by the corporation bears to the total assets of the corporation. *Id.* This rule applies only if (1) the decedent owned, directly, at death ten percent or more of the combined voting power of all voting stock of the corporation and (2) the decedent owned, directly or indirectly, at death more than 50 percent of the total voting stock of the corporation or more than 50 percent of the total value of all stock of the corporation. *Id.* Taxpayers are deemed to have a principle purpose of tax avoidance if they meet the five year tax liability test or the net worth test. *Id.* Exceptions

death.<sup>21</sup>

## B. Tax Expatriation

### 1. Income Tax

An individual who relinquishes his or her U.S. citizenship<sup>22</sup> with a “principal purpose”<sup>23</sup> of tax avoidance<sup>24</sup> is generally<sup>25</sup> subject to a certain U.S. income tax regime for ten years<sup>26</sup> following expatriation.<sup>27</sup>

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from this tax avoidance treatment apply in certain circumstances . . . such as dual citizenship. *Id.* See also The Economic Growth and Tax Relief Reconciliation Act of 2001 which repealed the estate tax for estates of decedents dying after December 31, 2009. *Id.* at n.7. However the Act included a “sunset” provision, pursuant to which the Act’s provisions do not apply to estates of decedent’s dying after December 31, 2010. *Id.*

20. S. REP. NO. 107-283, at 11 (stating that property includes real estate and tangible property located within the United States and that for U.S. citizens or long term residents who terminate their residency for income tax reasons, it will also include their stock owned by a foreign corporation).

21. See *supra* note 19.

22. See I.R.C. § 11, *supra* note 8.

23. See I.R.C. § 877 ((a)(2)(B) (discussing the “tax liability test” and “net worth test”). The average annual net income tax (as defined in § 38(c)(1)) of such individual for the period of five taxable years ending before the date of the loss of United States citizenship is greater than \$100,000 (tax liability test) or the net worth of the individual as of such date is \$500,000 or more (net worth test). *Id.* The dollar amount thresholds contained in the tax liability test and the net worth test are indexed for inflation in the case of a loss of citizenship or termination of residency occurring in any calendar year after 1996. *Id.* For the calendar year 2002, the dollar thresholds for the tax liability test and the net worth test are \$120,000 and \$599,000, respectively. *Id.* An individual who falls below thresholds is not automatically treated as having a principle purpose of tax avoidance, but nevertheless is subject to the expatriation tax provisions if the individual’s loss of citizenship or termination of residency in fact did have as one of its principle purposes the avoidance of tax. *Id.* See also, Omnibus Consolidated Appropriations Act of 1997, Pub. L. No. 104-208, 110 Stat. 3009 (1997). In response to well-publicized expatriations of U.S. citizens as a tax avoidance technique, Congress added amendments to § 877 with the Health Reform Act (“HRA of 1996”):

1. To presume a tax avoidance purpose for certain wealthy or high-income individuals;

2. To expand the re-sourcing rules of section 877 of the Internal Revenue Code (26 USC hereinafter IRC); and

3. To extend the rule to U.S. estate and gift taxes.

24. I.R.C. § 877(a)(2)(B). If an individual meets either the “tax liability test” or the “net worth test” then it will be assumed that their expatriation is motivated by tax avoidance purposes. *Id.*

25. I.R.C. § 877, *supra* note 23 (discussing exceptions to “tax liability test” and the “net worth test” in I.R.C. § 877(C)).

26. I.R.C. § 877(d)(2)(B) (2002) (applying to any exchange during a ten year period beginning on the date the individual loses United States citizenship).

27. I.R.C. § 877(a) (2002) (providing that expatriates will generally be taxed on their U.S. source income for the ten year period preceding the close of the tax year, unless it can be shown that the change was not for the principal purpose of avoiding U.S. tax). Exceptions to the automatic assumption that expatriation is tax motivated are discussed in I.R.C. § 877(c).

Even where the tax expatriate also ceases to be a U.S. resident,<sup>28</sup> the individual is subject to several provisions relating to U.S. income tax.<sup>29</sup> The tax expatriate is subject to U.S. income taxation on his or her U.S. source income<sup>30</sup> at the same rates<sup>31</sup> as if the tax expatriate was still a U.S. citizen.<sup>32</sup> The tax expatriate is not taxable in the U.S. on the tax expatriate's foreign sourced<sup>33</sup> income.<sup>34</sup> In addition, tax expatriates are taxed on certain exchanges<sup>35</sup> of property<sup>36</sup> where the transferred property

28. S. REP. NO. 107-283, at 12 (2002). An individual is treated as having relinquished U.S. citizenship on the earliest of four possible dates: (1) The date that the individual renounces U.S. nationality before a diplomatic or consular officer of the United States; (2) The date that the individual furnishes to the State Department a signed statement of voluntary relinquishment of U.S. nationality confirming the performance of an expatriating act; or (3) The date that the State Department issues a certificate of loss of nationality; or (4) The date that a U.S. court cancels a naturalized citizen's certificate of naturalization. *Id.*

29. I.R.C. § 877(d)(2)(B) (2002) (providing that an expatriate will still be subject to U.S. tax ten years after the date of expatriation).

30. *See supra* note 13.

31. I.R.C. § 1 (2002).

32. I.R.C. § 877. An individual covered by the expatriation tax is subject to tax on U.S. source income and gains for a ten-year period following expatriation at the graduated rates applicable to U.S. citizens. *See* I.R.C. § 877(a)(1). The tax under the code is imposed only if the tax exceeds the tax determined under I.R.C. § 871 imposed on nonresident aliens. *Id.* The expatriation tax on income applies for tax years ending within ten years of the date of the termination of residency. *Id.* Deductions are allowed to the extent that they are allocable to gross income, but the capital loss carryover is not available. *See* I.R.C. § 877(b)(2). An expatriate is also subject to the alternative minimum tax. *Id.* For tax years beginning on or before December 31, 1999, an expatriate may also be subject to the tax on lump-sum distributions under I.R.C. § 402(d)(1). *Id.*

33. I.R.C. § 877 (d)(1)(A–B) (2002). U.S. source income includes (1) gains from the sales or exchange of property (other than stock or debt obligations) located in the United States; (2) gains on the sales or exchanges of stock of a domestic corporation; (3) debt obligations of U.S. persons, including the federal, state, and local governments. *Id.*

34. I.R.C. § 877(d)(1)(A).

35. I.R.C. § 877(d)(2)(B) (discussing the tax implication of exchanges within I.R.C. § 877). § 877(d)(2)(B) provides:

(d) Special rules for source, etc.—For purposes of subsection (b)—

(2) Gain recognition on certain exchanges.—

(B) Exchanges to which paragraph applies.—This paragraph shall apply to any exchange during the ten year period beginning on the date the individual loses United States citizenship if—

(i) gain would not (but for this paragraph) be recognized on such exchange in whole or in part for purposes of this subtitle,

(ii) income derived from such property was from sources within the United States (or, if no income was so derived, would have been from such sources), and

(iii) income derived from the property acquired in the exchange would be from sources outside the United States.

*Id.* *See also* I.R.C. § 877(d)(2)(C). This section provides an exception stating:

Subparagraph (A) shall not apply if the individual enters into an agreement with the Secretary which specifies that any income or gain derived from the property acquired in

generates U.S. source income<sup>37</sup> and the property received generates foreign sourced<sup>38</sup> income.<sup>39</sup> Moreover, tax expatriates who contribute property<sup>40</sup> to a foreign corporation<sup>41</sup> are generally<sup>42</sup> still taxed directly<sup>43</sup> on any income<sup>44</sup> or gain<sup>45</sup> generated by the transferred property.<sup>46</sup>

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the exchange (or any other property which has a basis determined in whole or part by reference to such property) during such ten year period shall be treated as from sources within the United States. If the property transferred in the exchange is disposed of by the person acquiring such property, such agreement shall terminate and any gain which was not recognized by reason of such agreement shall be recognized as of the date of such disposition.

36. I.R.C. § 877(d)(1)(A)-(C) (defining property as including real estate, tangible property located within the United States, gifts, and stocks).

37. I.R.C. § 877(d), *supra* note 16.

38. *Id.*

39. *Id.*

40. I.R.C. § 877(d)(4). Income or gain received by a controlled foreign corporation (“CFC”), as defined under I.R.C. § 957, with respect to property transferred to the CFC by a U.S. shareholder within the ten-year period, is treated as received by the shareholder and not the CFC. *Id.* For determining the application of the rule, the individual transferring property to the corporation is treated as a U.S. citizen. I.R.C. § 877 (d)(4)(B). The rule applies only if the income received by the individual with respect to the property would have been treated as U.S. source income. *Id.* The income must be U.S. source income immediately before the contribution. I.R.C. § 877 (d)(4)(A)(ii). The rule also applies to income or gain from property owned by the CFC, the basis of which is determined in whole or in part by reference to the transferred property. *Id.* Upon a sale of the CFC’s stock by such an individual, a pro rata share of the property is treated as sold for fair market value on the date the stock is sold. I.R.C. § 877 (d)(4)(C). The Secretary of the Treasury is authorized to issue anti-abuse regulations and information reporting regulations to implement this source rule. I.R.C. § 877 (d)(4)(D)-(E). Until regulations are issued, individuals must comply with the rules set forth in Notice 97-19 at ¶ 27,425.17. *Id.* *E.g.*, Edna Fitzgerald contributed property to a CFC within two years after her loss of citizenship. Income from the property would have been taxed as U.S. source income. Two years later, Fitzgerald sold 50 of her 100 shares of stock in the corporation. Consequently, there is a deemed sale of 50 percent of the property at fair market value, and any gain from the deemed sale is taxable to Fitzgerald.

41. I.R.C. § 7701(a)(5) (2002). The word “foreign” when applied to a corporation or partnership means a corporation or partnership which is not domestic. *Id.*

42. *See supra* note 40 (demonstrating by example).

43. I.R.C. § 877 (d)(4)(A)(ii). The individual transferring property to the corporation is treated as a U.S. citizen. *Id.* The rule applies only if the income received by the individual with respect to the property would have been treated as U.S. source income. *Id.* The income must be U.S. source income immediately before the contribution. *Id.*

44. *Id.*

45. I.R.C. § 877 (d)(4)(C). The rule also applies to income or gain from property owned by the CFC, the basis of which is determined in whole or in part by reference to the transferred property. *Id.* Upon a sale of the CFC’s stock by such an individual, a pro rata share of the property is treated as sold for fair market value on the date the stock is sold. *Id.* The Secretary of the Treasury is authorized to issue anti-abuse regulations and information reporting regulations to implement this source rule. I.R.C. § 877 (d)(4)(D)-(E). Until regulations are issued, individuals must comply with the rules set forth in Notice 97-19. *Id.*

46. *Id.*

## 2. Estate Tax

The estate of an individual who relinquished his or her U.S. citizenship<sup>47</sup> with a “principal purpose”<sup>48</sup> of tax avoidance<sup>49</sup> is generally<sup>50</sup> subject to a certain U.S. estate tax regime for ten years<sup>51</sup> following expatriation.<sup>52</sup> Even where the tax expatriate also ceased to be

47. I.R.C. § 11, *supra* note 8.

48. I.R.C. § 877 (a)(2)(B) (discussing the test used to determine if an expatriate’s principle purpose in expatriating was motivated by tax avoidance).

49. I.R.C. § 2107 (2002) (discussing the tax rate for tax motivated expatriation). According to I.R.C. § 2107:

A tax computed in accordance with the table contained in I.R.C. § 2001 is hereby imposed on the transfer of the taxable estate, determined as provided in I.R.C. § 2106, of every decedent nonresident not a citizen of the United States if, within the ten year period ending with the date of death, such decedent lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A.

*Id.* E.g., at the time of his death, H, a nonresident expatriate decedent the transfer of whose estate is subject to the tax imposed by section 2107(a), owned a 60 percent interest in M Company, a foreign partnership, which in turn owned stock issued by N Corporation, a foreign corporation. The stock in N Corporation held by M Company, which constituted 50 percent of the total combined voting power of all classes of stock entitled to vote in N Corporation, was valued at \$50,000 at the time of H’s death. In addition, W, H’s wife, also a nonresident not a citizen of the United States, owned at the time of H’s death stock in N Corporation constituting 25 percent of the total combined voting power of all classes of stock entitled to vote in that corporation. The fair market value of the assets of N Corporation which, at the time of H’s death, were situated in the United States constituted 40 percent of the fair market value of all assets of that corporation. It is assumed for purposes of this example that the executor of H’s estate has not elected to value the estate on the alternate valuation date provided in § 2032.

50. I.R.C. § 2001 (2002) (discussing various taxes for expatriates and their exceptions). The gift tax which is calculated on the total of all gifts made after June 6, 1932, but before extending the period of limitations on assessment for a gift tax return, the terms omitted items and amount shown on the return refer only to gifts made during the calendar year for which the return is being made.

*Id.* In determining whether there has been a 25 percent omission, an increase in the valuation of items disclosed in the return is not taken into account. *Id.*

51. S. REP. NO. 107-283, at 11. The Senate Report stated that U.S. citizens and long term residents who terminate their U.S. residency within the ten years have special rules that apply to them for estate tax purposes when the expatriate unless their expatriation was not made for tax avoidance purposes. *Id.* See also I.R.C. § 2107 (a)(1) (2002).

52. I.R.C. § 2107(b). This section provides in pertinent part:

(b) Gross estate.—For purposes of the tax imposed by subsection (a), the value of the gross estate of every decedent to whom subsection (a) applies shall be determined as provided in I.R.C. section 2103, except that—

(1) if such decedent owned (within the meaning of I.R.C. section 958 (a)) at the time of his death ten percent or more of the total combined voting power of all classes of stock entitled to vote of a foreign corporation, and

(2) if such decedent owned (within the meaning of I.R.C. section 958(a)), or is considered to have owned (by applying the ownership rules of I.R.C. section 958(b)), at the time of his death, more than 50 percent of—

(A) the total combined voting power of all classes of stock entitled to vote of such corporation, or

a U.S. resident,<sup>53</sup> the estate is subject to several provisions relating to U.S. estate taxes.<sup>54</sup> The tax expatriate's estate is generally<sup>55</sup> and proportionately<sup>56</sup> subject to U.S. estate taxation on foreign corporation stock owned by the estate that owned the U.S. based assets.<sup>57</sup>

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(B) the total value of the stock of such corporation, then that proportion of the fair market value of the stock of such foreign corporation owned (within the meaning of I.R.C. section 958(a)) by such decedent at the time of his death, which the fair market value of any assets owned by such foreign corporation and situated in the United States, at the time of his death, bears to the total fair market value of all assets owned by such foreign corporation at the time of his death, shall be included in the gross estate of such decedent. For the purposes of the preceding sentence, a decedent shall be treated as owning stock of a foreign corporation at the time of his death if, at the time of a transfer, by trust or otherwise, within the meaning of sections 2035-2038, inclusive, he owned such stock.

*Id.*

53. I.R.C. § 877(e). This section provides:

(e) Comparable treatment of lawful permanent residents who cease to be taxed as residents.—

(1) In general.—Any long-term resident of the United States who—

(A) ceases to be a lawful permanent resident of the United States (within the meaning of section 7701(b)(6)), or

(B) commences to be treated as a resident of a foreign country under the provisions of a tax treaty between the United States and the foreign country and who does not waive the benefits of such treaty applicable to residents of the foreign country,

shall be treated for purposes of this section and sections 2107, 2501, and 6039G in the same manner as if such resident were a citizen of the United States who lost United States citizenship on the date of such cessation or commencement.

*Id.*

54. See I.R.C. § 2107(b), *supra* note 52.

55. S. REP. NO. 107-283, at 11 (stating that the decedent's estate includes the proportion of the decedent's stock in a foreign corporation that the fair market value of the U.S. situs assets owned by the corporation bears to the total assets of the corporation).

This rule applies only if: (1) the decedent owned, directly, at death ten percent or more of the combined voting power of all voting power of all voting stock of the corporation; and (2) the decedent owned, directly or indirectly, at death more than 50 percent of the total voting stock of the corporation or more than 50 percent of the total value of all stock of the corporation.

*Id.*

56. I.R.C. § 2107(c)(2)(C) (stating that such property's proportionate share is the percentage which the value of such property bears to the total value of all property included in the gross estate solely by reason of subsection (b)).

57. I.R.C. § 2107(b), *supra* note 52.

### III. THE DRAFT FAST ACT

#### A. Proposed Law Changes

##### 1. Triggering Sale of Holdings

The Draft Fast Act would generally<sup>58</sup> treat all tax expatriate<sup>59</sup> property<sup>60</sup> as sold on the day before<sup>61</sup> the expatriation date<sup>62</sup> for

58. Armed Forces Tax Fairness Act of 2002, H.R. 5063, 107th Cong. (2002) (hereinafter referred to as “Act”). The Act allows certain exceptions for tax treatment of expatriates which are:

An individual shall not be treated as a covered expatriate if—

(A) the individual—

(i) became at birth a citizen of the United States and a citizen of another country and, as of the expatriation date, continues to be a citizen of, and is taxed as a resident of, such other country, and

(ii) has not been a resident of the United States as defined in I.R.C. § 7701(b)(1)(A)(ii) during the five taxable years ending with the taxable year during which the expatriation date occurs, or

(B)(i) the individual’s relinquishment of United States citizenship occurs before such individual attains age 18 1/2, and

(ii) the individual has been a resident of the United States (as so defined) for not more than five taxable years before the date of relinquishment.

*Id.*; Proposed 877A(c)(2).

59. Act, *supra* note 58; Proposed 877A(e)(1) defines expatriate as:

(1) EXPATRIATE- The term ‘expatriate’ means—

(A) any United States citizen who relinquishes citizenship, and

(B) any long-term resident of the United States who—

(i) ceases to be a lawful permanent resident of the United States (within the meaning of I.R.C. § 7701(b)(6)), or

(ii) commences to be treated as a resident of a foreign country under the provisions of a tax treaty between the United States and the foreign country and who does not waive the benefits of such treaty applicable to residents of the foreign country.

*Id.* “Covered Expatriate” also means expatriate. Proposed 877(A)(c).

60. See Act, *supra* note 58; Proposed 877A(a)(1) (providing that: “Mark-to-Market is all property of a covered expatriate to whom this section applies shall be treated as sold on the day before the expatriation date for its fair market value”).

61. Act, *supra* note 58.

62. *Id.*; Proposed 877A(e)(2). Proposed 877(A)(e)(2)(A-B) defines “expatriate date” as:

(A) the date an individual relinquishes United States citizenship, or

(B) in the case of a long-term resident of the United States, the date of the event described in clause (i) or (ii) of paragraph (1)(B). Section 877A(e)(3) defines relinquishment of citizen as: A citizen shall be treated as relinquishing United States citizenship on the earliest of— (A) the date the individual renounces such individual’s United States nationality before a diplomatic or consular officer of the United States pursuant to paragraph (5) of section 349(a) of the Immigration and Nationality Act (8 U.S.C. 1481(a)(5)), (B) the date the individual furnishes to the United States Department of State a signed statement of voluntary relinquishment of United States nationality confirming the performance of an act of expatriation specified in paragraph (1), (2), (3), or (4) of section 349(a) of the Immigration and Nationality Act (8 U.S.C. 1481(a)(1)-

determining its fair market value.<sup>63</sup> The tax expatriate<sup>64</sup> would generally<sup>65</sup> also recognize<sup>66</sup> any gain<sup>67</sup> or loss<sup>68</sup> from the sale<sup>69</sup> of property,<sup>70</sup> although, certain gain would be excluded.<sup>71</sup> A tax expatriate

(4)),

(C) the date the United States Department of State issues to the individual a certificate of loss of nationality, or

(D) the date a court of the United States cancels a naturalized citizen's certificate of naturalization. Subparagraph (A) or (B) shall not apply to any individual unless the renunciation or voluntary relinquishment is subsequently approved by the issuance to the individual of a certificate of loss of nationality by the United States Department of State.

*Id.*

63. See Act, *supra* note 60.

64. See Act, *supra* note 58.

65. Act, *supra* note 58; Proposed 877A(a)(3) (discussing the exception for taxes on gains).

The Act states:

(3)(A) IN GENERAL—The amount which, but for this paragraph, would be includible in the gross income of any individual by reason of this section shall be reduced (but not below zero) by \$600,000. For purposes of this paragraph, allocable expatriation gain taken into account under subsection (f)(2) shall be treated in the same manner as an amount required to be includible in gross income.

*Id.*

66. Act, *supra* note 58; proposed 877(A)(a)(2). Proposed 877(A)(a)(2) provides:

Any gain arising from such sale shall be taken into account for the taxable year of the sale, and any loss arising from such sale shall be taken into account for the taxable year of the sale to the extent otherwise provided by this title, except that section 1091 shall not apply to any such loss. Proper adjustment shall be made in the amount of any gain or loss subsequently realized for gain or loss taken into account under the preceding sentence.

*Id.*

67. See *supra* note 66.

68. *Id.*

69. *Id.*

70. Act, *supra* note 58; proposed 877A(d). Proposed 877A(d) provides:

Special Rules for Pension Plans

(1) Exempt Property—This section shall not apply to the following:

(A) United States Real Property Interest—Any United States real property interest (as defined in section 897(c)(1)), other than stock of a United States real property holding corporation which does not, on the day before the expatriation date, meet the requirements of I.R.C. § 897(c)(2).

(B) Specified Property—Any property or interest in property not described in subparagraph (A) which the Secretary specifies in regulations.

*Id.*

71. Act, *supra* note 58; Proposed 877A(a)(3). Proposed 877(A)(a)(3) discusses the “exclusion of gain” and “cost of living adjustment.” *Id.* According to proposed 877A(a)(3)(a), the exclusion of gain is:

The amount which, but for this paragraph, would be includible in the gross income of any individual by reason of this section shall be reduced (but not below zero) by \$600,000. For purposes of this paragraph, allocable expatriation gain taken into account under subsection (f)(2) shall be treated in the same manner as an amount required to be includible in gross income.

*Id.* According to 877A(a)(3)(b), the cost of living adjustment is:

can make an election to be treated as a U.S. citizen under certain circumstances<sup>72</sup> or to defer certain taxes.<sup>73</sup>

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In the case of an expatriation date occurring in any calendar year after 2002, the \$600,000 amount under subparagraph (A) shall be increased by an amount equal to— (I) such dollar amount, multiplied by (II) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year, determined by substituting ‘calendar year 2001’ for ‘calendar year 1992’ in subparagraph (B) thereof. (ii) ROUNDING RULES—If any amount after adjustment under clause (i) is not a multiple of \$1,000, such amount shall be rounded to the next lower multiple of \$1,000.

*Id.*

72. Act, *supra* note 58; proposed 877A(a)(4). Proposed 877A(a)(4) discusses the “election to continue to be taxed as US citizen” stating:

- (A) If a covered expatriate elects the application of this paragraph—
- (i) this section (other than this paragraph and subsection (i)) shall not apply to the expatriate, but
  - (ii) in the case of property to which this section would apply but for such election, the expatriate shall be subject to tax under this title in the same manner as if the individual were a United States citizen.
- (B) REQUIREMENTS—Subparagraph (A) shall not apply to an individual unless the individual—
- (i) provides security for payment of tax in such form and manner, and in such amount, as the Secretary may require,
  - (ii) consents to the waiver of any right of the individual under any treaty of the United States which would preclude assessment or collection of any tax which may be imposed by reason of this paragraph, and
  - (iii) complies with such other requirements as the Secretary may prescribe.

(C) ELECTION—An election under subparagraph (A) shall apply to all property to which this section would apply but for the election and, once made, shall be irrevocable. Such election shall also apply to property the basis of which is determined in whole or in part by reference to the property with respect to which the election was made.

*Id.* S. REP. NO. 107-283 (2002).

Under the Bill an individual is permitted to make an irrevocable election to continue to be taxed as a U.S. citizen with respect to all property that otherwise is covered by the expatriation tax. This election is an “all or nothing” election; an individual is not permitted to elect this treatment for some property but not for other property. This election, if made, would apply to all property that would be subject to the expatriation tax and to any property the basis of which is determined by reference to such property. Under this election, the individual would continue to pay U.S. income taxes at the rates applicable to U.S. citizens following expatriation on any income generated by the property and on any gain realized on the disposition of the property. In addition, the property would continue to be subject to U.S. gift, estate, and generation-skipping transfer taxes. . . . The individual also 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 requires.

*Id.*

73. Act, *supra* note 58; proposed 877A(4)(b) (discussing the election to defer taxes). Proposed 877A(4)(b) provides:

- (1) IN GENERAL—If the taxpayer elects the application of this subsection with respect to any property treated as sold by reason of subsection (a), the payment of the additional tax attributable to such property shall be postponed until the due date of the return for the taxable year in which such property is disposed of (or, in the case of property disposed of

## 2. Collecting Estate Taxes from U.S. Heirs

The Draft Fast Act uses the U.S. income tax rules to collect what otherwise would be estate taxes from U.S. citizens who inherit property from tax expatriates.<sup>74</sup> The Draft Fast Act provides that anyone inheriting from a tax expatriate<sup>75</sup> who was subject to the above mark-to-market rules<sup>76</sup> would be required to take the property<sup>77</sup> as income<sup>78</sup> for U.S. income tax purposes.<sup>79</sup> After reporting the receipt of the property

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in a transaction in which gain is not recognized in whole or in part, until such other date as the Secretary may prescribe).

(2) DETERMINATION OF TAX WITH RESPECT TO PROPERTY—For purposes of paragraph (1), the additional tax attributable to any property is an amount which bears the same ratio to the additional tax imposed by this chapter for the taxable year solely by reason of subsection (a) as the gain taken into account under subsection (a) with respect to such property bears to the total gain taken into account under subsection (a) with respect to all property to which subsection (a) applies.

*Id.* S. REP. NO. 107-283, at 17. The Senate Report provides:

An individual is permitted to elect to defer payment of the mark-to-market tax imposed on the deemed sale of the property. Interest is charged for the period the tax is deferred at a rate two percent points higher than the rate normally applicable to individual underpayments. Under this election, the mark-to-market tax attributable to a particular property is due when the property is disposed of (or, if the property is disposed of in whole or in part in a non-recognition transaction, at such other time as the Secretary may prescribe). The mark-to-market tax attributable to a particular property is an amount which bears the same ratio to the total mark-to-market tax for the year as the gain taken into account under these rules for the year. The deferral of the mark-to-market tax may not be extended beyond the individual's death. In order to elect deferral of the mark-to-market tax, the individual is required to provide adequate security to the Treasury to ensure that the deferred tax and interest will be paid. Other security mechanisms are permitted provided that the individual establishes to the satisfaction of the Secretary that the security is adequate. . . . The amount (including any interest, penalties and certain other items) shall be a lien in favor of the United States on all U.S. situs property owned by the individual. The lien shall arise on the expatriation date.

*Id.*

74. *Id.* at 19-20. The Senate Report provides that:

[U]nder the Armed Forces Tax Fairness Act of 2002 the exclusion from income provided in I.R.C. § 102 (relating to exclusion from income for the value of property acquired by gift or inheritance) does not apply to the value of any property received by gift or inheritance from a former citizen or former long-term resident (i.e., an individual who relinquished U.S. citizenship or terminated U.S. residency), subject to the exceptions described above relating to certain dual citizens and minors. Accordingly, a U.S. taxpayer who receives a gift or inheritance from such an individual is required to include the value of such gift or inheritance in gross income and is subject to U.S. tax on such amount.

*Id.*

75. *See Act, supra* note 59.

76. *See Act, supra* note 60 (discussing the mark-to-market provision).

77. S. REP. NO. 107-283, at 20.

78. *Id.*

79. *Id.* The Senate Report states that:

as income, the recipient would then be able to take a tax basis in the received property equal to the property's value.<sup>80</sup> There are exceptions<sup>81</sup> applied where no estate tax return is required to be filed<sup>82</sup> and where no tax would otherwise be owed had the tax expatriate<sup>83</sup> not expatriated.<sup>84</sup> The gift tax rules have also been modified by the Draft Fast Act.<sup>85</sup>

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Having included the value of the property in income, the recipient would then take a basis in the property equal to that value. The tax does not apply to property that is shown on a timely filed tax return and that is a taxable gift by the former citizen or former long-term resident, or property that is shown on a timely filed estate tax return and included in the gross U.S. estate of the former citizen or former long-term resident (regardless of whether the tax liability shown on such a return is reduced by credits, deduction, or exclusions available under the estate and gift tax rules). In addition, the tax does not apply to property in cases in which no estate or gift tax return is required to be filed, where no such return would have been required to be filed if the former citizen or former long-term resident has not relinquished citizenship or terminated residency, as the case may be.

*Id.*

80. *See Act, supra* note 79.

81. *Id.*

82. *Id.*

83. *Id.*

84. *Id.*

85. Joint Committee on Taxation, *supra* note 12. (stating that nonresident non-citizens generally are subject to gift tax on certain transfers by gift of U.S. situs situated property). It further provides:

Such property includes real estate and tangible property located within the United States. Unlike the estate tax rules for U.S. stock held by nonresidents, however, nonresident noncitizens generally are not subject to U.S. gift tax on the transfer of intangibles, such as stock or securities, regardless of where such property is situated. Special rules apply to U.S. citizens who relinquish their U.S. citizenship or long-term residents of the United States who terminate their U.S. residency within the ten years prior to the date of transfer, unless such loss did not have as one of its principle purposes the avoidance of tax. Under these rules, nonresident noncitizens are subject to gift tax on transfers of intangibles, such as stock or securities. Taxpayers are deemed to have a principle purpose of tax avoidance if they meet the five year liability test of the net worth test. . . . Exceptions from this tax avoidance treatment apply in certain circumstance such as dual citizenship and other individuals who submit a timely and complete ruling request with the IRS as to whether their expatriation or residency termination has a principle purpose of tax avoidance.

*Id.* *See also*, I.R.C. § 2501(a) provides:

(2) Transfers of intangible property.—Except as provided in paragraph (3), paragraph (1) shall not apply to the transfer of intangible property by a nonresident not a citizen of the United States.

(3)Exception.

(A) Certain individuals.—Paragraph (2) shall not apply in the case of a donor who, within the ten year period ending with the date of transfer, lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A.

(B) Certain individuals treated as having tax avoidance purpose.—For purposes of subparagraph (A), an individual shall be treated as having a principal purpose to

## IV. WILL THE DRAFT FAST ACT DETER TAX EXPATRIATION?

The Draft Fast Act<sup>86</sup> is likely to deter certain individuals from expatriating for tax reasons. The Draft Fast Act attempts to deter tax expatriation by denying the tax expatriate certain intended tax benefits of the expatriation.<sup>87</sup> If a taxpayer views tax expatriation as a financial decision and solely weighs the financial benefits and costs of the decision, the denial of the tax benefits outlined in the Draft Fast Act would likely lean a potential tax expatriate against choosing to expatriate.

However, the Draft Fast Act<sup>88</sup> is unlikely to deter the most determined individuals from expatriating for tax reasons. Although the Draft Fast Act denies tax expatriates certain intended tax benefits of the expatriation,<sup>89</sup> some tax expatriates see expatriation as more than a financial decision.<sup>90</sup> Rather, they see it as a political cause.<sup>91</sup> Many of

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avoid such taxes if such individual is so treated under I.R.C. § 877(a).

*Id.*

86. Act, H.R. 5063.

87. S. REP. NO. 107-283, at 13 (stating that “the Committee is aware that some people each year relinquish their U.S. citizenship or terminate their U.S. residency for the purpose of avoiding U.S. income, estate and gift taxes” to “reduce their annual U.S. income tax liability and [to] reduce or eliminate their U.S. estate tax liability”).

88. Act, H.R. 5063.

89. *Id.* This Act discusses the various new rules concerning expatriation and makes expatriation more costly for the expatriate by imposing the mark-to-market provision where all property of a covered expatriate shall be treated as sold on the day before the expatriation date for its fair market value. *Id.* Furthermore, the new bill imposes changes concerning inheritance and gift taxes for the beneficiaries of the expatriate. *Id.* The beneficiary of an expatriate would have to recognize the gift or inheritance and would not receive the tax benefit found in section 102 of the code. *Id.* Also, the expatriate would be taxed on retirement plans and trusts. *Id.*

90. See Take Back America: American Citizenship or U.S. Citizenship, at <http://www.freedomcommittee.com/2/freedom/expatbrochure.pdf>. It stated that:

Briefly, taxation is based upon the debt of the United States (Congress) to the Federal Reserve (a private corporation). Franklin D. Roosevelt and the Congress of the United States contracted with international bankers for a loan presented to the people as the “New Deal.” A vehicle then had to be constructed to make the Citizens responsible for the Congressional extravagance. The Social Security Insurance system (now FICA) was devised for this purpose.

This nefarious (evil), unconscionable contract bound every American under a co-surety obligation. We the People were warned by the Supreme Court in *Helvering v. Davis*, 301 U.S. 619, 81 L.Ed. 1307, 57 S.Ct. 904 that Social Security is not insurance but “welfare;” and in *Fleming v. Nestor*, 363 U.S. 603, 4 L.Ed.2d 1435, 80 S.Ct. 1367 (1960) we have no vested interest. Having no vested interest informs us that payment from the Social Security system is discretionary and not obligatory. Thus, by law and contract, when you retire FICA is not required to compensate you at all.

Further, if you visit a law library and peruse Title 26, United States Code Annotated (the infamous IRS code), at the beginning you are informed that our system of taxation is based upon voluntary compliance. Though true, people do not realize that the voluntary

these tax expatriates generally have already dropped out of the voluntary compliance tax system by the time they actually relinquish their citizenship.<sup>92</sup> As such, the Draft Fast Act is likely to be viewed by the

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segment infers those who have not contracted into the sub-status of U.S. citizenship.

*Id.*

91. Martin A. Sullivan, *News Analysis—Democrats Revisit Expatriate Tax: With Neutrality & Justice For All?*, 19 TAX NOTES INT'L 1705, Nov. 1, 1999, at 1705. This article discusses the spectrum of political views concerning expatriation and divides the spectrum into three parts: the principle of punishment, the personal autonomy approach, the principle of neutrality. *Id.* at 1706-07. The principle of punishment says that an expatriate should be punished because they are ungrateful and unpatriotic. *Id.* at 1706. The normal method under this approach is to heavily penalize the expatriate and tax them more to expatriate than if they remained in the United States. *Id.* This approach has been criticized on constitutional and human rights grounds. *Id.* On the other end of the spectrum is the "personal autonomy" approach. *Id.* Basically this approach says that if someone is willing to forego their United State citizenship, then they should be allowed to do so. *Id.* Temple Law School Professor Alice Abreu best summed up this approach when she said:

I believe both that expatriation carries a price and that the price is high enough. That so few people expatriate shows that most Americans agree. . . . I therefore conclude that the revenue, retribution, deterrence, and symbolism that adoption of any of the proposals would produce are not worth the complexity and distributional lopsidedness that enactment of any of the three expatriation proposals would bring. Citizenship can matter, and to many people it matters a lot. That it matters little to a few wealthy individuals should not result in the enactment of provisions that will further complicate the law at the expense of people for whom citizenship matters so much that they will exercise their right to renounce it, whatever the tax cost.

*Id.* The middle ground is the "neutral approach." *Id.* Basically, this approach advocates that an expatriate should be taxed no more or no less when they expatriate. *Id.* at 1706-07. Surprisingly, this approach was embraced by the House Ways and Means committee in 1996 when they said:

The Committee recognizes that citizens of the United States clearly have a basic right under both U.S. and international law not only to leave the United States to live elsewhere, but also to relinquish their U.S. citizenship. The Committee does not believe that the Internal Revenue Code should be used to stop U.S. citizens or residents from expatriating; however, the Committee also does not believe that the Code should provide a tax incentive for expatriating.

*Id.* (quoting House Ways and Means Committee, "Expatriation Tax Act of 1995."). See also Rep. Bill Archer, 95 *TNI 113-7 Full Text: H.R. 1812, "Expatriation Tax Act of 1995,"* 95 TAX NOTES INT'L 113-7, June 13, 1995 (quoting the language of the House report in controversy).

92. See Take Back America: American Citizenship or U.S. Citizenship, at <http://www.freedomcommittee.com/2/freedom/expatbrochure.pdf>. It stated the United States citizenship is a contract and that:

For more information on Rights lost through U.S. citizenship see Black's Law Dictionary, Fourth or Fifth Editions (B'sLD, FE) under 'Liberty.' To state just a few Rights, freedom of contract; freedom of locomotion and movement [*11 AmJur (1st Series) Sec. 329, Personal liberty*] (*travel in your automobile on the public highways without driver's license*); Right to marry and have a family (*not permission through marriage license, a three party contract, you, your spouse and the state*); right to pursue chosen calling; right to earn a livelihood in any lawful calling (*no forced business or occupational license*); etc. (*Italicized notes added*). A Note to emphasize the ludicrousness of licensing: *license: "permission from a competent authority to do something, that without the permission would be illegal, a trespass, or a tort"* B'sLD, FE. So, could you expound upon what is *illegal, a trespass or a tort* about getting

tax expatriation community<sup>93</sup> as just another governmental hurdle that must be avoided to reach its goal of ceasing to be a part of the U.S. taxation system. Creative accountants and lawyers<sup>94</sup> will likely find ways<sup>95</sup> to circumvent the new regime, and the U.S. will continue to lose many of the wealthiest members of its tax base.<sup>96</sup>

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married; earning a livelihood in a lawful calling; traveling on the public highways to church, your job, the grocery store? Black's Law Dictionary, *ibid.*, evinced these as Rights, not licensed privileges. Hence, through statutes, you now need licenses to attempt survival. With licensing we experience one of the pleomorphic (many forms) characters of *power, control and the proliferation of prejudice.*

*Id.* (emphasis in original). The author further stated:

To reclaim your Rights secured under the Constitution of the United States, Amendments 1 through 10 (unencumbered) and alluded to in the Declaration of Independence we have written a "*Declaration of Expatriation/ Repatriation.*" Please understand, you are only giving up the U.S. citizenship, NOT your American Citizenship. These documents, along with other documents that will be addressed below, will help you regain your Rights as an American Citizen. You will notice the President of the United States of your expatriation by U.S. Registered Mail. Neither the President nor the Justice Department will dispute the enumerated, articulated and published facts. The Expatriation/Repatriation (with letter to the President is eight plus pages) shows the contracts to be fraudulent and they incorporate undue influence as a vehicle to bind American Citizens into the co-surety status of U.S. citizen.

*Id.* (emphasis ommitted).

93. See Rep. Charles B. Rangel, *Rangel Release on His Bill to Prevent Expatriation*, 2002 TAX NOTES TODAY 112-33, June 11, 2002, at ¶ 8. Prominent expatriates include a grandson of J. Paul Getty; a son of the shipping magnate Jacob Stolt-Nielsen; and Joseph J. Bogdanovich, the son of the Star-Kist mogul. *Id.* at ¶ 8.

94. Amy Hamilton, *Tax Avoidance Expatriation Dominates House Floor Debate*, 2002 TAX NOTES TODAY 139-4, July 19, 2002. (*summary*) (stating that the debates concerning the proposed expatriation bill became very heated, and Lloyd Doggett, D-Texas, was one of the staunchest supporters of the bill). Hamilton further stated:

Ways and Means Committee member Lloyd Doggett, D-Texas, launched the attacks on Kies and Angus during floor consideration of the fiscal 2003 Legislative Branch appropriations. Doggett said Kies left the JCT to join PricewaterhouseCoopers where he lobbied on behalf of the section 877 Coalition to weaken the already modest limitations on these billionaires who renounce America. The Section 877 Coalition members remained secret, Doggett said, because Kies never revealed the clients who were paying for the lobbying in his official lobbyist disclosure reports. PricewaterhouseCoopers Consulting has since itself renounced America, reemerged, and reincorporated abroad to dodge taxes under the unusual name "Monday." Angus, who also served on the JCT, moved to PricewaterhouseCoopers 'and joined the same coalition fighting on behalf of the billionaire expatriates,' Doggett said. President Bush has since appointed her as the international tax counsel for Treasury, 'where she is undoubtedly seeking to ensure that her former clients pay their fair share,' Doggett said.

*Id.*

95. Rangel, *supra* note 93, at ¶ 8. After the last attempt to legislatively deter tax expatriation, many tax expatriates deliberately lost their citizenship without formally renouncing it, believing that was a simple way to avoid the legislation. *Id.*

96. Joint Committee of Taxation, *Executive Summary of JCT Report on Taxation of Expatriates*, 10 TAX NOTES INT'L 1981, June 12, 1995, at 1987. This summary provides:

## V. SEPTEMBER 11 AND BUDGET FACTORS

As we are all aware, the events of September 11, 2001,<sup>97</sup> sent the U.S. government into a flurry of single-purposed action relating to the War on Terrorism.<sup>98</sup> One issue, however, that was moved up to the

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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 principal purpose. 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 non-tax reasons.

*Id.* at 1981.

97. Herman P. Ayayo, *Apparent Terrorist Attacks Close U.S. Federal, State Governments*, 2001 WORLDWIDE TAX DAILY 177-1, Sept. 12, 2001, at 2. Ayayo stated:

A series of plane crashes and hijackings on September 11th that resulted in collapse of the two World Trade Center towers in New York City and damage to the Pentagon prompted the United States federal government to close all of its facilities around Washington, D.C. The decision to close the government—including the headquarters of the U.S. Department of Treasury and the Internal Revenue Service—came at 10:30 a.m. Eastern Daylight Time, shortly after leaders of the U.S. Senate and House of Representatives shut down the Capitol. The U.S. Supreme Court, Tax Court, and other courts in the District of Columbia closed, and most states and localities around the nation's capital also announced the closing of government offices and schools. The Federal Aviation Administration, Tuesday morning, shut down all aircraft departures nationwide. In the Washington, D.C., area, Reagan National Airport and Dulles International Airport announced they would be closed at least 24 hours; Baltimore-Washington International Airport announced that it would take arriving flights, but wouldn't allow departures. The SEC said on September 11th that there would be no trading on any securities exchanges that day, including the New York Stock Exchange and the NASDAQ Stock Market.

*Id.*

98. *Id.*; Rep. James F. Sensenbrenner Jr., *Tax Related Provisions of H.R. 3162, U.S. Patriot Act, as passed by House Available*, 2001 TAX NOTES TODAY 208-20, (Oct. 26, 2001) (abstract summary). Sensenbrenner provided:

The text of H.R. 3162, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001, introduced by Rep. James F. Sensenbrenner Jr., R-Wis., and passed by the House October 24 by a 357 to 66 vote, is available. The Senate cleared the bill on October 25 with a 98 to 1 vote. The bill would expand taxpayer disclosure regulations, require stricter compliance with Form 8300, and extend Treasury's power to monitor bank secrecy. The new bill combined the Financial Anti-Terrorism Act (H.R. 3004) and the Patriot Act (H.R. 2975), and includes a sunset provision that would allow Congress to review the expanded federal powers after four years.

*Id.* Rep. William M. Thomas, *W&M Committee Report Description of Economic Security and Recovery Act*, 2001 TAX NOTES TODAY 204-10, Oct. 19, 2001, at ¶ 8. Thomas states:

The terrorist attacks of September 11, 2001 have affected the United States in numerous

forefront of the Congressional calendar by the War on Terrorism was a response to individual expatriation.<sup>99</sup> In the Senate Finance Committee, the response took the form of the Draft Fast Act.<sup>100</sup>

Another factor that appears to be driving the refocus on the Draft Fast Act is the worsening budget deficit.<sup>101</sup> When the U.S. Government was flush with cash from the booming economy, interest in revenue raising activities did not seem to be on the top of the legislative agenda. However, with the current extended economic downturn, the U.S. Government is in need of ways to balance the budget (or at least come closer to balancing the budget).<sup>102</sup> Preliminary estimates of the impact of the Draft Fast Act indicate that it could raise as much as \$656 million over ten years.<sup>103</sup> As such, if Congress can seek to curtail what it considers to be unpatriotic acts<sup>104</sup> by tax expatriates while also bringing

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ways. In addition to the tremendous number of lives lost, the September 11, 2001 attacks have caused adverse effects to the U.S. economy. Thousands of Americans have lost jobs. Consumer confidence and investor confidence are low. The Committee believes that it is necessary to spur economic growth and job creation and help struggling business and unemployed workers. The provisions approved by the Committee will stimulate and strengthen the economy.

*Id.* (emphasis added).

99. Patti Mohr, *Rangel-Gephardt Bill Targets Individual Expatriates*, 2002 TAX NOTES TODAY 112-6, June 11, 2002, at 2-3. (discussing how Congress views the act of expatriation as unpatriotic). "These individuals simply refuse to contribute to the common good in a country where the political and economic system has benefited them enormously," Rangel said of the bill. "Avoiding that responsibility through renouncing citizenship should not be tolerated." *Id.*; See also Hamilton, *supra* note 94.

100. Act, *supra* note 3.

101. *Supra* note 4, *Corporate Inversion Transaction: Tax Policy Implications*, stated the market conditions have been a factor in the recent increase in inversion activity . . . [T]ax liability may be less significant because of current economic and market factors.

102. Patti Mohr & Warren Rojas, *Enron Investigation Generates New Tax Shelter, Pension Legislation*, 2002 TAX NOTES TODAY 13-1, Jan. 17, 2002, at 3-4. (discussing new legislation in order to help employee's keep their pension plan safe from unethical companies, like Enron, and stating that with the collapse of Enron and other notable companies, plus our weakening economy, that there is a need for legislation that would increase the United States tax base).

103. Warren Rojas, *Senate Taxwriters Adopt Military Package with New Expatriation Curb*, 27 TAX NOTES INT'L 1485, Sept. 23, 2002, at 1486. Rojas writes:

According to the U.S. Joint Committee on Taxation, the military tax breaks in the bipartisan Foreign and Armed Services Tax Fairness Act (H.R. 5063) will initially cost US \$91 million in 2003. However, a new expatriation tax curb for individuals and the extension of some familiar U.S. Internal Revenue Service user fees is projected to post long-term revenue gains of US \$16 million over five years and US \$2 million over ten . . . The individual expatriate proposal would replace current law on a prospective basis and is projected to raise an estimated US \$656 million over ten years. The extension of some long-standing Internal Revenue Service user fees through 2012 is projected to raise another US \$341 million over the next decade.

*Id.*

104. Mohr, *supra* note 99; See also Hamilton, *supra* note 94.

the budget closer to balance, especially in an election year, the temptation would seem almost impossible. Evidence of this temperament comes from the statements of Senator Grassley's spokesperson who was discussing the potential for a renewed interest in revenue raising tax legislation. The spokesperson stated that "From what I'm hearing about the budget, we may need some offsets."<sup>105</sup>

## VI. CONCLUSION

The patriotic fever that was released following September 11, 2001,<sup>106</sup> led several influential lawmakers to seek passage of tax legislation that would reduce the tax incentives that Americans would receive for expatriating from the United States.<sup>107</sup> The legislation took the form of the Draft Fast Act<sup>108</sup> which seeks to deny tax expatriates the tax benefits that they would otherwise receive from expatriation.<sup>109</sup>

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105. Mohr & Rojas, *supra* note 102.

The Enron bankruptcy and investigation have prompted House and Senate taxwriters to move legislation to protect workers' employer-sponsored 401(k) plans and to reexamine tax shelter legislation. Although Congress remains in recess, the Enron collapse has already stirred enough controversy that Hill lawmakers and Washington bureaucrats are making inquiries and looking for legislative and administrative solutions. In addition to the three federal agencies looking into the case, three House committees and seven Senate committees, including the Senate Finance Committee, have scheduled hearings on the many components of the Enron collapse.

*Id.* at 3.

106. Rojas, *supra* note 103 (adding the tax changes as offsets on the one year anniversary of the September 11, 2001 attacks).

107. Act, *supra* note 3. See also S. REP. NO. 107-283 (2002), at 17-23 (discussing some of the penalties that would be imposed on individuals for expatriating such as the Mark-to-Market provision, the tax on the expatriates heirs, and other changes that would further affect an individual who expatriated, including pensions plans and trusts. Furthermore, an expatriate would be denied re-entry into the United States after expatriating, even if only for a visit).

108. See *generally id.* (discussing the proposed changes to section 877 of the Code which would deter some individuals from expatriating due to new restriction the bill would impose such as the mark-to-market provision).

109. S. REP. NO. 107-283, at 13. The Senate Report provides:

Specifically, Congress wants to change expatriation law because some individuals each year relinquish their U.S. citizenship or terminate their U.S. residency for the purposes of avoiding U.S. income, estate, and gift taxes. By doing so, such individuals reduce their annual U.S. income tax liability and reduce or eliminate their U.S. estate tax liability. The Committee realizes that citizens and residents of the United States have the right not only physically to leave the United States to live elsewhere, but also to relinquish their citizenship or terminate their residency. Furthermore, Congress does not feel that the IRS should be used to stop U.S. citizens and residents from relinquishing citizenship or terminating residency; however, Congress also does not believe that the Code should provide a tax incentive for doing so. Basically that the individual's decision to relinquish citizenship or terminate residency should be tax neutral.

*Id.* See also Sullivan, *supra* note 91; Rep. Bill Archer, *Expatriation Tax Act of 1995*, 95 TAX

Certain congressional critics argue that the last major attempt<sup>110</sup> to prevent tax expatriation failed.<sup>111</sup> Thus, the Draft Fast Act contains provisions that seek to bolster the failed solution, including punishing tax expatriates by: (1) treating all of the tax expatriate's holdings as if they had been sold the day before expatriation, thereby triggering all inherent capital gains on the holdings<sup>112</sup> and (2) requiring that estate taxes due from the death of a tax expatriate be collected against a domestic heir of the tax expatriate, rather than the tax expatriate's estate.<sup>113</sup> Currently, the Draft Fast Act is awaiting a floor vote in the Senate.

The Draft Fast Act<sup>114</sup> is likely to deter certain individuals from expatriating for tax reasons. By denying tax expatriates many of the tax benefits of expatriation,<sup>115</sup> the Draft Fast Act is likely to lean the average taxpayer against expatriation based on a cost-benefit analysis. In other

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NOTES INT'L 113-17, June 8, 1995 (discussing the idea of tax neutrality).

110. McMenamin, *supra* note 2; See also Sullivan, *supra* note 91, at 1705.

111. See *supra* note 110.

112. Proposed 877(A)(1) (providing that "Mark-to-Market is all property of a covered expatriate to whom this section applies shall be treated as sold on the day before the expatriation date for its fair market value"). S. REP. NO. 107-283, at 14. The Senate Report states:

The bill generally subjects certain U.S. citizens who relinquish their U.S. citizenship and certain long-term residents who terminate their U.S. residency to tax on the net unrealized gain in their property as if such property were sold for fair market value on the day before the expatriation or residency termination. The mark-to-market provision is applicable to U.S. citizens who relinquish citizenship and long-term residents if he or she was a lawful permanent resident for at least eight out of the fifteen taxable years ending with the year in which the termination of residency occurs.

*Id.*

113. *Id.* at 19-20. The Senate Report discusses the new proposed legislation concerning beneficiaries and states that under the proposal:

[T]he exclusion from income provided in section 102 of the Code does not apply to the value of any property received by gift or inheritance from an individual who was subject to the mark-to-market expatriation tax (i.e., an individual who relinquished U.S. citizenship or terminated U.S. residency and to whom the mark-to-market tax was applicable). Accordingly, a U.S. taxpayer who receives a gift or inheritance from such an individual is required to include the value of such gift or inheritance in gross income and is subject to U.S. tax on such amount. Having included the value of the property in income, the recipient would then take a basis in the property equal to the value. The tax does not apply to property that is shown on a timely filed gift return and that is a taxable gift by the former citizen or former long-term resident, or property that is shown on a timely filed estate tax return of the former citizen or former long-term resident. In addition, the tax would not apply to property in cases in which no estate or gift tax return is required to be filed, where no such return would have been required to be filed if the former citizen or former long-term resident had not relinquished citizenship or terminated U.S. residency.

*Id.*

114. Act, H.R. 5063 *supra* note 3.

115. See *supra* note 113.

words, if the benefits of tax expatriation do not outweigh its costs, the taxpayer is unlikely to choose tax expatriation. However, the Draft Fast Act<sup>116</sup> is unlikely to deter the most determined individuals from expatriating for tax reasons. Certain tax expatriates see expatriation as a political cause rather than a financial decision.<sup>117</sup> Many of these tax expatriates generally have already dropped out of the voluntary compliance tax system by the time they actually relinquish their citizenship.<sup>118</sup> As such, the Draft Fast Act is unlikely to deter these taxpayers from choosing tax expatriation.

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116. S. REP. NO. 107-283 (2002).

117. Joe Saladino, *The America's Bulletin: Expatriation Challenge*, available at <http://www.freedomcommittee.com/1/freedom/ExpatChallenge.pdf>. Saladino argues that citizens have a right to expatriate and that the right was conferred upon by us Congress itself. The 40<sup>th</sup> Act of Congress, Session II, Chapter 249-250 states:

‘Whereas the right of expatriation is a natural and inherent right of all people indispensable to the enjoyment of the right of life, liberty, and the pursuit of happiness. . .’ This is a political statement made by Congress and now on the record forever. Expatriation has been recognized by Congress to be a natural and inherent right of all people. Expatriation is not a privilege granted by Congress. If it is a natural and inherent right, then it cannot be restricted or prohibited by government no matter what laws they might wish to pass in the future. Congress understood this when they went on to say ‘That any declaration, instruction, opinion, or decision of any officers of this government which denies, restricts, impairs, or questions the right of expatriation, is hereby declared inconsistent with the fundamental principles of this government.’

*Id.* (emphasis omitted). Joe Saladino further argues that expatriation is a natural and inherent right which can not be taken away by Congress. *Id.*

118. Bob Bauman, *The Sovereign Society Offshore A-Letter Expatriation Anyone?*, March 26, 2002, available at <http://www.sovereignsociety.com/vmembers.php?nid=322>; Joe Saladino, *The America's Bulletin: Expatriation*, available at <http://www.freedomcommittee.com/1/freedom/index.html>. Saladino argues that:

expatriation is not giving up your social security number, driver's license, car tags, professional licenses, etc. to go live in the desert under a rock. . . . Expatriation is not exiting the United States and leaving yourself without a country. Many people are uncomfortable with the idea of being a citizen of any country and many want to expatriate in such a way that they are no longer citizens of any country. One should keep in mind that under common law, one cannot be compelled to do anything unless by contract. If one has no contract with the government, then government cannot compel you to do anything under common law. Our goal is expatriation in such a way that one is only under the Organic Constitution and common law and not colorable statutes.

*Id.* Saladino then lists what expatriation must accomplish.

(1) The assumed adhesion contracts of the social security and the U.S. postal service must be voided in a lawful manner; (2) Other adhesion contracts which have not been mentioned in the record must be voided by a general reference to any type of license or certification; (3) One must expatriate from the U.S. corporate government and repatriate back into the Republic State wherein one was born and as an American Citizen; and (4) Expatriation must also position one to defend their expatriates status in the future.

*Id.*