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Expatriation, Double Taxation, and Treaty Override: Who Is Eating *Crow* Now?

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COMMENTS

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I. INTRODUCTION

In 1994, *The Wall Street Journal* reported that Kenneth Dart, billionaire and president of Dart Container, which controls a large share of the U.S. foam cup market, avoided paying millions in U.S. taxes by renouncing his U.S. citizenship.[1] Dart chose to give up his citizenship in order to become a citizen of Belize, a Central American country widely known as a tax haven.[2] Through his formal expatriation,[3] Dart avoided the payment of U.S. taxes on estate taxes, future earnings, and deferred income (i.e. capital gains). Arguably, the lost benefits of U.S. citizenship are greater than the gained benefits of Belizean citizenship and tax-avoidance.[4] Dart, however, reaps the benefits of

1. Laurie P. Cohen, *Kenneth Dart Forsakes U.S. for Belize*, WALL ST. J., Mar. 28, 1994, at C1.

2. *Id.*

3. Expatriation is the "voluntary act of abandoning one's country, and becoming the citizen or subject of another." BLACK'S LAW DICTIONARY 576 (6th ed. 1990).

4. Although expatriation is an effective tax-avoidance device, it may not be profitable or convenient for a U.S. citizen to renounce his or her citizenship. An individual considering expatriating should weigh the tax savings that result from expatriating against the following ancillary issues. First, the taxpayer should consider the flexibility of U.S. nationality and immigration laws because he or she may want to visit the United States or return if living abroad becomes intolerable. Second, a taxpayer should research the resident country's internal laws relating to foreign citizenship. For example, the issues of

both U.S. citizenship and tax-avoidance. Although he is no longer a U.S. citizen, Dart can visit, vacation, or live part of the year in the United States because Dart's family members retained their U.S. citizenship.[5] The State Department, however, rejected one element of Dart's plan when it denied his request to make his home in Sarasota, Florida, the Belizean consulate.[6]

The Kenneth Dart story is not entirely unusual. In addition to *The Wall Street Journal* article on Dart, *Forbes Magazine* published its own report which revealed a number of expatriation incidents among America's super-rich.[7] The list of high-profile, wealthy expatriates include Ted Arison, founder of Carnival Cruise Lines, who renounced citizenship to become an Israeli citizen; John Dorrance III, Campbell Soup heir, who renounced citizenship in favor of Ireland; and Michael Dingman, Chairman of ABEX Corporation, who is now a Bahamian citizen.[8]

Expatriation is not threatening to become epidemic. It is estimated that an average of 650 Americans expatriate annually while 50,000 non-U.S. citizens apply for U.S. citizenship monthly.[9] Because those who do expatriate are generally ex-

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whether the resident country will facilitate travel abroad or whether there are any fees associated with the issuance of citizenship documents may be important factors to consider. Third, an analysis of living costs and taxation in the new country is essential. Most countries that are "tax havens" have high costs of living; or alternatively, may charge high customs or inheritance taxes. Fourth, if the taxpayer has source-income from another country, he or she may want to consider the effect of tax treaties, and whether that particular treaty permits the source and resident country to tax the same income, or if the income is taxed at the source, is that rate higher than the resident country. Thomas St.G. Bissell, *Can Wealthy U.S. Citizens Reduce Taxes Through Expatriation?*, 22 EST. PLAN. 83 (1995).

5. This proposition is overly simplistic. Internal Revenue Code Section 7701 limits the amount of time that Dart may actually remain present in the United States. If he is present in the United States for thirty-one days or less, then there are no tax consequences. However, under Subsection (b) of Section 7701, Dart is treated like a U.S. resident for tax purposes if he is present in the United States for more than thirty-one days in year one and the sum of the days on which Dart was present in the United States during the current year and the two preceding calendar years (when multiplied by the applicable multiplier under Section 7701(b)(3)(ii)) equals or exceeds 183 days. This is subject to exception under the closer connection test set forth in Section 7701(b)(3)(B).

6. Mark Albright, *That's a Whole Lot of Yacht*, ST. PETERSBURG TIMES, Dec. 4, 1995, at Bus. 2.

7. Robert Lenzner & Philippe Mao, *The New Refugees: Americans Who Give Up Citizenship to Save on Taxes*, FORBES MAG., Nov. 21, 1994, at 131.

8. Karen De Witt, *Some of the Rich Find a Passport Lost is a Fortune Gained*, N.Y. TIMES, Apr. 12, 1995, at A1.

9. Detlev Vagts, *The Proposed Expatriation Tax—A Human Rights Violation?*, 89 AM. J. INT'L L. 578 (1995).

tremely wealthy, the Treasury Department contends that the loss of tax revenue is substantial.[10] It was this revenue loss, coupled with the media attention surrounding these high profile expatriates, that brought the issue of expatriation to the forefront of political debate. The Clinton Administration, the House Ways and Means Committee, and the Senate Finance Committee all proposed amendments to Section 877, the Internal Revenue Code Section designed to recapture taxes from tax-motivated expatriates.[11] All three proposals sought to close a number of loopholes that expatriates had used to avoid the intended recapture of taxes lost through formal expatriation. In September of 1996, Congress enacted amendments to the "expatriation tax" in the Health Insurance Portability and Accountability Act of 1996.[12]

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10. The Treasury Department estimates that the amended expatriation tax will generate approximately $100 million without treaty override, or $450 million with treaty override, over the next five years. *Testimony of U.S. Treasury's Samuels At Finance Hearing On Taxation Of Expatriates*, 95 TAX NOTES INT'L 134-14 (1995). [hereinafter *Samuels Testimony*]. *See* discussion of treaty override *infra* Part V.

11. The House Ways and Means Committee, the Senate Finance Committee and the Clinton Administration submitted separate and divergent proposed amendments to the original expatriation tax. Each proposal purported to close the loopholes that made the original expatriation tax an effective tax-avoidance device. *See infra* Part II.B. (discussing the loopholes in the original expatriation tax). In addition to targeting the loopholes in the original expatriation tax, each included a provision that would impose a departure tax on long-term residents who relinquish residency.

The Clinton Administration and Senate Finance Committee's proposals were very similar. Under either approach, a U.S. citizen relinquishing citizenship, or a long-term resident relinquishing residency, was treated as if all assets were sold for fair market value immediately before expatriation. Gain would be recognized on this "deemed sale" only if the taxpayer's assets or retirement plans exceeded six-hundred-thousand dollars or the taxpayer's five-year average annual income was one-hundred-thousand dollars. The "deemed sale" provision was not included in the amendments to the original expatriation tax. Congress did use the income scale as the sole method for determining whether a citizen's primary motive for expatriating was tax-motivated.

The most conservative proposal was submitted by the House Ways and Means Committee. This approach was the closest to existing legislation. Under this proposal, a former citizen is taxed following formal expatriation on certain assets producing United States-source income for a ten-year period as if the expatriate was still a U.S. citizen. The only significant difference between the original expatriation tax and the House Ways and Means proposal is that the proposal eliminates the subjective motivation test and replaces it with an objective wealth test. *See* discussion *infra* Part III.A.

The amended expatriation tax enacted by Congress and signed by President Clinton closely resembles the House Ways and Means proposal incorporating a few principles from the Senate Finance Committee and Clinton Administration's proposals. The Senate and House hearings are rich with information on how tax-avoidance or, alternatively, treaty override can be accomplished under each proposal. For a brief synopsis on deficiencies in these proposals, see Christine L. Agnew, *The Proposed Expatriation Tax and Its Impact On International Tax Treaties*, 14 INT'L L.Q. 1 (Summer 1996).

12. Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191,

This Comment will argue that the amended expatriation tax is an over broad and ineffective means for accomplishing the intended objectives. In fact, the refined mechanism for enforcing the expatriation tax has opened the door to new problems: arbitrary enforcement and conflict with international tax treaties. Part II analyzes the need for an expatriation tax, the mechanics of the original expatriation tax, and the abuse which led to the enactment of the amended expatriation tax. Part III discusses the recent amendments to the expatriation tax and explains the significance of the changes. Parts IV and V illustrate the arbitrary enforcement which may arise when a court is deciding whether to enforce the amended expatriation tax. Specifically, Part IV demonstrates how a taxpayer could convince a court that enforcement of the amended expatriation tax undermines congressional intent, undermines treaty partners' intent, and materially violates international tax treaties. Conversely, Part V demonstrates how the Commissioner of the Internal Revenue Service (Commissioner) could argue that Congress intended the expatriation tax to violate tax treaties, an acceptable practice under the "later-in-time" rule. In addition, the failure to enforce the amended expatriation tax rewards the unscrupulous for treaty-shopping and penalizes the principled for failing to do the same. Part VI considers alternatives to treaty conflict and arbitrary enforcement. Finally, Part VII examines policy aspects of the amended expatriation tax.

II. BACKGROUND

The U.S. tax system is unique, particularly regarding jurisdiction. Income and estate taxes are based on citizenship and residence.[13] The U.S. tax system rests on a broad exercise of taxing jurisdiction that extends to aliens residing within the United States and U.S. citizens living abroad.[14] The system breaks down, however, in the areas of deferred income and estate

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§ 511, 1996 U.S.C.C.A.N. (110 Stat.) 1936, 2093 (to be codified at I.R.C. § 877).

13. Compare the Canadian tax system where taxes are based solely on residency. An individual residing in the country for more than 184 days is required to pay Canadian taxes. Diane Francis, *Canada: It's Unfair That Non-Residents Can Avoid Paying Taxes*, FIN. POST, Apr. 13, 1995, at 19.

14. The Sixteenth Amendment to the U.S. Constitution gives Congress "the power to lay and collect taxes on income, from whatever source derived, and without regard to any census or enumeration." U.S. CONST. amend. XVI. *See also* I.R.C. § 61 (1996) (defining gross income as "income from whatever source derived").

taxes.

American estate taxes rates reach as high as fifty-five percent,[15] among the highest in the industrialized world.[16] These expensive tax rates can be avoided by renouncing citizenship because the United States does not tax a deceased foreigner's estate.[17] Therefore, expatriation is an advantageous tax-avoidance device in the estate planning context.[18]

Another avenue for tax-avoidance is in the area of deferred income. Many corporate executives, like Dart, take portions of their salaries in investment form like stock. The money made when the stock is sold is taxed at a lower rate and at a later date.[19] This has a two-fold tax benefit: 1) it allows the taxpayer to defer payment of taxes; and 2) it decreases the rate at which such income would ordinarily be taxed. Similarly, shareholders receiving a stock dividend that receives nonrecognition treatment under Section 306 of the Internal Revenue Code are afforded the opportunity to shelter income until such stock is sold. The opportunity to shelter income and to receive a capital gain rate operates as an incentive to invest. The benefits received are subject to a recapture of taxes at a later date, such as when stock is sold. Expatriates who renounce citizenship before any income is realized escape recapture of taxes.[20] If income is realized after citi-

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15. I.R.C. § 2001(c)(1) (1996).

16. Bissell, *supra* note 4, at 83.

17. *But see* I.R.C. § 2101(a) (1996) (imposing a tax on a transferred taxable estate described in Section 2106 which limits the estate tax to that portion of the decedent's estate situated within the United States). For tax-avoidance purposes, the expatriate would avoid paying estate taxes on all property outside of the territorial United States.

18. *But see* Hay v. Commissioner, 145 F.2d 1001, 1003 (4th Cir. 1944) (finding that a former citizen who expatriated to avoid potential death duties had to pay taxes on the taxable gain involving a transaction that occurred while the former citizen was a resident of Nassau in the Bahama Islands). The court stated: "We do not think that a taxpayer can avoid the incidence of an income tax by splitting a transaction into nontaxable parts if a taxable gain is derived from the transaction considered in its entirety." *Id.* at 1004.

19. An employee who renders services in exchange for stock in a corporation is taxed as ordinary income on the fair market value of the stock, if that value is ascertainable, on the date such stock is issued. That value becomes the taxpayer's basis in the stock. The tax advantage of this transaction occurs on the disposition of the stock. The recognition rules under Section 1001 require income to be recognized and realized upon the disposition of property, and in this example, stock. The capital character of gain or loss recognized on the disposition of the stock is governed by Section 1221, provided that the stock is not held for inventory purposes, subject to a holding period set forth in Section 1223.

20. *But see* I.R.C. § 897(a)(2)(A)(ii) (1996) (taxing a nonresident alien on the gain realized on the disposition of real property); I.R.C. § 871(a)(2) (1996) (taxing the gain on the disposition of United States-source capital assets of a nonresident alien present in the

zenship is lost, the United States lacks jurisdiction to collect taxes on that deferred income.

The underlying economic policy, facilitating tax breaks to foreigners, is sound. For example, it is clear that the United States declines to impose a capital gains tax on foreigners because such an imposition would discourage foreign investment. However, this policy is frustrated when Americans in high tax brackets relinquish citizenship to take advantage of foreign tax breaks.

A. *The Original Expatriation Tax*

In 1966, Congress enacted a tax to prevent expatriation abuses in the capital gain and estate planning contexts.[21] Codified in Internal Revenue Code Section 877(a), the expatriation tax provided:

> Every nonresident alien individual who at any time after March 8, 1965, and within the 10-year period immediately preceding the close of the taxable year 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 B, shall be taxable for such taxable year in the manner provided in subsection (b) if the tax imposed pursuant to such subsection exceeds the tax which, without regard to this section, is imposed pursuant to section 871.[22]

Under the expatriation tax, a special taxation regime applied to a U.S. citizen who renounced citizenship, but only if the loss of citizenship was principally tax-motivated.[23] Determinations regarding a taxpayer's principal motive for expatriating only required the Secretary of the Treasury (Secretary) to establish that it was reasonable to believe that, but for this Section, the taxpayer would receive a significant tax benefit.[24] The burden then shifted to the taxpayer to prove that his or her motive was not tax-avoidance despite the significant tax benefits gained through

United States for more than 183 days).

21. Foreign Investors Tax Act of 1966, Pub. L. No. 94-455, 90 Stat. 1520, 1620-1624.

22. I.R.C. § 877(a) (1996).

23. *Id.*

24. I.R.C. § 877(e) (1996).

expatriation.[25] If the expatriate failed, the former citizen was taxed for the ten year period following formal expatriation.[26]

Double taxation and fiscal evasion were serious concerns under the original expatriation tax.[27] Double taxation occurred if the taxpayer became a citizen or resident of a country that taxed the same income[28] and an existing tax treaty did not cede taxing jurisdiction.[29] Fiscal evasion occurred when both the taxpayer and the taxpayer's new resident country failed to report to the United States gain realized after the taxpayer relinquished citizenship or residency. In response to the problem of double taxation and fiscal evasion, the United States renegotiated most tax treaties to include a saving clause provision that dealt specifically with the issue of Section 877.

B. *Tax-Avoidance Under the Original Expatriation Tax*

Although the original expatriation tax was Congress' response to the use of expatriation as a tax-avoidance device in the capital gain and estate planning contexts, tax-motivated expatriates found three separate loopholes in the tax that enabled them to continue avoiding U.S. taxes.

The first loophole arose when a tax-motivated expatriate manipulated the subjective motivation test used to determine the taxpayer's motive for expatriating.[30] Internal Revenue Code Section 877(e), set forth the burden of proof for establishing whether a citizen's motivation for expatriating was tax-avoidance. It provided:

> If the Secretary establishes that it is reasonable to believe that an individual's loss of United States citizenship would, but for this section, result in a substantial reduction for the

25. *Id.*
26. I.R.C. § 877(a) (1996).
27. For a discussion of these concerns under the amended expatriation tax, see *infra* text accompanying notes 64-67.
28. For example, the taxpayer in Revenue Ruling 79-152 expatriated to another country. Subsequently, the taxpayer realized a large capital gain on his U.S. capital assets. The United States and the taxpayer's new country wanted to tax the gain on United States-source income. Rev. Rul. 79-152, 1979-1 C.B. 237.
29. *See* discussion *infra* Parts IV, V.
30. I.R.C. § 877(a) (1996).

> taxable year in the taxes on his probable income for such year, the burden of proving for such taxable year that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle B shall be on such individual.[31]

The taxpayer's burden of proof has an extremely low threshold primarily because it is difficult, if not impossible, to prove that the taxpayer's subjective motive for expatriating is *not principally* tax-motivated.[32]

A second loophole in the tax existed for the "patient expatriate." Under the original expatriation tax, there was a finite period, ten years, within which a taxable event had to occur in order for the government to tax the realized income.[33] If the taxpayer survived and did not sell any assets during the ten-year period, there was no taxable event to trigger any U.S. taxes. In the meantime, however, the expatriate was not completely prohibited from enjoying the fruits of his or her assets. The taxpayer could use the assets as collateral to secure a loan, and although the taxpayer had effectively liquidated the asset without selling it, there was no taxable event because a loan with a corresponding obligation to repay is not a taxable event.[34]

The third loophole arose in the area of foreign investments. Foreign assets acquired while the taxpayer was a U.S. citizen were not taxed upon expatriation.[35] Therefore, a U.S. citizen who acquired foreign assets during his or her citizenship, and subsequently expatriated, never paid taxes on the disposition of that property. As long as the investor chose a foreign jurisdiction with lower tax rates, the investor was able to escape U.S. taxes and create substantial tax savings.

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31. I.R.C. § 877(e) (1996).

32. Dart expatriated to Belize in order to increase his personal security. However, Dart is not the first to provide an attenuated "non-tax-avoidance" reason for expatriating. Michael Dingman, Chairman of ABEX Corporation, explained that his reason for expatriating was not tax-avoidance, rather he always wanted to become a Bahamian citizen. *See* De Witt, *supra* note 8, at A1.

33. I.R.C. § 877(a) (1996).

34. Crane v. Commissioner, 331 U.S. 1 (1947).

35. I.R.C. § 877(c) (1996) provides in part: "[T]he following items of gross income shall be treated as income from within the United States: (1) SALE OF PROPERTY . . . located in the United States. (2) STOCK OR DEBT OBLIGATIONS.—Gains on the sale or exchange of stock issued by a domestic corporation or debt obligations . . . ." *Id.*

III. THE AMENDED EXPATRIATION TAX

In August 1996, Congress enacted three major amendments to the expatriation tax.[36] First, Congress replaced the subjective motivation test with an objective wealth test.[37] Second, Congress expanded the tax to reach not only U.S. citizens, but also certain long-term residents.[38] Finally, Congress recharacterized the types of gain and income treated as United States-source income, thereby expanding the range of income subject to the expatriation tax.[39]

A. *The Objective Wealth Test Replaces the Subjective Motivation Test*

The subjective motivation test applied under the original expatriation tax, which required the Secretary to prove the expatriate had a tax-avoidance motive, has been largely replaced by an objective wealth test which automatically creates a presumption of a tax-avoidance motive for certain wealthy individuals.[40] Under the amendments, a taxpayer is presumed to have a tax-avoidance motive if the taxpayer's average annual income or total net assets exceeded a certain level.[41]

Under the amended expatriation tax, the Secretary no longer carries the burden of establishing whether the taxpayer's pri-

36. Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, § 511, 1996 U.S.C.C.A.N. (110 Stat.) 1936, 2093 (to be codified at I.R.C. § 877).

37. *Id.* § 511(a) (to be codified at I.R.C. § 877(a)).

38. *Id.* § 511(g)(1)(B) (to be codified at I.R.C. § 877(d)).

39. *Id.* § 511(c) (to be codified at I.R.C. § 877(d)).

40. *Id.* § 511(a) (to be codified at I.R.C. § 877(a)).

41. *Id.* The criteria are contained in the new objective wealth test which provides:

> (2) CERTAIN INDIVIDUALS TREATED AS HAVING A TAX-AVOIDANCE PURPOSE.— For purposes of subsection (a), an individual shall be treated as having a principal purpose to avoid tax if—
>
> (A) the average annual net income (as defined in section 38(c)(1)) of such individual for the period of 5 taxable years ending before the date of the loss of United States citizenship is greater than $100,000, or
>
> (B) the net worth of the individual as of such date is $500,000 or more.
>
> In the case of the loss of United States citizenship in any calendar year after 1996, such $100,000 and $500,000 amounts shall be increased by an amount equal to such dollar amount multiplied by the cost-of-living adjustment determined under section 1(f)(3) . . . . Any increase shall be rounded to the nearest multiple of $1,000.

mary motive for expatriating was tax-avoidance.[42] Similarly, the taxpayer no longer has the opportunity to rebut that presumption with attenuated and unrealistic explanations.[43] As a result, the amended tax has a larger net to recapture deferred income and estate taxes. The tax not only captures those who previously escaped taxes under the original expatriation tax by establishing that their primary motive was not tax-avoidance, but it also captures those taxpayers who are expatriating for valid reasons.[44]

There is a narrow list of exceptions to the presumption of tax-avoidance under the objective wealth test. If certain taxpayers file a ruling request with the Secretary within one year after formal expatriation, the former citizen will not be subject to the expatriation tax.[45] To be eligible, a taxpayer must meet one of the following criteria:

> (1) was born with dual citizenship and retains citizenship in the other country; (2) becomes a citizen of the country of the individual's birth, the birth country of a spouse, or the birth country of either parent; (3) terminates citizenship before the age of 18 1/2; (4) was present in the United States for less than 30 days each year of a ten-year period; or (5) is exempted by regulation.[46]

These exceptions only apply to U.S. citizens relinquishing citizenship. The exceptions are not an option for long-term residents relinquishing residency.[47]

Id.

42. However, the subjective test remains in force for those that do not meet the criteria of the objective wealth test. In those cases, the Secretary still must establish that it is reasonable to believe the expatriate had a tax-avoidance motive. Health Insurance Portability and Accountability Act of 1996, § 511(f), 1996 U.S.C.C.A.N. (110 Stat.) 1936, 2093 (to be codified at I.R.C. § 877) (redesignating the subjective test from I.R.C. § 877(e)-(f)).

43. *See, e.g., supra* note 32.

44. Many expatriates relinquish citizenship and move to countries with tax rates comparable to, or higher than, those imposed by the United States tax system. Joint Comm. on Taxation, Issues Presented By Proposals to Modify the Tax Treatment of Expatriation, J.C.S. -17-95, (1995)[hereinafter Joint Comm. Report].

45. Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191 § 511(b)(1), 1996 U.S.C.C.A.N. (110 Stat.) 1936, 2093 (to be codified at I.R.C. § 877(c)).

46. *Id.*

47. *Id.*

B. *Taxation of Long-Term Residents Terminating Residency: Investors Go Home*

Unlike the original expatriation tax, the amended expatriation tax subjects former long-term residents to a tax on income earned for ten years following the date of expatriation.[48] For purposes of Section 877, long-term permanent residents are those individuals who lawfully reside as a permanent resident in the United States for eight of the fifteen years preceding expatriation.[49] If the former long-term resident expatriates, meets the objective wealth test and fails to establish residency in a jurisdiction that will not cede taxing jurisdiction to the United States,[50] he or she will be taxed for the ten years following expatriation "in the same manner as U.S. citizens who lose citizenship"[51] and may be taxed by his or her home country. The most immediate effect of this provision is to discourage foreign investors seeking to build a commercial base or reside in the United States for any significant amount of time.

C. *Recharacterizing United States-Source Income and Gain Under the Amended Expatriation Tax*

The original expatriation tax limited taxation of expatriates to gains on the sale or exchange of stock issued by a *domestic* corporation.[52] Under the original expatriation tax, an expatriate could restructure his or her interest in a corporation to avoid taxes. For example, a controlling shareholder in a parent corporation could create a wholly owned foreign subsidiary by exchanging his or her shares in the parent corporation for shares in the foreign subsidiary. This would be a tax-free reorganization

48. *Id.* § 511(f) (to be codified at I.R.C. § 877(e)(1)).

49. *Id.* § 511(f) (to be codified at I.R.C. § 877(e)(2)).

50. A country would not cede taxing jurisdiction to the United States if the imposition of the expatriation tax directly conflicts with the terms of a negotiated tax treaty. *See* discussion *infra* Part IV.

51. Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, § 511(a), 1996 U.S.C.C.A.N. (Stat. 110) 1936, 2093 (to be codified at I.R.C. § 877(a)).

52. I.R.C. § 877(c) (1996).

under the Internal Revenue Code.[53] This reorganization allowed the expatriate shareholder to avoid taxes on the disposition of shares in the foreign subsidiary because the original expatriation tax did not tax an expatriate's gain on the disposition of stock issued by a *foreign* corporation.[54]

The amended expatriation tax now taxes income and gains derived from a foreign corporation in which the taxpayer owned a fifty percent interest at the time of formal expatriation.[55] The taxpayer will be taxed "to the extent of earnings and profits earned and accumulated before the termination of citizenship or residency."[56] In addition, an expatriate taxpayer will be taxed on the disposition of property to a controlled foreign corporation.[57] If the taxpayer transfers property to a controlled foreign corporation, the taxpayer steps into the corporation's shoes. The taxpayer, not the controlled foreign corporation, is taxed on the receipt of property.[58]

As drafted, the amended expatriation tax closes only one of the three loopholes: tax-avoidance by wealthy expatriates under the subjective motivation test.[59] The amendments replace the subjective motivation test with an objective wealth test which makes tax-avoidance theoretically impossible. It does not eliminate tax-avoidance by expatriates who wait ten years before realizing income under the Code and regulations. The amendments partially address tax-avoidance through foreign investment, but only to the extent that the taxpayer owns fifty percent of a foreign corporation. This does not prevent tax-avoidance when a taxpayer has a diversified portfolio and invests in several foreign corporations or limits his or her stock interest in a foreign corporation to forty-nine percent.

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53. *Id.* § 368 (1996). A taxpayer structuring this type of transaction also runs the risk of a reallocation of income and deductions under Section 482 which allows the Secretary of the Treasury to reallocate income among taxpayers when the business is controlled directly or indirectly by the same interest for tax-avoidance purposes. The Secretary could treat the Section 368 reorganization as a sale of a capital asset subject to tax under Section 61(a)(3).

54. I.R.C. § 877(c)(2) (1996).

55. Health Insurance Portability and Accountability Act of 1996, § 511(c) (to be codified at I.R.C. § 877(d)).

56. 1996 TAX LEGISLATION: LAW AND EXPLANATION 109 (CCH., 1996).

57. Health Insurance Portability and Accountability Act of 1996, § 511(c) (to be codified at I.R.C. § 877(d)).

58. *Id.; see also* Joint Comm. Report, *supra* note 44.

59. *But see supra* text accompanying note 46.

IV. THE AMENDED EXPATRIATION TAX AND CURRENT BILATERAL TAX TREATIES—THE TAXPAYER'S PERSPECTIVE

In the amended expatriation tax, Congress created a new loophole that arises in the context of bilateral tax treaties. A taxpayer could use this loophole to argue that the amended tax violates the terms of tax treaties and, therefore, under existing law, the treaty controls. A court that finds this argument persuasive will be forced to allow the tax treaty to shelter the taxpayer from tax liability under the expatriation tax.

The primary motive underlying tax treaties is to create a forum which facilitates international trade and investment.[60] This is accomplished by eliminating barriers to the "international exchange of goods and services and the international movement of capital and persons."[61] Tax treaties effect this forum through bilateral agreements geared toward avoiding the two most serious tax barriers: double taxation and fiscal evasion.[62] Thus, the focus in treaty negotiations often centers on drafting a treaty that coordinates the mutual exchange of information to limit fiscal evasion and a system for ceding taxing jurisdiction to avoid the incidents of double taxation.[63]

Double taxation usually occurs when one country taxes on the basis of residence and another country taxes on the basis of source.[64] Double taxation can also arise when two treaty countries reach inconsistent resident determinations.[65] However, an expatriation tax also has potential for double taxation. For example, if the United States exercises its taxing jurisdiction pursuant to the amended expatriation tax and the former citizen's new country seeks to tax the same income or disposition of assets

60. WILLIAM H. NEWTON, III, INTERNATIONAL INCOME TAX AND ESTATE PLANNING, § 5.02, n.5 (1995). *See also* Eric J. Smith, *The U.S.-Mexico Tax Treaty*, 8 FLA. J. INT'L L. 97, 98 (1993) (citing *International Aspects of United States Income Taxation: Proposals on United States Income Tax Treaties*, 2 A.L.I. 1 (1992)).

61. Smith, *supra* note 60, at 98.

62. NEWTON, *supra* note 60, § 5.02. *See also supra* text accompanying notes 27-29.

63. Smith, *supra* note 60, at 98.

64. NEWTON, *supra* note 60.

65. In the treaty context, both residence and citizenship are determined by each treaty partner's internal law. It is possible for a taxpayer to be a resident of two or more countries. In addition, a taxpayer could be considered a citizen of one country and a resident of another. This may lead to double taxation where one country, for example the United States, levies taxes based on citizenship and another country taxes the income based on resident status.

under its internal tax laws, the expatriate will end up paying tax twice on the same income. An income tax treaty eliminates the incidents of double taxation of expatriates in one of the following ways: 1) the treaty would not preserve the right of the country to tax its former citizens—saving clause does not expressly mention former citizens; 2) the general treaty provisions provide relief from double taxation apply; and 3) pursuant to the taxpayer's request, the "competent authorities"[66] of the two countries reach an agreement to alleviate double taxation.[67]

A. *The Saving Clause—A Vehicle for Capturing and Avoiding Taxes*

Most U.S. tax treaties contain a saving clause.[68] Generally, a saving clause reserves the United States a right to tax its residents and both present and former citizens regardless of the treaty's other terms.[69] One particular issue that arises in the expatriation context is whether the saving clause provision allows the United States to retain taxing jurisdiction over a former citizen.[70]

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66. The third method for avoiding double taxation will not be examined here because it is beyond the scope of this Comment. Such analysis must be case specific taking into consideration the relationship between the treaty partners.

67. Joint Comm. Report, *supra* note 44.

68. MERTENS LAW OF FEDERAL INCOME TAXATION § 45.32.30 (Cum. Supp. Jan. 1996). *See also* MERTENS LAW OF FEDERAL INCOME TAX § 45.32 (1995).

69. For example, the saving clause in the United States and Mexico tax treaty provides:

> Notwithstanding any provision of the convention except paragraph 4, a Contracting State may tax its residents (as determined under Article 4 (Residence), and by reason of citizenship may tax its citizens as if the Convention had come into effect. For this purpose, the term "citizen" shall include former citizen whose loss of citizenship had as one of its principal purposes the avoidance of tax, but only for a ten year period following such loss.

Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, with Protocol, Sept. 18, 1992, U.S.-Mex., S. TREATY DOC. NO. 103-07, art. 3[hereinafter Double Taxation Treaty].

70. Since the United States is virtually alone in taxing its citizens, the Treasury must negotiate with treaty partners to reserve the United States a right to tax its citizens abroad. Absent a bilateral agreement to exchange information, the United States would have difficulty determining the amount of income earned by citizens abroad and foreign taxes paid that are creditable against the taxpayer's U.S. taxes. A saving clause may further broaden the scope of U.S. taxing jurisdiction because some saving clause provisions broaden the definition of citizen to include a former citizen whose primary reason for expatriating is tax-avoidance. *See, e.g.*, *Id.*

The trend among recent saving clause provisions is to expressly preserve the United States' right to tax its former citizens under certain circumstances, notwithstanding any other provision in the treaty.[71] This illustrates the "U.S. discomfort with the notion of constraining domestic taxing authority through an international agreement."[72] Currently there are three types of saving clauses. These saving clauses include: 1) saving clauses that apply to current citizens, but do not expressly mention former citizens (Class I); 2) saving clauses that apply to current and former citizens for ten years after the loss of citizenship if such loss had for one of its principal purposes tax-avoidance (Class II);[73] and 3) saving clauses that apply to citizens after the loss of citizenship regardless of the reason for the loss (Class III).[74] Of the forty-five saving clauses in currently existing tax treaties, forty-one fall within Class I or Class II.[75]

1. *Crow*: Tax-Avoidance Under the Original Expatriation Tax

The original expatriation tax was enacted as part of the Foreign Investors Act of 1966 (FITA).[76] Section 110 of FITA provided that "[n]o amendment made by this article shall apply in any case where its application would be contrary to any treaty obligation of the United States."[77] Thus, Congress made it clear that no provision in FITA, including the expatriation tax, should be construed in a manner that conflicts with U.S. treaties.

Crow v. Commissioner,[78] the seminal case on expatriation, reaffirmed congressional intent that a FITA provision should give deference to U.S. treaties when a conflict arises. The issue in *Crow* was whether the former United States-Canada Tax Treaty, which precluded the United States from taxing U.S. capital gains earned by Canadian residents, prevented the application of the

71. Richard L. Dorenberg, *Overriding Tax Treaties: The U.S. Perspective*, 9 EMORY INT'L L. REV. 71, 72-73 (1995).

72. *Id.*

73. *See, e.g.*, Double Taxation Treaty, *supra* note 69, at art. 3.

74. Joint Comm. Report, *supra* note 44.

75. *Id.*

76. Foreign Investors Tax Act of 1996, Pub. L. No. 94-455, 90 Stat. 1520, 1620-1624.

77. *Id.*

78. 85 T.C. 376 (1985).

original expatriation tax.[79] The court concluded that the treaty prevented the United States from exercising its taxing jurisdiction over its former citizens' capital gains income realized after the former U.S. citizen became a Canadian resident.[80] Because the treaty contained a Class I saving clause, the United States did not retain the right to tax its former citizen after expatriation without regard to other treaty provisions.[81] In effect, the capital gain provision in the tax treaty trumped the original expatriation tax.[82] Therefore, the narrow impact of the *Crow* decision is the creation of an additional avenue for tax-avoidance—treaty-shopping. A broader reading of *Crow* supports the proposition that a tax treaty controls when a FITA provision and the treaty conflict.

2. *Crow:* Tax-Avoidance Under the Amended Expatriation Tax

Section 110 of FITA clarified congressional intent that the original expatriation tax should not be construed to conflict with tax treaties.[83] The amended expatriation tax, however, is not as clear. While the House Ways and Means Committee Report implied that the amended expatriation tax should not be construed in a manner that conflicts with existing tax treaties,[84] no such language appears in the actual amendments. If the amendments are interpreted with the legislative history, then *Crow* still has persuasive authority. Under a *Crow* analysis, an expatriate who becomes a resident in a country that has a Class I or Class II saving clause may argue that the treaty is in *direct* conflict with the amended expatriation tax and the United States is precluded from taxing the expatriate's income.

Under a Class I saving clause, the taxpayer would argue that the United States is attempting to tax its former citizen because the tax is imposed after formal expatriation and the saving clause only preserves the United States right to tax its current

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79. *Id.* at 377.

80. *Id.* at 392.

81. *Id.* at 385.

82. *Id.* at 392.

83. Foreign Investors Tax Act of 1996, Pub. L. No. 94-455, 90 Stat. 1520, 1620-1624.

84. H.R. REP. NO. 104-496, 104th Cong., 2d Sess., at 155 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1865, 1956.

citizens. Under *Crow*, any attempt to tax a former citizen is in direct conflict with the tax treaty and the United States is precluded from exercising its taxing jurisdiction over the expatriate.

An expatriate residing in a country with a Class II saving clause would argue that the United States may not impose its taxing jurisdiction without first inquiring into the taxpayer's primary motivation for expatriating. The over broad objective wealth test does not provide any mechanism to exclude those expatriates who are not renouncing citizenship for tax-avoidance purposes. Clearly, the treaty partner underscored the importance of a tax-avoidance motive by including that requirement in its saving clause. The United States cannot exercise its taxing jurisdiction if such an exercise would directly conflict with the requirement that the United States first determine that the taxpayer's primary motive is tax-avoidance. Therefore, a former citizen may use the *Crow* argument to avoid the amended expatriation tax in both Class I and Class II treaty countries. A former citizen could not make a *Crow* argument in a Class III treaty country because those countries permit the United States to exercise taxing jurisdiction over a former citizen irrespective of motive.[85]

The expansion of taxing jurisdiction over long-term residents relinquishing residency under the amended expatriation tax violates all tax treaties, regardless of which type of saving clause it contains. There is not a single treaty saving clause that preserves the United States' right to tax its former long-term residents.[86] Thus, any attempt to tax a long-term resident, where such tax would contravene another tax provision in the treaty expressly prohibiting taxation, is in direct conflict with the treaty.[87] Under *Crow*, the treaty controls.

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85. For a summary of countries falling within Class I, Class II, and Class III treaty savings clauses, see CONGRESSIONAL JOINT COMMITTEE PRINTS, J.C.S.-17-95, CONG., SESS. (DOC. 95-5490) *reprinted in Section 877—Expatriation to Avoid Tax*, TAX NOTES TODAY, June 1, 1995, Appendix A.

86. Note that a saving clause never reserves the United States a right to tax its former residents. The fact that a tax treaty explicitly includes citizens and former citizens and that it explicitly includes residents without mentioning former residents is an indication that neither the United States nor the treaty partner ever contemplated an attempt to exercise such broad taxing jurisdiction. An attempt to tax former residents, if enforced, could be construed as a material breach of the tax treaty.

87. Former Secretary of Tax Policy, Leslie Samuels, foreshadowed the treaty conflicts relating to the taxation of former citizens and residents under the amended expatriation tax. "The Committee is also aware that certain existing income tax treaties may

If a court determines that the amended expatriation tax's legislative history is persuasive, then *Crow* is still on point. When a former citizen moves to a Class I or Class II saving clause country, the former citizen can argue that the United States lacks taxing jurisdiction. A former resident can argue that Class I, Class II, and Class III saving clauses directly conflict with the amended expatriation tax, and, therefore, the United States lacks taxing jurisdiction. The surprising effect is that this analysis rewards those expatriates who treaty-shop and penalizes those who do not. Those failing to treaty-shop are obviously not expatriating to avoid taxes, nor are they the taxpayers the amendments intended to capture. These expatriates would not have been subject to taxation under the former taxing regime. Instead, this analysis allows the tax-motivated expatriate to become an unintended beneficiary by ensuring tax-avoidance through treaty-shopping. The tax-avoiding expatriate runs a greater risk of taxation under the former regime if the Commissioner determines that his or her subjective motive was tax-avoidance.

V. TREATY OVERRIDE UNDER THE AMENDED EXPATRIATION TAX—THE COMMISSIONER'S PERSPECTIVE

Crow is not a guarantee to tax-avoidance for tax-motivated expatriates. Since the enactment of FITA and the *Crow* decision, much has changed in Congress' posture toward treaty override. The Technical and Miscellaneous Revenue Act of 1988 (TAMRA) generally, and the codification of the "later-in-time rule" in Section 7852(d) of the Internal Revenue Code specifically, demonstrate Congress' proclivity for overriding tax treaties.

Under present law, U.S. statutes and treaties are on a theoretical parity.[88] Both have the force of federal law.[89] Because

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not permit the United States to assert its taxing jurisdiction on former citizens or long-term residents who are residents of such countries . . . . [T]he new provisions [of the amended expatriation tax] will take precedence over treaties for a period of ten years." *Samuels Testimony*, *supra* note 10.

88. NEWTON, *supra* note 60, § 5.03.

89. I.R.C. § 894(a) (1996), as amended by The Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, 102 Stat. 3342 (Nov. 10, 1988), reduced the amount of deference between domestic legislation and international tax treaties to "due regard." Due regard in this context is determined by Section 7852(d), which provides: "[f]or purposes of determining the relationship between a provision of a treaty and any law of the United States, affecting revenue, neither the treaty nor the law shall have preferential status by

they are equal, there is a need to establish a system for determining primacy. The mechanism for determining primacy in the United States is the "later-in-time" rule. The "later-in-time" rule provides that an inconsistent, subsequent federal statute, in this case the amended expatriation tax, would preempt a provision in an earlier tax treaty.

The premise that internal laws can now override international tax treaties has not only been accepted by Congress,[90] but also by the Supreme Court. A series of Court opinions, long before the enactment of Section 7852(d), legitimized Congress' carte blanche power to override tax treaties.[91] For example, in *Whitney v. Robertson*,[92] the Court explained that the "later-in-time" rule, now codified in Section 7852(d), is "[t]he duty of courts . . . to construe and give effect to the latest expression of sovereign will."[93]

The amended expatriation tax does not contain an express provision like FITA Section 110 that expressly disfavors treaty override. This absence in light of the codification of the "later-in-time" rule and the precedent of *Whitney* and its progeny create an environment ripe for treaty override. The Commissioner could validly argue that Congress did not include a provision like FITA Section 110 in the amended expatriation tax because it intended to override tax treaties. In fact, Congress did contemplate and intend treaty override because it was considered throughout the legislative history.[94]

Congress recognized that treaty override could occur, and its decision not to include a provision deferring to tax treaties in cases of conflict demonstrates that Congress intended to enforce this tax irrespective of the international consequences.

As the *Crow* court noted, "Congress must weigh the potential for abuse against sound foreign policy considerations. Neither the [commissioner] through administrative action nor the [c]ourt through judicial interpretation can substitute its judgment for

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reason of its being a treaty or law." In essence, Section 7852, together with Section 894, places Code provisions and tax treaties on equal ground.

90. *Id.*

91. *See* Botiller v. Dominguez, 130 U.S. 238, 247 (1889); The Chinese Exclusion Case, 130 U.S. 581, 600 (1889); Fong Yue Ting v. U.S., 149 U.S. 698, 721 (1893).

92. 124 U.S. 190 (1887).

93. *Id.* at 195.

94. *See supra* note 87.

that of Congress in these matters."[95] In other words, it is not the duty of the court to reconstruct what Congress failed to include.

Although a tax-motivated expatriate could argue that a specific tax treaty directly conflicts with the amended expatriation tax, it is unsettled whether *Crow* or the "later-in-time" rule controls. Courts enforcing the amended expatriation tax face a double-edged sword. On the one hand, if a court enforces the amended expatriation tax, it may violate tax treaties between the United States and Class I, Class II, or Class III saving clause countries, and such a decision may disregard Congress' implicit intent to respect these treaties as evinced by the legislative history. On the other hand, if a court does not enforce the amended expatriation tax, it rewards treaty-shopping and frustrates the purpose of the amendments by generating another loophole.

VI. ALTERNATIVES TO TREATY OVERRIDE AND TAX-AVOIDANCE: AMENDING AMENDMENTS

The potential for treaty override is not something that United States' treaty partners will take lightly.[96] While reviewing the proposed legislation, the Joint Committee on Taxation noted that the United States could renegotiate Class I, Class II, and Class III tax treaties.[97] Assuming the possibility that some countries will renegotiate tax treaties, "this provision [of the expatriation tax] does not change the fundamental nature of the treaty override: our treaty partners entered into a bargain with the United States that they did not expect to be broken unilaterally."[98] Moreover, if the United States does not clarify its intended or unintended position on treaty override and courts enforce the amended expatriation tax under the "later-in-time" rule, a protesting treaty partner could seek a remedy under Article 60 of the Vienna Convention which states, "material breach of a bilateral treaty by one of the treaty parties entitles the other to invoke the breach as a ground for terminating the treaty or suspending its operation in whole or in part."[99] Below are some suggestions that could reduce the potential conflicts between the

95. *Crow*, 85 T.C. at 393.

96. *Samuels Testimony*, *supra* note 10.

97. *Id.*

98. *Id.*

99. Vienna Convention on the Law of Treaties, May 23, 1969, 8 I.L.M. 679, 701 (1969).

amended expatriation tax and tax treaties.

A. *Amending the Incidence of Double Taxation*

The Treasury Department foreshadowed the potential for double taxation before the enactment of the amended expatriation tax.[100] As one might expect, the Treasury Department, which has the primary responsibility for tax-treaty negotiations, suggests an alternative to statutory override of Class I, Class II, and Class III tax treaties. The Treasury contends that the meaning of the term "United States citizen," undefined in tax treaties, could be modified to prevent statutory override of tax treaties.[101] The United States could redefine "United States citizen" for expatriation tax purposes. The amended expatriation tax imposes a tax on long-term residents meeting certain residency conditions. As noted earlier, a tax on former long-term residents will conflict with Class I, Class II, and Class III treaty saving clause provisions because the United States is attempting to impose its taxing jurisdiction over a former resident.[102] The United States could expand the definition of U.S. citizen to include certain long-term residents who reside in the United States for eight out of fifteen years. By expanding this definition, the United States may exercise its taxing jurisdiction over the former long-term resident, now defined as citizens, in Class III countries. If the United States altered the objective motivation test to include a subjective assessment, these former long-term residents, now deemed citizens, could be taxed in Class I, Class II, and Class III countries.

Although the term "United States citizen" is undefined in tax treaties, determinations defining citizenship are traditionally governed by the Immigration and Nationality Act.[103] The

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100. *See supra* note 87.

101. *Samuels Testimony, supra* note 10. The Treasury's proposal to amend the meaning of the term "U.S. citizen" attempted to alter the dates on which a U.S. citizen becomes a former citizen for purposes of the proposed deemed sale provision. That provision is discussed thoroughly in the proposals, but was not enacted with the other amendments. The Treasury is not cited here for its specific proposal. Rather, it is cited for the proposition that the term "U.S. citizen" is malleable and can be altered in existing treaties to prevent treaty override.

102. *See supra* note 86 and accompanying text.

103. *See* Joint Comm. Report, *supra* note 44. *See also* Immigration and Nationality Act § 349, 8 U.S.C. § 1481 (1988).

amended expatriation tax, however, would be imposed on a non-resident individual, characterized as a citizen for expatriation tax purposes, who is not a citizen under the immigration statutes.[104]

The Treasury Department argues that the United States is free to interpret undefined treaty terms by referencing the definition that is in effect at the time of interpretation.[105] Even though assessing a meaning contrary to that which was agreed upon in treaty negotiations may be interpreted as an implicit treaty override under internal law, it is not an explicit treaty override warranting international remedies under Article 60 of the Vienna Convention.[106]

B. *Modification of the Former Subjective Motivation Test*

The amended expatriation tax violates Class I and Class II tax treaties insofar as it taxes U.S. citizens without regard to the individual's primary motive for expatriating.[107] The subjective motivation test under the amended expatriation tax, by itself,

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104. Immigration and Nationality Act § 349, 8 U.S.C. § 1481 (1988).

105. *See Samuels Testimony*, *supra* note 10. Former Secretary of Tax Policy Leslie Samuels argues that the Joint Committee on Taxation's concern that the amended expatriation tax will violate existing treaties is "unfounded." The United States interprets the undefined term U.S. citizen by referencing "the meaning that is in effect at the time of interpretation" as opposed to the meaning the terms had when the treaty went into effect, most likely the definition under the Immigration and Nationality Act. This approach, he argues, is consistent with international norms and will be explicitly stated in the 1995 Organization for Economic Cooperation and Development (OECD) model income tax treaties. One could argue, though, that interpreting a tax treaty requires a court "give precise meaning consistent with the genuine shared expectations of the contracting parties." *Crow*, 85 T.C. at 380 (citing Maximov v. United States, 373 U.S. 49 (1963)). The Supreme Court also noted :

> [I]t is particularly inappropriate for a court to sanction a deviation from the clear import of a solemn treaty between this Nation and a foreign sovereign, when, as here, there is no indication that application of the words of the treaty according to their obvious meaning effects a result inconsistent with the intent or expectations of its signatories.

Maximov, 373 U.S. at 54.

106. *See* Vienna Convention, *supra* note 99. A treaty partner that is also a developing country could still argue that any attempt to alter the meaning of the term U.S. citizen is an explicit override of a negotiated treaty. Treaties with developing countries do not follow the model OECD rules because these rules do not serve the special needs of developing countries.

107. *See supra* Part IV.A (discussing the conflict between the objective wealth test and tax treaties).

was an ineffective mechanism to prevent fiscal evasion.[108] Proposed legislation could repeal the objective wealth test that violates Class I and Class II tax treaties and replace it with a motivation test that is both subjective and objective. Elements of such a test might evaluate whether the expatriate leaves a significant presence in the United States as determined by a set of subjective and objective factors including: checking or savings account, residence, and presence of a spouse and children. These factors together, or in some combination, could be used to determine the taxpayer's motive for expatriating.

A restructured subjective and objective test has been introduced and successfully used by Canadian courts to determine expatriate tax motives. In *Wassick v. M.N.R.*,[109] the Canadian Tax Court looked at the nature of time spent in Canada to determine whether the taxpayer was a resident of Canada for tax purposes. Despite the fact that the taxpayer lived in Canada for seventy-five to one-hundred days,[110] the court found that the *nature* of his time spent in Canada was more like an ordinary resident than a visiting expatriate.[111] The court looked to objective factors including where the taxpayer maintained his checking account, whether he had a jointly owned residence with his girlfriend, and the presence of a child in the country.[112]

C. *Congressional Intent*

Congress could avoid the incidents of double taxation, or alternatively treaty override, by explicitly indicating its intent with respect to the amended expatriation tax. A statement of whether Congress explicitly intends for Section 110 of FITA to continue to apply or whether TAMRA Section 7852(d) reflects the intended relationship between the amended expatriation tax and current bilateral tax treaties would be instructive to courts enforcing the amended expatriation tax and to Treasury officials in charge of renegotiating conflicting tax treaties. Such a statement will lead

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108. *See supra* Part II.B (discussing the deficiencies under the original expatriation tax that underscored the need to amend the subjective motivation test).

109. 1994 Can. Tax Ct. LEXIS 3055.

110. A taxpayer must live in Canada for more than 184 days in order to be consider a resident for tax purposes. Francis, *supra* note 13.

111. *Wassick*, 1994 Can. Tax Ct. LEXIS 3055.

112. *Id.*

to either double taxation or treaty override, but at least the enforcement of the amended expatriation tax would yield consistent results domestically and internationally.

VII. POLICY ISSUES

The amended expatriation tax is an over broad and ineffective means for achieving Congress' objectives. Under the amended expatriation tax, an expatriate whose primary purpose for relinquishing citizenship is tax-avoidance can move to a country with a favorable saving clause provision and potentially avoid the tax altogether.

A. *Horizontal Tax Equity*

Horizontal tax equity is a basic precept upon which the United States tax system rests. "It is virtually a maxim of taxation that in addition to being fair, a good tax system must be perceived as being fair."[113] Horizontal tax equity requires that similarly situated individuals receive the same tax treatment unless there are economic hardships that would make it difficult for a taxpayer to meet his or her tax obligation.[114] Under both the original expatriation tax and the amended expatriation tax, the United States government is trying to capture taxes that would fall due eventually.[115] In theory, the tax attempts to equalize long-term tax burdens between those who retain citizenship and those who expatriate. In practice, however, the original and the amended expatriation tax violate principles of tax equity.

The original and the amended expatriation tax create unequal treatment between expatriates and taxpayers who retain their citizenship. Under the former regime, unequal treatment resulted when tax-avoiding expatriates abused the subjective

113. Renee Sobel, *United States Taxation of Its Citizens Abroad: Incentive or Equity*, 38 VAND. L. REV. 101, 103 (1985). *See also* John H. Christie, *Citizenship as a Jurisdictional Basis for Taxation: Section 911 and the Foreign Source Income Experience*, 8 BROOK. J. INT'L L. 109, 132 (1982).

114. John Papahronis, *Taxation of Americans Abroad Under ERTA: An Unnecessary Windfall*, 4 J. INT'L L. & BUS. 586, 593 (1982) (citing Philip F. Postlewaite & Gregory E. Sterns, *Innocents Abroad? The 1978 Foreign Earned Income Act and the Case for Its Repeal*, 65 VA. L. REV. 1093, 1115 (1979)).

115. Vagts, *supra* note 9, at 578.

motivation test, waited for the ten-year window to close or shifted assets to another country prior to expatriation. The new regime continues to facilitate unequal treatment among citizen and expatriate taxpayers by rewarding patient expatriates. It also exemplifies unequal tax treatment between expatriates and tax-motivated expatriates. This tax rewards the unscrupulous who engage in treaty-shopping to effectuate individual tax-avoidance schemes and penalizes the conscientious with the potential for double taxation.

B. Horizontal Tax Equity in Practice

One of the main objectives of the proposed expatriation tax is to restore public confidence in horizontal tax equity principles. "[P]ublic confidence in our tax system is eroded by the perception that some wealthy individuals are able to escape paying taxes through devices that are not generally available to all taxpayers."[116] Therefore, in principle, the amended expatriation tax effectively addresses the horizontal tax equity problems that arise from the subjective motivation test. It does not, however, dispose of the horizontal tax equity issues raised by the patient expatriate and foreign investment abuses.

The amended expatriation tax introduces some of its own challenges to horizontal tax equity—such as incentive to treaty-shop. Although the extent to which the United States is willing to go in order to capture a small percentage of the population's income for purposes of horizontal tax equity remains unclear, it is clear that this goal can never be achieved under the amended expatriation tax. The tax will either violate horizontal tax equity between citizen and expatriate taxpayers who treaty-shop, or it will violate horizontal tax equity among expatriate and tax-motivated expatriates.

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116. *Samuels Testimony, supra* note 10.

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