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# Citizens Abroad and Social Cohesion at Home: Refocusing a Cross-Border Tax Policy Debate

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UNIVERSITY OF  
**NOTRE DAME**  
THE LAW SCHOOL

# CITIZENS ABROAD AND SOCIAL COHESION AT HOME: REFOCUSING A CROSS-BORDER TAX POLICY DEBATE

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## **Citizens Abroad and Social Cohesion At Home: Refocusing a Cross-Border Tax Policy Debate**

*Michael S. Kirsch\**

*Modern developments raise significant questions about the future importance (or non-importance) of formal citizenship status. For example, while many have interpreted the European Union project, with its emphasis on the free movement of individuals, as portending the decreasing relevance of nationality, recent developments, such as the “Brexit” vote, suggest that national identity remains an important factor for many individuals. While much of the public debate over citizenship focuses on areas, such as immigration, that are more obviously tied to formal citizenship status, this debate also impacts cross-border tax policy.*

*Over the past decade, several scholars have addressed the use of citizenship status as a jurisdictional basis upon which to tax the foreign-source income of individuals who live outside of their country of citizenship. Some writers have defended the United States’ use of this citizenship-based taxation (“CBT”) to tax the foreign income of citizens living abroad, while a more significant number of scholars have rejected it and proposed that the United States tax the foreign income of U.S. citizens only if they reside in the United States (residence-based taxation, or “RBT”).*

*This Article considers the competing normative arguments surrounding the use of citizenship as a jurisdictional basis to tax, and distills the strengths and weaknesses of each. In so doing, it highlights the most salient factors upon which the debate hinges, and illustrates the importance of difficult-to-measure predictions of how both individuals and society will react to different regimes.*

*The Article ultimately concludes that the debate between CBT and RBT often overemphasizes the subjective circumstances of particular individuals, and underemphasizes the broader impact of the alternative regimes on social cohesion within the United States. When coupled with the significant residence neutrality concerns that may arise under an RBT regime and the resulting potential to create a permanent class of wealthy U.S. citizens living abroad who would not be subject to taxation, these social cohesion concerns suggest that the United States should continue to exercise citizenship-based taxing jurisdiction. However, the Article acknowledges that such a CBT regime can only be defended in practice if the IRS and Congress are willing to address the significant practical compliance concerns faced by many citizens living abroad.*

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## INTRODUCTION

Developments over the past few decades raise important questions regarding the future importance (or lack thereof) of an individual's citizenship status. For example, the European Union, with its emphasis on freedom of movement, might be viewed as de-emphasizing the importance of nation-state citizenship in favor of a supranational identity. However, more recent developments, such as the "Brexit" vote, suggest that predictions of the demise of national citizenship's importance may be exaggerated, and that national identity remains an important factor for many individuals and countries.<sup>1</sup>

While much of the scholarly and political discussion has focused on areas, such as immigration law, that are more obviously tied to citizenship status, the role of citizenship has also become the focus of international tax policy debate. This debate focuses on the use of citizenship status as a jurisdictional basis upon which to tax income that arises outside of an individual's country of citizenship. Some scholars, including myself,<sup>2</sup> have defended the United States' use of citizenship to tax the foreign income of citizens living abroad (so-called citizenship-based taxation, or "CBT"). Increasingly, however, other scholars have downplayed the importance of citizenship status, suggesting that it should play no role (or only a minimal role) in determining whether an individual should be subject to tax on income that arises outside of the country of citizenship. Instead, they suggest a country should tax its citizen's foreign-source income only if the citizen actually resides in the country (so-called residence-based taxation, or "RBT").<sup>3</sup>

This Article considers the competing normative arguments raised in this context and attempts to distill the strengths and weaknesses of each, as applied to both CBT and RBT. In doing so, it highlights the most salient factors upon which the debate hinges, and illustrates the importance of difficult-to-measure predictions of how both individuals and society will react to different regimes. In particular, it suggests that much of the earlier debate is misdirected—rather than focusing only (or primarily) on the subjective impact of the rules on the individual citizen-taxpayer, it is important to consider the impact of these rules on the broader community. When the potential impact on social cohesion is

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<sup>1</sup> Cf. Mark Twain, *Mark Twain Amused*, N.Y.J., June 2, 1897, p.1 ("The report of my death was an exaggeration").

<sup>2</sup> See Michael S. Kirsch, *Revisiting the Tax Treatment of Citizens Abroad: Reconciling Principle and Practice*, 16 FLA. TAX REV. 117 (2014) [hereinafter Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*]; Michael S. Kirsch, *Taxing Citizens in a Global Economy*, 82 N.Y.U. L. REV. 443 (2007) [hereinafter Kirsch, *Taxing Citizens*]

<sup>3</sup> Both groups of scholars agree that a country has the right to tax income that arises within its borders, regardless of the taxpayer's residence or citizenship status.

considered, particularly to the extent that formal citizenship status still has meaning to a significant percentage of those who hold it, the case for CBT is significantly strengthened. The Article also briefly considers (but ultimately dismisses) the possibility of a middle ground between the current CBT regime and an RBT regime for taxing the foreign source income of U.S. citizens.

Part I provides a brief summary of the principal justifications for, and criticisms of, CBT, and a summary of proposed RBT-based replacements. Part II then distills the principal normative arguments underlying the CBT versus RBT debate. Of particular note, this analysis identifies an often underappreciated aspect of the debate: arguments in favor of a shift to RBT tend to focus on the subjective adverse impact of CBT on particular classes of citizens living overseas, while arguments in favor of retaining CBT are grounded in concerns about the impact of RBT on the social cohesion of the broader United States community. Part III then compares the relative magnitude and importance of the competing normative claims. It concludes that the social cohesion concerns, particularly when coupled with the incentives an RBT regime might create for the creation of a permanent class of wealthy, untaxed U.S. citizens living abroad, suggest that the United States should continue to exercise citizenship-based taxing jurisdiction. In doing so, however, the IRS and Congress must be willing to acknowledge that many overseas citizens face significant practical compliance-related concerns, and must be willing to implement appropriate statutory and administrative relief to address these practical aspects of the CBT regime.

## I. THE LANDSCAPE OF THE DEBATE

The United States, unlike other countries,<sup>4</sup> uses citizenship as a jurisdictional basis upon which to tax individuals. As a result, a United States citizen is subject to U.S. income<sup>5</sup> taxation regardless of whether the individual resides in the United States or abroad, and regardless of where the income arises. This broad jurisdictional exercise is sometimes referred to as “citizenship-based taxation” (“CBT”) of worldwide income. In addition to exercising CBT over non-resident citizens, the United States taxes the worldwide income of individuals who reside in the United States, regardless of their citizenship status.<sup>6</sup> Many other countries also exercise this type of “residence-based taxation” (“RBT”) over the worldwide income of their residents. In addition to the exercise of CBT and/or RBT, both of which focus on the status of the individual earning the income, most countries also exercise some form of source-based taxation—*i.e.*, the taxation of income that arises within a country’s territory, regardless of the status of the taxpayer earning the income.<sup>7</sup> Accordingly, the principal difference between CBT and RBT concerns the taxation of foreign source income earned by a citizen living abroad—under a CBT regime the country of citizenship generally taxes that foreign source income of a nonresident citizen, while under an RBT regime the country of citizenship does not tax it.<sup>8</sup>

This brief summary of the United States’ use, and other countries’ nonuse, of CBT is both overbroad and underbroad. It is overbroad because the United States’ exercise of CBT has some significant exceptions. A U.S. citizen who works abroad and meets certain statutory exceptions is allowed to exclude from gross income approximately \$100,000 of foreign earned income, plus an additional amount for housing expenses each year.<sup>9</sup> Also, to the extent a U.S. citizen pays foreign income tax on income that arises abroad, the United States allows the individual to claim a foreign tax credit for the foreign taxes paid.<sup>10</sup> Accordingly, it is possible that a U.S. citizen living abroad might owe no U.S. income tax (or only a residual amount) after applying the foreign earned income exclusion and/or the foreign tax credit.

The summary is underbroad because, despite foreign countries’ general nonreliance on CBT, many foreign countries nonetheless tax their citizens living abroad in certain circumstances. This extended jurisdiction occurs in the context of the foreign country’s RBT regime, which might, for example, make the definition of tax resident “sticky”, continuing to treat a citizen who moves abroad

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<sup>4</sup> See generally Kirsch, *Taxing Citizen*, *supra* note 2, at 445 n.5.

<sup>5</sup> Citizenship is also used as a jurisdictional basis to impose the U.S. federal estate and gift tax. See Treas. Reg. § 20.0-1(b).

<sup>6</sup> See I.R.C. § 1.1-1(b).

<sup>7</sup> See Kirsch, *Taxing Citizens*, *supra* note 2, at 448–49.

<sup>8</sup> See Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note 2, at 121–22; see also Ruth Mason, *Citizenship Taxation*, 89 SO. CAL. L.REV. 101, 112 (2016); Daniel Shaviro, *Taxing Potential Community Members’ Foreign Source Income*, [Draft at 5].

<sup>9</sup> See I.R.C. § 911.

<sup>10</sup> See generally I.R.C. § 901.

as a tax resident for a specified number of years.<sup>11</sup> Because of the significant exceptions that apply to the taxation of U.S. citizens, and the extended reach of some other countries' residence-based regimes, Daniel Shaviro has observed that

the United States could reasonably be viewed as not in substance a dramatic outlier. Indeed, even if our overall reach as to [potential community members] is unusually broad, keeping in mind both who is taxable on [foreign source income] and how much U.S. tax they owe (or what compliance burdens they occur), the gap may be narrowing as other countries, concerned about tax-motivated temporary or permanent expatriation, move in our general direction.<sup>12</sup>

Despite these caveats, the extent of the United States' formal reliance on citizenship as a jurisdictional basis is admittedly unique. Given that the United States' approach differs significantly from the commonly utilized methods for taxing individuals in a global setting, it is important to consider whether the United States' position remains justifiable, particularly in an ever more global world. The following subparts summarize the main arguments supporting the United States' general approach (many of which I have explained in greater detail elsewhere),<sup>13</sup> along with the main arguments against the United States' approach.<sup>14</sup>

#### A. *The Brief Case for Citizenship-Based Taxation*

The most long-standing justification for CBT concerns the benefits that citizenship confers on an individual.<sup>15</sup> As the Supreme Court observed in *Cook v. Tait*, the 1924 case upholding a constitutional challenge to CBT, "the government, by its very nature, benefits the citizen and his property wherever found, and therefore has the power to make the benefit complete."<sup>16</sup> The benefits available to U.S. citizens include the right to enter the United States at any time, the right to vote, and the potential availability of personal and property protection overseas.<sup>17</sup>

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<sup>11</sup> See Edward A. Zelinsky, *Citizenship and Worldwide Taxation: Citizenship as an Administrable Proxy for Domicile*, 96 IOWA L. REV. 1289 (2011); Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note 2, at 127–28; see also Shaviro, *supra* note 8, at [Draft pp. 6–13] (providing examples of other countries that tax the foreign-source income of individuals who do not have current-year physical presence).

<sup>12</sup> Shaviro, *supra* note 8, at [Draft 17].

<sup>13</sup> See generally Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note 2.

<sup>14</sup> See *id.* at 123–40 (summarizing the spectrum of views).

<sup>15</sup> This justification was invoked in legislative history when citizenship-based taxation was first implemented under the Civil War-era income tax and when it was reintroduced in the 1894 income tax.

<sup>16</sup> *Cook v. Tait*, 265 U.S. 47, 56 (1924).

<sup>17</sup> For a more detailed discussion of these and other benefits, including their practical and theoretical limits, see Kirsch, *Taxing Citizens*, *supra* note 2, at 471–76 (concluding that, despite some limitations, these benefits retain value even in a modern world); see also Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note 2, at 124.



While this benefits argument has intuitive appeal, both I and others have observed its shortcomings as a principal justification for CBT.<sup>18</sup> Even in a wholly domestic context, the benefits rationale is no longer viewed as a sufficient justification for imposing a progressive income tax. After all, under a progressive income tax there is not necessarily a correlation between the taxes paid and the benefits received. In an international context, any such correlation may be even more tenuous. For example, an individual living abroad does not have the current enjoyment of many tangible benefits generated by federal tax expenditures, such as federal highways and federally funded schools (although she might someday return to the United States and receive the benefit of the United States having maintained those programs and infrastructure during her absence). A more extreme example involves an individual born abroad who acquires U.S. citizenship at birth by reason of the U.S. citizenship of one or both of her parents. Such an individual might never have entered the United States and might have no plans to do so, and her enjoyment of any direct benefits of federal expenditures would accordingly be very limited. In such a situation, the only valuable benefit of citizenship might be the ability to enter and reside in the United States in the future if her plans unexpectedly change.

Perhaps the most that can be said of the benefits argument is that there is at least some objective value to holding U.S. citizenship. After all, many non-citizens presumably would pay a significant amount of money (if they had the financial capacity to do so) in order to obtain U.S. citizenship. However, the subjective value of citizenship to a particular taxpayer is much more varied and depends on a number of factors—*e.g.*, whether and how frequently the individual intends to enter the United States and whether she intends to permanently reside or work here; the status of the individual as a citizen of another country in addition to the United States; and the economic and social circumstances in the foreign country in which she might otherwise reside, among other factors.

Thus, while the benefits rationale has some salience to the CBT discussion (indeed, it might explain why at least some overseas citizens continue to retain their US citizenship—and its attendant tax burden—despite their lack of present plans to return), it cannot be the sole (or even primary) justification for CBT. Standing alone, the benefits rationale might justify some type of minimum level of annual charge, but not necessarily the current progressive marginal income tax system utilized by the United States.

The modern progressive marginal income tax is often justified under ability-to-pay principles, rather than the benefits rationale. Under ability-to-pay principles, the cost of supporting a community is distributed among the community's members based on their ability to pay. While ability-to-pay

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<sup>18</sup> See, *e.g.*, Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note 2 **Error! Bookmark not defined.**, at 124–25. Shaviro notes that “perhaps benefits serves an entirely different function here than it does in domestic tax policy debate. Rather than relating to the libertarian quest for despised redistribution, it serves as an intuitive proxy for being entirely among ‘us.’” Shaviro, *supra* note 8, at [Draft 29].

arguments typically focus on distributional aspects—*e.g.*, the steepness of progressive marginal tax rates—they also raise a threshold question that is particularly relevant to the CBT issue: “*whose* ability to pay” is relevant.<sup>19</sup> In particular, are U.S. citizens living abroad sufficiently connected to the United States such that we should expect them to share in its financial support?

Given the wide range of individual circumstances, the degree of subjective U.S.-connectedness varies significantly among nonresident U.S. citizens.<sup>20</sup> Many nonresident citizens, particularly those who were born and raised in the United States and may consider permanently returning to the United States at some future date, retain a strong connection to the country. Others, who may have been born in the United States but who have lived the majority of their life abroad and have no intention of returning to the United States, might have less of a subjective connection to the country (particularly if they were born to non-citizen parents who were temporarily in the United States—*e.g.*, as students—and they left the United States while still children). Similarly, a citizen who was born abroad and obtained citizenship by reason her parents’ U.S. citizenship, but who has lived her entire life outside the United States and has no intention of moving to the United States, might have a limited subjective connection to the United States. At the extreme, it is possible that a citizen in one of these latter groupings might not even be aware of her U.S. citizenship status.<sup>21</sup>

Despite this range of subjective circumstances, it is possible to make general observations that apply to a significant portion of citizens abroad. Indeed, organizations representing the interests of U.S. citizens abroad frequently do so, particularly in the context of congressional hearings for legislation that would benefit overseas citizens.<sup>22</sup> For example, a representative of one such organization, after noting that she had been born and raised in the United States but had moved to France for business reasons nineteen years earlier, observed:

Most Americans living overseas are just as “home grown” as I am, and many have family situations similar to mine. We have accepted or chosen to live overseas to represent our businesses or to follow our dreams, but we are also conscious of the fact that we are unofficial representatives of the United States in everything we do and say while there. We keep our links to the United States as strong as possible, visiting “home” as often as possible, educating our children in U.S. schools if we can afford it and if they are available where we live. We go to great lengths to make sure that our children have U.S. citizenship and valid passports. We

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<sup>19</sup> Kirsch, *Taxing Citizens*, *supra* note 2, at 480.

<sup>20</sup> For a more detailed explanation of this issue, see *id.*, at 479–88; see also Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note 2, at 125–27.

<sup>21</sup> These particular subgroups are discussed in more detail *infra* notes 86–102 and accompanying text.

<sup>22</sup> See generally, Kirsch, *Taxing Citizens*, *supra* note 2, at 481–82.

struggle to ensure that our U.S. tax obligations are met. We vote in U.S. elections despite the difficulties with absentee balloting.<sup>23</sup>

After noting that overseas citizens advocacy groups had convinced the State Department to reverse its longstanding policy that presumed that a U.S. citizen who acquired foreign nationality intended to relinquish her U.S. citizenship, she observed that this “wonderful” policy change not only would eliminate “heart-wrenching cases where U.S. citizenship could have been unintentionally lost, ... [but also] symbolically it goes much further, for it indicates that at least one part of the Washington establishment recognizes that *our presence overseas in no way diminishes our deep emotional attachment to our country.*”<sup>24</sup>

Similar appeals to the communal ties between the United States and its citizens abroad have been made by overseas citizen advocacy groups seeking the inclusion of overseas citizens in the official U.S. census count. For example, the executive director of one such advocacy group asserted that census inclusion “will respond to the patriotic desire of the American community around the world to be counted, to be measured, to be seen in its proper proportions as a *dynamic part of our society.*”<sup>25</sup>

Granted, these and similar statements might merely reflect self-serving declarations by citizens advocacy groups in the context of lobbying for desired legislation.<sup>26</sup> Even so, over the past few decades these appeals to communal ties have been effective in securing overseas citizens a number of favorable results for which their advocacy groups have lobbied strongly, including more effective ability to vote for President, Vice President, and members of Congress;<sup>27</sup> ensuring that U.S. citizens acquiring foreign nationality were not presumed to have relinquished their U.S. citizenship;<sup>28</sup> and protecting the ability of U.S. citizens living abroad to transmit citizenship to their children born abroad.

Given the importance of these communal ties-based arguments in securing requested legislation and administrative policies, it is not unreasonable to invoke the same arguments in determining whether citizens abroad are members of the broader United States community for purposes of supporting that community.

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<sup>23</sup> *U.S. Citizens Overseas: Hearing Before the Subcomm. On International Operations of the H. Comm. On Foreign Affairs*, 102d Cong. 65, 38 (1991) (statement of Stephanie H. Simonard). Ms. Simonard was testifying on behalf of the World Federation of Americans Abroad, an umbrella organization whose membership included a number of other advocacy groups for U.S. citizens abroad, and which she described as representing “by far the largest group of non-U.S. government individuals and businesses that exists overseas reaching all parts of the earth where Americans congregate.” *Id.*

<sup>24</sup> *Id.* at 39 (statement of Stephanie H. Simonard).

<sup>25</sup> *Americans Abroad, How Can We Count Them?: Hearing Before the Subcomm. On the Census of the H. Comm. On Government Reform*, 107<sup>th</sup> Cong. 46 (2001) (statement of Thomas W. Fina, Executive Director, Democrats Abroad) (emphasis added).

<sup>26</sup> See Kirsch, *Taxing Citizens*, *supra* note 2, at 482.

<sup>27</sup> See generally *id.*, at 474–75 (discussing the Uniformed and Overseas Citizens Absentee Voting Act, and critiquing efforts by overseas citizens advocacy groups to secure a single member of Congress, or nonvoting delegate, who would represent the interests of overseas citizens).

<sup>28</sup> See *supra* note 25 and accompanying text (describing change in State Department policy).

Indeed, Congress apparently has adopted this broad view of the community in the case of the traditional non-financial obligation of citizenship—the obligation to defend the country if called upon. While the United currently does not have a military draft, all male citizens—including those residing outside the United States—are required to register with the Selective Service upon reaching age 18.<sup>29</sup>

Admittedly, many U.S. citizens living abroad do not fit the traditional portrait of an overseas citizen invoked by advocacy groups in the lobbying activities described above. Nonetheless, even a U.S. citizen whose personal ties to the United States are not as strong as those described above may still have significant ties to the country. Indeed, the fact that a U.S. citizen (at least one who is aware of her citizenship status) retains that citizenship implies some level of voluntary self-identification with the United States.<sup>30</sup> Admittedly, for some U.S. citizens living overseas this connection might be so tenuous as to bring into question their membership in the community that has an obligation to financially support the United States under ability-to-pay principles. As discussed *infra*,<sup>31</sup> specific exceptions might be appropriate for these limited groups without undermining the applicability of ability-to-pay principles to those overseas citizens whose circumstances are closer to the traditional portrait frequently invoked by advocacy groups in non-tax settings (*e.g.*, when seeking more favorable legislation).

#### B. *The Brief Case Against Citizenship-Based Taxation*

Other scholars have argued that the problems—both theoretical and practical—associated with CBT justify the repeal of CBT in the United States.<sup>32</sup> In its place, they generally advocate various forms of residence-based taxation. In order to set the stage for a discussion of the competing normative values at stake, this subpart summarizes some of the principal concerns raised by other scholars, as well as their proposed alternatives to CBT.<sup>33</sup>

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<sup>29</sup> See 50 U.S.C. § 453(a) (generally requiring registration by “every male citizen of the United States, and every other male person residing in the United States”). By distinguishing “every male citizen” from “every other male person residing in the United States”, this language implies that the obligation rests on male citizens whether resident or not. This interpretation is confirmed by the Selective Service System’s website. See *Register Online*, SELECTIVE SERVICE SYS., <https://www.sss.gov/regver/wfregistration.aspx> (providing separate registration links for citizens living inside the United States and citizens living outside the United States); see also Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note 2 **Error! Bookmark not defined.**, at 197 n.360 and accompanying text.

<sup>30</sup> See Kirsch, *Taxing Citizens*, *supra* note 2, at 481.

<sup>31</sup> See *infra* notes 86–102 and accompanying text.

<sup>32</sup> Cf. Zelinsky, *supra* note 11 (supporting CBT, but as a proxy for domicile, rather than on its own merits). But see Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note 2 **Error! Bookmark not defined.**, at 128 (suggesting that Zelinky’s argument is, in part, based on a benefits rationale for CBT).

<sup>33</sup> This summary does not purport to be a complete compilation of all the articles written in this area. Rather, it attempts to highlight each of the principle arguments of which the author is aware. For a more detailed analysis of the arguments against CBT, see generally Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note 2 **Error! Bookmark not defined.**, at 128–40, 181–210.

## 1. Objections to Citizenship-Based Taxation

Some scholars have conceded that CBT has theoretical merit,<sup>34</sup> but that the United States should, nonetheless, eliminate CBT on practical, administrative grounds. For example, Cynthia Blum and Paula Singer, writing in 2008, concluded that “[o]ur disagreement with Professor Kirsch about the wisdom of citizenship-based taxation centers on issues of compliance and administrability.”<sup>35</sup> They highlighted both the compliance problems faced by taxpayers, and the enforcement difficulties faced by the IRS in an international context. These administrative issues have become more prominent in the past few years with the enactment and implementation of the Foreign Account Tax Compliance Act (“FATCA”).<sup>36</sup> The FATCA regime, by bringing foreign financial institutions within the scope of the U.S. information reporting system, has the potential to increase the IRS’ ability to enforce the CBT regime, but at the same time it has created additional compliance-related problems for U.S. citizens overseas. Simultaneously, the IRS’ increased enforcement efforts with respect to the Foreign Bank Account Report (“FBAR”) and other required forms has increased the compliance burdens on overseas citizens.<sup>37</sup>

Other scholars, while noting the administrability problems with CBT,<sup>38</sup> also object to CBT on more substantive grounds. For example, Reuven Avi-Yonah rejects benefits-based arguments, asserting that the right to enter the United States “seems a weak basis for such a heavy price as worldwide taxation.”<sup>39</sup> In addition, he reasons that the United States’ CBT regime cannot be based on ability-to-pay concerns, given that many overseas citizens end up paying little or no U.S. income tax because of the foreign earned income exclusion and the foreign tax credit.<sup>40</sup> Accordingly, he concludes that “[w]e should not base a broad rule such as ability-to-pay taxation of nonresident citizens on the relatively few cases of citizens living overseas in countries that have no or low income taxes.”<sup>41</sup>

Bernard Schneider also rejects benefits-based justifications, focusing particularly on overseas citizens who have little connection to the United States, such as those born in the United States to non-citizen parents who were only temporarily present in the United States, and those born abroad to U.S.-citizen

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<sup>34</sup> Cynthia Blum and Paula Singer’s acknowledgement of the theoretical merit of CBT is based on a combination of principles, including the benefits rationale, fairness, and the potential incentives to reside abroad created by an RBT regime. See Cynthia Blum & Paula Singer, *A Coherent Policy Proposal for U.S. Residence-Based Taxation of Individuals*, 41 *VAND. J. TRANSNAT’L L.* 705, 716 (2008).

<sup>35</sup> See *id.* at 710–11 (footnotes omitted).

<sup>36</sup> FATCA is codified in I.R.C. §§ 1471–1474.

<sup>37</sup> For a detailed analysis of the impact of FATCA and FBAR enforcement on overseas citizens, see Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note 2 **Error! Bookmark not defined.**, at 140–81.

<sup>38</sup> Reuven Avi-Yonah notes that “administrability is perhaps the strongest argument for not taxing nonresident citizens.” Reuven Avi-Yonah, *The Case Against Taxing Citizens*, 58 *Tax Notes Int’l* 389, 394 (May 3, 2010).

<sup>39</sup> *Id.* at 392.

<sup>40</sup> *Id.* at 393.

<sup>41</sup> *Id.*

parents but who have never lived here, held a U.S. passport, or otherwise received any direct benefit from U.S. citizenship and, in extreme cases, might not even be aware of their U.S. citizen status. He observes that “[a]lthough it is fair to say that U.S. citizenship is likely to have some value for most U.S. expatriates, this value is impossible to quantify. An unquantifiable, even inchoate right is a very weak peg on which to hang the heavy hat of worldwide taxation . . . .”<sup>42</sup>

Similarly, in rejecting ability-to-pay arguments, Schneider focuses on citizens with a tenuous connection to the United States, acknowledging that

Short-term expatriates clearly should be considered members of U.S. society for purposes of this analysis, [but] the argument will generally be much weaker with reference to long-term expatriates, depending on their ties to the United States. The argument for comparison falls apart completely in connection with accidental, nominal, and unaware citizens, whose connection to the United States is typically minimal to nonexistent.<sup>43</sup>

In contrast, Ruth Mason acknowledges that the ability-to-pay argument, which views overseas citizens as having a social obligation to support the community of which they are arguably members, has some appeal. She notes that “although citizenship is not a perfect proxy for national community membership, it is a better proxy across a range of cases than at least some residence standards, including the substantial presence test the United States uses to tax aliens.”<sup>44</sup> Nonetheless, she rejects CBT because “citizenship taxation is a poor proxy for national community membership in many other cases,”<sup>45</sup> and also because of administrative and enforcement compliance concerns.<sup>46</sup>

Mason also raises efficiency concerns regarding the impact of CBT on potential immigration to the United States.<sup>47</sup> She argues that, at the margin,

[c]itizenship taxation presumably discourages both initial migration and naturalization by marginal migrants from other countries. . . . The higher the immigrant’s income or wealth, the more current U.S. law discourages her from naturalizing. For immigrants to the United States who may be contemplating retiring back home or moving to a third country, the citizenship tax stands as a barrier to naturalization, and probably also to initial migration.<sup>48</sup>

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<sup>42</sup> Bernard Schneider, *The End of Taxation without End: A New Tax Regime for U.S. Expatriates*, 32 Va. Tax Rev. 1, 50 (2012).

<sup>43</sup> *Id.* at 45.

<sup>44</sup> Mason, *supra* note 8, at 143. She also concludes that “the social-obligation theory represents a more convincing case for citizenship taxation” than does the benefits theory. *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> *See id.* at 143–50.

<sup>47</sup> *See id.* at 143.

<sup>48</sup> *Id.* at 160–61.

Mason argues that this disincentive will hurt the United States in attempting to lure skilled and highly educated migrants, and accordingly will have negative impacts on the U.S. economy.<sup>49</sup>

## 2. Proposed Alternatives to Citizenship-Based Taxation

Opponents of citizenship-based taxation generally suggest that the United States replace it with some form of residence-based taxation for its citizens. Under RBT (which the United States already applies to noncitizen residents), a U.S. citizen would only be taxed on foreign income if she were a resident of the United States.<sup>50</sup> If the citizen did not reside in the United States, she would not be taxed on foreign income (although, like a nonresident noncitizen, she generally would be taxable on U.S. source income).

While these RBT proposals share broad similarities, they differ on many specific points.<sup>51</sup> For example, they reflect varying ideas on the important threshold question of identifying when a citizen is a “resident” for tax purposes. Avi-Yonah suggests that the United States use the same “resident” test that currently applies to noncitizens—i.e., a three-year weighted day count to determine “substantial presence”.<sup>52</sup> Blum and Singer also suggest the extension of the existing substantial presence test to citizens, but would make some modifications (*e.g.*, applying a three-year residence taint to a citizen who meets the substantial presence test).<sup>53</sup> As I previously summarized,

Schneider is more equivocal regarding the definition of tax residence that should apply to citizens, suggesting that Congress could either extend the substantial presence test currently applicable to aliens, or implement a more subjective ‘bona fide residence’ test based on a number of subjective factors. To the extent the substantial presence test is extended to citizens,

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<sup>49</sup> See also Daniel Shaviro, *Tax Policy Colloquium, Week 6: Ruth Mason’s “Citizenship Taxation”*, START MAKING SENSE (Mar. 4, 2015), <http://danshaviro.blogspot.com/2015/03/tax-policy-colloquium-week-6-ruth.html> (agreeing with Mason’s assertion that CBT might discourage high-income potential immigrants from becoming citizens).

<sup>50</sup> Of course, a resident citizen, like a resident noncitizen, would also be taxed on U.S. source income.

<sup>51</sup> For an earlier critique of several of these proposals, see Kirsch, *supra* note 2 **Error! Bookmark not defined.**, at 134–40.

<sup>52</sup> See REUVEN AVI-YONAH & PATRICK W. MARTIN, *TAX SIMPLIFICATION: THE NEED FOR CONSISTENT TAX TREATMENT OF ALL INDIVIDUALS (CITIZENS, LAWFUL PERMANENT RESIDENTS AND NON-CITIZENS REGARDLESS OF IMMIGRATION STATUS) RESIDING OVERSEAS, INCLUDING THE REPEAL OF U.S. CITIZENSHIP BASED TAXATION* 7 (2013), <http://www.procopio.com/article/tax-simplification> (“The test to determine whether U.S. citizens . . . residing overseas would be taxed as a ‘resident alien’ would be the same definition as currently exists in 7701(b)(1)(A)(ii).”)

<sup>53</sup> See Blum & Singer, *supra* note 34, at 75; *cf.* Edward A. Zelinsky, *Citizenship and Worldwide Taxation: Citizenship as an Administrable Proxy for Domicile*, 96 IOWA L. REV. 1289, 1323–41 (2011) (discussing other countries that apply “sticky” residence rules to their citizens, thereby retaining taxing jurisdiction for a number of years after a citizen loses residence status). In contrast, Schneider explicitly rejects this sticky concept of residence. See Schneider, *supra* note 42, at 66.

Schneider, too, would modify certain aspects of it in order to prevent perceived abuses.<sup>54</sup>

Mason, while not purporting to reach a definitive answer, suggests that the United States could “move from citizenship as the sole basis for worldwide tax to a more substantive inquiry that accounts for additional contacts between the taxpayer and the state,”<sup>55</sup> treating citizenship as one factor in determining residence. For example, a citizen who maintains an abode in the United States could be taxed on worldwide income, or “citizenship could function as a rebuttable presumption of tax residence, and citizens would have the burden to show that they had closer personal and economic connections to another state.”<sup>56</sup> Daniel Shaviro, in tentative comments on Mason’s proposals, expresses general agreement from an efficiency perspective, observing that “a standard that relies on several different factors may end up, with proper design, inducing less tax-motivated distortion overall” compared to a test that relied on a single factor, such as citizenship.<sup>57</sup> He acknowledges, however, that the “fiend or goblin ... is in the details.”<sup>58</sup> In a later article, Shaviro notes that an individual’s physical location and mental status are the “two factors that would appear clearly to have strong intuitive appeal.”<sup>59</sup>

Most proponents of RBT acknowledge that some type of “exit tax” would be needed to prevent citizens from abandoning U.S. residence shortly before selling their assets and thereby avoiding U.S. tax on the gains that accrued during U.S. residence.<sup>60</sup> The exit tax is, in effect, a specific anti-abuse provision aimed at addressing one of the more obvious ways in which taxpayers could utilize tax-motivated residence changes in order to reduce their U.S. tax liability (some RBT proponents suggest that additional anti-abuse provisions might also be needed).<sup>61</sup> Most RBT exit tax proposals are loosely based on Internal Revenue Code section 877A, which currently imposes a mark-to-market regime on citizens who lose their citizenship.<sup>62</sup> While the current provision triggers gain (above a threshold amount) when certain citizens “exit” the tax system by renouncing or otherwise losing U.S. citizenship, under the RBT proposal gain would be triggered when a citizen “exits” the tax system by changing her residence. The RBT proposals vary as to the sensitivity of this triggering event. Schneider’s proposal, for

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<sup>54</sup> Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 136 (footnotes omitted). Perhaps the most taxpayer-favorable proposal is that put forth by the overseas-citizens advocacy group, American Citizens Abroad, which would defer to the taxpayer’s self-certification to determine whether she is a U.S. tax resident. *See id.* (critiquing the American Citizens Abroad proposal).

<sup>55</sup> Mason, *supra* note 8, at 164.

<sup>56</sup> *Id.*

<sup>57</sup> Shaviro, *supra* note 49.

<sup>58</sup> *Id.*

<sup>59</sup> Shaviro, *supra* note 8, [Draft at 21].

<sup>60</sup> *See, e.g.,* AVI-YONAH & MARTIN, *supra* note 52, at 8–9; Blum & Singer, *supra* note 34, at 731–32; Schneider, *supra* note 42, at 66–67; *see generally*, Kirsch, *Revisiting the Taxation of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 136–39.

<sup>61</sup> *See* Mason, *supra* note 8, at 165–68.

<sup>62</sup> *See generally* Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 137 & n.86.



example, would trigger the tax whenever a citizen shifts from tax resident to nonresident status,<sup>63</sup> while Blum and Singer’s proposal, because of its three-year residence status taint, would not automatically trigger the exit tax when the individual moved.<sup>64</sup> Avi-Yonah proposes an even less sensitive trigger, imposing the exit tax only on citizens who are tax residents for at least eight of the past fifteen years prior to departure.<sup>65</sup> Mason, noting some concerns with the application of exit taxes, suggests that they might be made elective, so that a citizen, upon becoming a nonresident, could choose to either remain subject to the worldwide tax regime or could choose to incur the exit tax.<sup>66</sup>

In addition to addressing the definition of “resident” (and the potential consequences, if any, of a change in residence status), RBT proposals need to address the manner in which the U.S. will tax nonresident citizens. In particular, should the U.S. merely apply the current tax regime applicable to nonresident noncitizens, or should nonresident citizens be taxed differently than nonresident noncitizens? The RBT proposals vary in this regard. Under Avi-Yonah’s proposal, nonresident citizens “would be subject to U.S. income and withholding taxation the same as other non-resident aliens.”<sup>67</sup> Presumably, this approach would allow nonresident citizens to claim the same exclusions currently available to nonresident aliens, including the non-taxation of U.S. bank deposit interest, portfolio interest on U.S. corporate debt instruments, and gain from the disposition of most stock in U.S. companies.<sup>68</sup>

One final point deserves mention in the context of alternatives to CBT. As I have observed elsewhere, the RBT proposals generally focus on income tax concerns, and often gloss over the significant estate and gift tax concerns that could arise in the absence of CBT.<sup>69</sup> Indeed, for many wealthy citizens, a shift to RBT in the transfer tax setting would open significantly more tax planning opportunities than would a shift to RBT in the income tax setting.<sup>70</sup>

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<sup>63</sup> See Schneider, *supra* note 42, at 66–67.

<sup>64</sup> See Blum & Singer, *supra* note 34, at 735.

<sup>65</sup> See AVI-YONAH & MARTIN, *supra* note 52, at

<sup>66</sup> See Mason, *supra* note 8, at 167.

<sup>67</sup> See AVI-YONAH & MARTIN, *supra* note 52, at 8.

<sup>68</sup> With respect to gains, Avi-Yonah would impose a mark-to-market tax upon becoming a nonresident, but only if the citizen had been a U.S. tax resident for at least eight of the past fifteen years. See *supra* note 65 and accompanying text.

<sup>69</sup> See Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 139–40.

<sup>70</sup> See *id.* at 200–05.

## II. DISTILLING THE UNDERLYING NORMATIVE ARGUMENTS

As Part I illustrates, both proponents and opponents of CBT invoke traditional tax policy norms—*e.g.*, fairness, efficiency, and administrability—in support of their position. Having summarized the principal arguments for and against CBT and RBT, this Part II now focuses on these norms in more detail, analyzing how well the various RBT proposals, as well as the CBT regime, furthers them. In addition, this Part addresses the impact of CBT and the RBT proposals on other normative values beyond the traditional tax policy norms, with special emphasis on the impact on social cohesion.

### A. *Fairness: Ability-to-Pay Principles*

As discussed above,<sup>71</sup> citizenship constitutes a significant communal tie between the individual and the country of citizenship. I believe this tie generally is sufficient to bring non-resident citizens within the community of those who are expected to share the financial burden of supporting the United States under its ability-to-pay-based progressive income tax system.

#### 1. Lack of Pure Ability-to-Pay Principles under Current Law

Some critics of CBT, however, have observed that aspects of the current CBT-based system (in particular, the foreign earned income exclusion and foreign tax credit) allow many U.S. citizens living abroad to pay less U.S. income tax, and therefore provide less financial support for the U.S. community, than a U.S.-resident citizen with similar income.<sup>72</sup> Thus, it is argued that the current system itself does not reflect ability-to-pay principles, and thus these principles provide weak justification for continuing a CBT regime. While this argument correctly points out that the current regime does not reflect pure ability-to-pay principles, such principles still remain a central part of the regime. The regime, by backing off of taxation for some foreign income of citizens abroad,<sup>73</sup> is merely acknowledging that there are competing concerns in the international context. In the modern mobile world, it is possible that an individual can be a member of multiple communities simultaneously. Indeed, even if all countries adopted RBT regimes, an individual could still be a tax resident of two (or more) countries, given the lack of uniformity in countries' definitions of "resident." Moreover,

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<sup>71</sup> See *supra* notes 19–31 and accompanying text.

<sup>72</sup> See, *e.g.*, Zelinsky, *supra* note 32, at 1322; Mason, *supra* note 8, at 140–41; Avi-Yonah, *supra* note 38, at 393; see also Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 126 n.33 and accompanying text. In some cases (*e.g.*, an individual whose only income is foreign earned income that is less than the foreign earned income exclusion amount, or all of whose income is foreign source income that is taxed by a foreign country at relatively high tax rates), the individual might not owe any residual U.S. income tax.

<sup>73</sup> These concerns also extend to citizens residing within the United States, as reflected in the availability of the foreign tax credit for these individuals.

even under an RBT regime, if the residence country taxes its resident's worldwide income, it typically will allow a foreign tax credit in order to prevent double-taxation. In such circumstances, the residence country should not be seen as abandoning ability-to-pay principles for its community members (however defined); rather, it should be viewed as allowing concerns related to double-taxation to trump pure ability-to-pay concerns.

As I previously observed, similar reasoning applies when the United States allows an overseas citizen to claim a foreign tax credit:

[I]n this context the foreign tax credit, in addition to alleviating double taxation, could be viewed as an acknowledgement by the United States that the citizen living abroad is a part of two societies, with the United States ceding primary taxing rights to the country where the individual has the more immediate current connection. But to the extent that the foreign country finances its activities with a level of income tax that is lower than that imposed by the United States, the residual amount of taxes should be paid to help support the United States, where the individual also maintains a voluntary societal connection.<sup>74</sup>

Thus, the ability of an overseas citizen to reduce her U.S. tax liability by the foreign tax credit does not necessarily undermine ability-to-pay arguments for CBT. Indeed, even if the U.S. were to shift to an RBT regime, a U.S. citizen who resides in the United States but has foreign income would be allowed to claim a foreign tax credit (just as U.S.-resident citizens in such circumstances can do under the current regime), yet we generally don't view such a concession (which exists today) as undermining the general ability-to-pay principles underlying the U.S. income tax system.

Admittedly, the foreign earned income exclusion—by eliminating U.S. income tax on approximately \$100,000 of foreign earned income—is less consistent with the ability-to-pay perspective that treats overseas citizens as having sufficient communal ties to impose CBT. Nonetheless, the existence of the foreign earned income exclusion does not significantly undermine the view that overseas citizens generally are part of the United States community for CBT purposes. First, it could be argued that the foreign earned income exclusion is an unjustified policy,<sup>75</sup> and rather than use its existence to argue for the repeal of CBT, the foreign earned income exclusion itself could be repealed. Assuming that the exclusion is retained, in some circumstances the exclusion may merely operate as an administratively simpler proxy for the foreign tax credit (e.g., a citizen abroad whose moderate foreign earned income is taxed at a relatively high

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<sup>74</sup> Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 126 n.33.

<sup>75</sup> For a more detailed critique of the foreign earned income exclusion, see Kirsch, *Taxing Citizens*, *supra* note 2; *see also* Mason, *supra* note 8, at 141, noting that a pure ability-to-pay rationale for CBT would require the repeal of the foreign earned income exclusion and the allowance of unlimited foreign tax credits.

tax rate in the foreign country), or as a relatively moderate concession to the compliance issues and other complexities that citizens living abroad might face. To the extent that a citizen abroad has a higher level of earned income, the foreign earned income exclusion will not shelter all (or, in the case of very high income levels, much) of it, and the U.S. citizen will still owe U.S. taxes under general ability-to-pay principles. Similarly, to the extent the individual's income is from investments, the exclusion will not shelter U.S. tax on any of it, thereby preserving the application of ability-to-pay principles.

In a related argument, Ruth Mason argues that

[i]f substantial connections and full national community membership trigger full moral obligations to contribute taxes according to ability to pay, then more limited connections and partial membership may trigger more limited tax obligations. One thing is clear: since the social-obligation theory determines the amount of a person's tax liability by reference to her ability to pay, the theory should not result in full tax liability to multiple societies. If multiple and partial national community memberships are possible, the question then becomes how a taxpayer's obligation should be divided among the states in which she is a member.<sup>76</sup>

After observing that tax treaties generally implement a winner-take-all tie-breaker for dual tax residents, she observes that “despite the tie-breaker rules and the U.S. saving clause, the citizenship tax does not result in winner-take-all taxation.”<sup>77</sup> Instead, due to the foreign tax credit, citizenship-based taxation “may result in splitting the individual's social-obligation contribution across two states.”<sup>78</sup> While she concedes that this may be the fair result when the nonresident American is viewed as a member of both national communities, in cases “where the nonresident American is no longer a member of the U.S. national community, her residual taxation by the United States is less fair than would be a winner-take-all approach that awarded to her residence state the exclusive authority to tax her worldwide income.”<sup>79</sup> This argument, however, assumes that the overseas citizen is “no longer a member of the U.S. national community.” As discussed above,<sup>80</sup> a strong case can be made that the retention of citizenship itself should, as a general matter, cause the individual to be considered part of the national community.

## 2. Special Treatment of Citizens Under RBT Proposals

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<sup>76</sup> Mason, *supra* note 8, at 138.

<sup>77</sup> *Id.*

<sup>78</sup> *Id.* at 139.

<sup>79</sup> *Id.*

<sup>80</sup> See *supra* notes 19–31 and accompanying text.

The connection of overseas citizens to the U.S. community is (implicitly) reinforced by some arguments raised by supporters of RBT. While some RBT proponents—most notably, Reuven Avi-Yonah<sup>81</sup>—would treat nonresident citizens in much the same way that nonresident noncitizens are treated, others envision separate rules. For example, Cynthia Blum and Paula Singer propose a three-year residence taint on citizens who cease being residents under the substantial presence test,<sup>82</sup> while Bernard Schneider suggests a subjective bona fide residence test for citizens (while noncitizens presumably would continue to use the substantial presence test).<sup>83</sup> Ruth Mason considers a number of possible tests that would move away from citizenship taxation, but not all the way to strict residence taxation,<sup>84</sup> such as a focus on whether a citizen (but not a noncitizen) maintains an abode in the United States, or a rebuttable presumption that a citizen (but not a noncitizen) has a tax residence in the United States.<sup>85</sup>

The further these proposals go in treating nonresident citizens differently from nonresident noncitizens, the more they implicitly acknowledge that there is something special about citizenship. In particular, they seem to acknowledge that a citizen living abroad, even for an extended period, retains a special connection to the United States that a nonresident noncitizen does not. While these RBT proponents most likely would argue that whatever connection is retained is not sufficient to justify the perpetual taxation of a nonresident citizen's foreign source income, that admitted connection nonetheless suggests that there is a special tie for citizens that does not apply to noncitizens, thereby providing at least some further support for the view that a citizen is part of the U.S. community.

### 3. Relevance of Accidental, Nominal, and Unaware Citizens

CBT opponents also suggest that the communal-ties argument for ability-to-pay taxation, although it may have relevance for overseas citizens who were raised in the United States and plan to return there, is much less persuasive for specific subgroups of overseas citizens—so-called “accidental,” “nominal,” or “unaware” or “unknowing” citizens—thereby undermining the general case for CBT.<sup>86</sup> In this context, “accidental citizens” are those “who were born in the United States to noncitizen parents temporarily present in the country on a short-term basis and who left the country soon thereafter,”<sup>87</sup> while “nominal” citizens

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<sup>81</sup> See *supra* note 52 and accompanying text; see also *supra* note 65 and accompanying text (Avi-Yonah proposal to trigger the exit tax only for citizens who were long-term residents, using a similar 8-of-15 year test that currently applies to lawful permanent residents).

<sup>82</sup> See *supra* note 53 and accompanying text.

<sup>83</sup> See *supra* note 54 and accompanying text.

<sup>84</sup> See Mason, *supra* note 8, at 163–65.

<sup>85</sup> See *id.*

<sup>86</sup> See generally Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 132–33.

<sup>87</sup> *Id.* at 133.

are those “who were born abroad to a U.S. citizen parent (or parents) and acquired citizenship by descent, even though the individuals may have little or no connection to the United States and may never have lived here, held a U.S. passport, or otherwise derived any benefit from U.S. citizenship status.”<sup>88</sup> At the extreme, “unaware” or “unknowing” citizens are those “accidental” or “nominal” citizens who were “not even aware of their status as a U.S. citizen”<sup>89</sup> until discovering it in the context of a tax compliance situation. This latter group “could include, for example, individuals born outside the United States who were not aware of the identity, much less the U.S. citizenship status, of a biological parent.”<sup>90</sup> The IRS has reported that in some cases, the U.S. citizenship status was only discovered by an unknowing citizen’s executor after her death.<sup>91</sup>

Each of these subgroups raises different concerns in the context of ability-to-pay analysis. Obviously, an unknowing citizen presents the weakest case for CBT. It is difficult to argue that a person who is unaware of her U.S. citizenship status (and whom the State Department presumably does not know is a U.S. citizen) has any meaningful communal ties to the United States, such that she should be expected to financially support the country (at least with respect to the period when she was unaware). Of course, as a practical matter, as long as the individual and the United States are both unaware of her citizenship status, her potential CBT liability is a moot point. However, even after she (or her executor) becomes aware of her citizenship, the communal-ties argument would be a weak basis upon which to attempt to collect income (or estate) taxes for prior years (if, for example, the IRS argued that the period of limitations for income tax assessment remained open due to the failure to file a past U.S. tax return),<sup>92</sup> and also has only limited relevance going forward, particularly if the individual abandons the newly-discovered citizenship soon thereafter.<sup>93</sup>

While the normative case for taxing unknowing citizens is weak, the difficulty arises in creating an objective and enforceable test for identifying these individuals and exempting them from taxation. In the absence of an appropriate

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<sup>88</sup> *Id.*.

<sup>89</sup> *Id.*.

<sup>90</sup> DEP’T OF TREAS., INCOME TAX COMPLIANCE BY U.S. CITIZENS AND U.S. LAWFUL PERMANENT RESIDENTS RESIDING OUTSIDE THE UNITED STATES AND RELATED ISSUES 39 (1998), available at <http://www.treasury.gov/press-center/press-releases/Documents/tax598.pdf>. The report also addresses “restored” citizens (*i.e.*, those who were treated as having lost citizenship under an erroneous interpretation of the law by the State Department, but whose citizenship was subsequently restored), and treats them similarly to “unknowing” citizens during the period before their citizenship was restored. *See id.* at 40–41. In the interest of disclosure, it should be noted that the author assisted in the drafting of that report while working at the IRS.

<sup>91</sup> *Id.* at 39 (the “IRS has received numerous inquiries from executors of foreign estates who have concluded that the decedent technically was a U.S. citizen but did not know it”).

<sup>92</sup> *Cf.* I.R.C. § 6501(c)(3) (in the case of a failure to file a return, income tax may be assessed at any time). This issue may be particularly relevant in the case of the estate tax, when a nonresident decedent may have had no knowledge of her U.S. citizenship status while alive, but such status is identified by her executor after her death. As the IRS mentioned in a 1998 report, the “IRS has received numerous inquiries from executors of foreign estates who have concluded that the decedent technically was a U.S. citizen but did not know it.

<sup>93</sup> *Cf.* DEP’T OF TREAS., *supra* note 90, at 40 (suggesting an abandonment of citizenship status within 6 months of discovery under such circumstances).

test, an individual who knows of her citizenship status may, nonetheless, act as an “unknowing” citizen for purposes of not paying taxes, yet may someday invoke citizenship (*e.g.*, by claiming a recent discovery of such status) if citizenship status becomes beneficial for non-tax purposes (*e.g.*, if the person decides to move to the United States). The Treasury Department, in a 1998 report on overseas citizens, considered a possible exemption for unknowing citizens who later discover their citizenship status, suggesting that “[a]n individual claiming the benefit of this [possible] exemption should bear the burden of proving that he or she had no knowledge of his or her U.S. citizenship during the period at issue,”<sup>94</sup> and further noting that “[b]ecause of the possibility of abuse, the criteria for lacking knowledge of U.S. citizenship should be strictly construed.” Relevant factors could include the “absence of past statements to the U.S. government claiming citizenship (*e.g.*, passport applications and filings for government benefits as a citizen),”<sup>95</sup> and “past statements indicating a belief that he or she is not a U.S. citizen (*e.g.*, applications for employment, applications to educational institutions, financial transaction documentation, foreign tax returns, request for a visa for travel to the United States, and entering the United States on a foreign passport).”<sup>96</sup> The Treasury Department report’s proposal also suggested that “[o]nce an individual becomes aware of his or her U.S. citizenship or, based on objective facts, should have become aware of such status, the individual could under this regime have a period of time (*e.g.*, six months) to abandon that status without U.S. tax consequences . . . , so long as he or she does not utilize the benefits of citizenship during that period.”<sup>97</sup> As noted above, this final aspect of the proposal is consistent with a communal-ties rationale for taxing the individual for subsequent periods if she chooses to retain citizenship beyond a reasonable period after becoming aware of it.<sup>98</sup>

The appropriate treatment of “nominal” or “accidental” citizens under a communal-ties argument is not as clear. The mere fact that a person was born abroad and acquired citizenship by descent (and therefore might be viewed as a “nominal” citizen under the taxonomy discussed above) does not necessarily suggest that she does not have significant ties to the United States. While some such individuals may feel little or no subjective connection to the United States, and have no plans to visit, let alone live, here, other such individuals may have strong subjective ties. While it is not possible to know the precise numbers (or even relative numbers) of individuals who fit each of these profiles, the number in the latter group presumably is significant. After all, American Citizens Abroad (“ACA”), a prominent lobbying group that represents the interests of overseas citizens, has expended significant efforts to ensure that the estimated 40,000 individuals born abroad to a U.S. citizen parent (or parents) are able to claim U.S. citizenship.<sup>99</sup> In advocating for citizens born abroad, ACA emphasizes “its

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<sup>94</sup> *Id.* at 39.

<sup>95</sup> *Id.*

<sup>96</sup> *Id.* at 39–40.

<sup>97</sup> *Id.* at 40.

<sup>98</sup> See *supra* note 93 and accompanying text.

<sup>99</sup> See *Citizenship*, American Citizens Abroad, <https://americansabroad.org/issues/citizenship>.

support of revised legislation to make it easier to transmit US citizenship to children born or adopted abroad,” noting that U.S. citizenship “*opens the door to membership in our society* and all other related rights.”<sup>100</sup>

Similar issues arise with so-called “accidental” citizens, who obtained citizenship because their parents were temporarily present in the United States at the time of their birth. Some of these citizens may have little or no subjective connection to the United States, while others may place significant value on their citizenship and may plan at some point to live in the United States. While it is also difficult to know the relative numbers of individuals within each of these subgroups, recent news reports suggest a significant increase in the number of individuals obtaining U.S. citizenship because of intentional efforts by their non-citizen mother to visit the United States in anticipation of delivery. In particular, news reports estimate that approximately 60,000 births occurred in the United States to Chinese nationals taking part in “birth tourism.”<sup>101</sup> While these U.S. citizen infants presumably will return to China and be raised there, their U.S. citizenship presumably could be very important to them, and many might be expected to move to the United States at some future time.

Given the broad range of circumstances faced by “nominal” or “accidental” citizens, the suggestion by some scholars that the plight of these citizens broadly undermines the case for CBT seems overstated. Many such citizens can be viewed as having significant ongoing ties to the United States. Accordingly, under a communal-ties argument, such individuals would not automatically be excluded from the group of individuals expected to support the country. Instead, as with “unknowing” citizens, perhaps an exemption could be enacted for those who satisfy an objective and enforceable test establishing their minimal ties. Such an exemption could be based, for example, on Code section 877A(g)(1)(B), which exempts certain dual citizens, and certain minors, who have limited U.S. contacts from the application of the exit tax upon loss of citizenship.<sup>102</sup>

#### 4. Do We Tax Because We Care?

Some might object to the ability-to-pay argument because of the “apparent paradox, or at least conundrum,” that “only if we decide that we care about you [] will we impose tax burdens on you.”<sup>103</sup> As I understand this concern, it implies

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<sup>100</sup> *Id.* (emphasis added).

<sup>101</sup> See Matt Sheehan, *Born in the USA: Why Chinese “Birth Tourism” is Booming in California*, THE HUFFINGTON POST (May 1, 2015), [http://www.huffingtonpost.com/2015/05/01/china-us-birth-tourism\\_n\\_7187180.html](http://www.huffingtonpost.com/2015/05/01/china-us-birth-tourism_n_7187180.html)

<sup>102</sup> Under I.R.C. § 877A(g)(1)(B)(i), an individual is exempt from the exit tax if she became at birth a citizen of the United States and another country, she continues to be taxed as a resident of that other country, and she has been a resident of the United States for not more than 10 of the preceding 15 taxable years. Under I.R.C. § 877A(g)(1)(B)(ii), an individual is exempt from the exit tax if she relinquishes U.S. citizenship before attaining age 18 ½, and she has been a U.S. resident for no more than 10 taxable years.

<sup>103</sup> Shaviro, *supra* note 8, at [Draft p.5].



some type of causation—*i.e.*, we care about you, and therefore we will tax you. I, however, believe that causation runs in a slightly different direction. Both the “caring for” and “taxing” flow from the first principle that citizenship makes you a member of the community (at least as argued previously). The reason U.S.-resident citizens care about citizens abroad (to the extent they do) is because citizenship is viewed as making them one of us. We don’t know the overseas citizen personally, but because of citizenship status, we view them as part of our community. Similarly, we tax the person because we view citizenship as making them a part of the community, with an obligation to support the community. Accordingly, both the care we have for an overseas citizen (relative to a random noncitizen living abroad) and the taxation imposed on an overseas citizen flow from the idea that citizenship makes them part of community (rather than taxation of the citizen flowing from our caring about the citizen).

##### 5. Inclusion of Noncitizen Residents in Community?

A final possible objection to including overseas citizens within the ability-to-pay community concerns the treatment of U.S. residents who are not citizens. Reuven Avi-Yonah, after acknowledging that the ability-to-pay argument for taxing nonresident citizens based on their communal ties “could be appealing if we only taxed citizens,” rejects the argument because we also treat resident aliens as part of the relevant ability-to-pay community.<sup>104</sup> Avi-Yonah apparently assumes that the relevant community can only be defined by a single factor—either citizenship or residence—and he implicitly concludes that residence trumps. It is not clear to me why, if indeed only one factor can be chosen, residence should automatically trump and citizenship should be discounted. After all, it is possible that many resident citizens (rightly or wrongly) feel a stronger subjective connection to other U.S. citizens, regardless of the other citizens’ residence, than they feel toward noncitizens residing in the United States. This stronger connection might be gleaned from the restrictions on social safety net benefits that each group faces. While nonresident citizens do not receive certain benefits, such as Food Stamps, Medicaid, and Medicare coverage while living outside the United States, these restrictions may be based on “a host of administrative and design problems.” including questions about benefits delivery, that arise in a cross-border setting.<sup>105</sup> In contrast, resident noncitizens (in particular, unauthorized immigrants) do not qualify for a host of benefits, such as Food Stamps or Medicaid coverage (other than certain emergency care), even though these benefits would not raise cross-border administrative design or delivery problems. This denial suggests that, at least in some contexts, resident noncitizens may be viewed (rightly or wrongly) as having weaker community ties than nonresident citizens. Accordingly, if a communal ties-based ability-to-pay

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<sup>104</sup> Avi-Yonah, *The Case Against Taxing Citizens*, 58 TAX NOTES INT’L 389 (May 3, 2010).

<sup>105</sup> See Shaviro, *supra* note 12, at [Draft pp. 22–23]. Shaviro concludes, though, that despite these practical problems, “we are inclined to care somewhat less about our own people when they are abroad for extended periods, rather than living among us.” *Id.* at [Draft p. 23].

argument can be made only with respect to one of these two groups, the argument may be even stronger with respect to nonresident citizens.

More fundamentally, however, I do not agree that only one factor can be relevant in defining the community under ability-to-pay principles. As Dan Shaviro notes, “two factors that would appear clearly to have strong intuitive appeal, when one thinks about the “us” category, are (a) people’s physical location and (b) something about their mental states, be this focused on their connections, sense of personal identity, or intentions regarding the future.”<sup>106</sup> He later suggests that citizenship could come within this latter category.<sup>107</sup> Resident noncitizens might be viewed as part of the community (with a responsibility to support it) based on their current physical presence, while nonresident citizens might be viewed as part of the community based on the factors discussed previously, including their possible future physical return (among other factors). While in many cases the two factors (residence and citizenship) will overlap (in the case of the hundreds of millions of citizens who reside in the United States), the relevance of the two factors is not mutually exclusive.

## B. *Efficiency – Competing Views*

Advocates of both CBT and RBT rely, in part, on efficiency claims, suggesting that their preferred approach will distort individuals’ decisions less than other approaches. However, in making these arguments, they focus on different margins.<sup>108</sup> Opponents of CBT generally focus on citizenship neutrality—*i.e.*, CBT’s impact on an individual’s decision of whether or not to retain U.S. citizenship. In contrast, proponents of CBT generally focus on residence neutrality—*i.e.*, RBT’s impact on an individual’s decision of where to establish and maintain residence for tax purposes.

### 1. Citizenship Neutrality Concerns

Under a CBT regime, an individual’s tax liability (for both income and transfer tax purposes) generally does not depend on her residence status. Merely moving abroad does not significantly impact the individual’s U.S. tax liability.<sup>109</sup> Accordingly, a CBT regime generally is residence-neutral, and does not impact a citizen’s residence decision.

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<sup>106</sup> Shaviro, *supra* note 12, at [Draft p. 21].

<sup>107</sup> *Id.* at [Draft p. 23].

<sup>108</sup> See generally Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 181–200 (discussing competing views of neutrality between CBT and RBT advocates).

<sup>109</sup> Specific features of the United States’ existing CBT regime—*e.g.*, the foreign earned income exclusion and foreign tax credit limitations—might cause minor distortion. For example, the foreign earned income exclusion, by allowing a citizen living abroad to exclude approximately \$100,000 (plus limited housing expenses) from gross income, could create an incentive to reside abroad. However, the tax savings from this limited exclusion would probably be a relatively minor factor in any decision to move abroad, relative to the non-tax costs (*e.g.*, financial and cultural) involved in the decision.

While CBT does not create an incentive to move abroad, once an individual is living abroad it might create an incentive to surrender U.S. citizenship. Under CBT, the taxation of a nonresident's foreign source income (as well as some U.S. source income)<sup>110</sup> generally turns on whether or not the individual is a U.S. citizen. Accordingly, it is not surprising that a CBT regime might encourage some nonresident citizens to surrender their U.S. citizenship, thereby potentially violating citizenship neutrality principles.

Despite this tax-motivated incentive, until relatively recently few individuals actually engaged in tax-motivated abandonment of citizenship. It is only in the past few years that the number of tax-motivated abandonments has increased (although the totals still remain relatively small). As I previously summarized:

Between 1998 and 2005, the number of individuals who surrendered or otherwise lost their U.S. citizenship gradually increased from approximately 400 per year to approximately 800 per year. Data for early years going back to 1991 reflects a similar number of annual renunciations. Because citizens who surrender citizenship are not required to give a reason, there is no way to know how many of these individuals surrendered citizenship for tax reasons. While a number of high-profile individuals who surrendered citizenship in those earlier years apparently did so for tax purposes, a significant number of individuals did so for nontax reasons.

The number of reported citizenship losses dropped significantly in 2006 through 2008. The reported number had dwindled to 167 for the 12-month period ending in the middle of 2009. However, beginning with the report for the third quarter of 2009, the number of reported losses of citizenship began to increase dramatically, resulting in 742 losses reported in calendar year 2009, 1,534 in 2010, and 1,781 in 2011. After a brief drop during 2012 (932) (which may have been attributable, at least in part, to anticipation that tax rates might be lowered and that the overseas enforcement initiatives would be scaled back if Mitt Romney were to be elected President), the reported losses again increased significantly with 3,000 renunciations reported in 2013.<sup>111</sup>

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<sup>110</sup> As a general matter, a nonresident non-citizen is not taxed on capital gain from the sale of U.S. corporate stock, as well as certain types of U.S. source interest.

<sup>111</sup> Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 181–84 (footnotes omitted).

This upward trend continued in 2014, with 3,415 losses reported,<sup>112</sup> and in 2015, with 1,795 reported during the first half of the year.<sup>113</sup>

This recent uptick in the number of renunciations is most likely due to increased IRS enforcement efforts, particularly with respect to the information reporting requirements for overseas accounts (*e.g.*, FBAR forms and related penalties), as well as the implementation of the FATCA regime, which will enable the IRS to obtain information (including, but not limited to, information on accounts held by citizens residing overseas) from foreign financial institutions.<sup>114</sup> Prior to these recent enforcement efforts, a significant number of U.S. citizens may have been living abroad without complying with their U.S. tax burdens (either because they were not aware of them, or because they discounted the IRS' ability to enforce the laws). To the extent the recent developments with FBAR and FATCA enforcement caused these individuals to pay attention to their potential U.S. tax liability, it is not surprising that a number of these individuals may have decided that the benefits of retaining U.S. citizenship did not justify the tax costs of contributing to U.S. society. Given that these individuals may be the ones who have the most tenuous subjective connections to the United States, their citizenship renunciation is not necessarily inconsistent with the communal-ties justification underlying CBT.<sup>115</sup>

The recent increase in citizenship renunciation may be driven not only by concerns about increased U.S. tax liability, but also, at least in part, by the significant U.S. tax compliance costs associated with living overseas. For example, the additional filing requirements applicable to overseas citizens often require these citizens to incur significant accounting and other professional fees, even if their U.S. tax liability is relatively modest (or zero).<sup>116</sup> Moreover, an overseas citizen with a foreign financial account potentially could be subject to significant failure-to-file penalties, even if no U.S. tax is owed.<sup>117</sup> Under these circumstances, it is possible that at least some U.S. citizens who, at the margin, might prefer to retain their citizenship and would be willing to pay residual U.S.

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<sup>112</sup> See Quarterly Publication of Individuals, Who Have Chosen to Expatriate, as Required by Section 6039G, 80 Fed. Reg. 7685 (Feb. 11, 2015) (1,062 individuals reported for the quarter ending December 31, 2014); Quarterly Publication of Individuals, Who Have Chosen to Expatriate, as Required by Section 6039G, 79 Fed. Reg. 64,013 (Oct. 27, 2014) (776 individuals reported for the quarter ending September 30, 2014); Quarterly Publication of Individuals, Who Have Chosen to Expatriate, as Required by Section 6039G, 79 Fed. Reg. 46,306 (Aug. 7, 2014) (576 individuals reported for the quarter ending June 30, 2014); Quarterly Publication of Individuals, Who Have Chosen to Expatriate, as Required by Section 6039G, 79 Fed. Reg. 25,176 (May 2, 2014) (1,001 individuals reported for the quarter ending March 31, 2014).

<sup>113</sup> See Quarterly Publication of Individuals, Who Have Chosen to Expatriate, as Required by Section 6039G, 80 Fed. Reg. 45,709 (July 31, 2015) (460 individuals reported for the quarter ending June 30, 2015); Quarterly Publication of Individuals, Who Have Chosen to Expatriate, as Required by Section 6039G, 80 Fed. Reg. 26,618 (May 8, 2015) (1,335 individuals reported for the quarter ending March 31, 2015).

<sup>114</sup> For a detailed analysis of these increased reporting requirements, and their potential impact on overseas citizens, see Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 140–81 & 210–21.

<sup>115</sup> See *supra* notes 19–31 and accompanying text.

<sup>116</sup> [cite estimates]

<sup>117</sup> See Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 161–72.

tax, if any, after application of the foreign tax credit and foreign earned income exclusion, might decide nonetheless to surrender their citizenship. Such compliance-cost driven expatriations are particularly problematic, potentially driving away (at least at the margin) individuals who otherwise would prefer to remain part of the extended U.S. community (paying residual U.S. taxes), without providing any commensurate benefit to the United States in return. As I have previously argued, these compliance-cost driven expatriations are best addressed by the IRS and Congress taking the unique circumstances faced by overseas citizens more seriously when implementing compliance and enforcement rules.<sup>118</sup>

Regardless of whether the recent uptick in citizenship surrenders is caused by concerns over U.S. tax liability itself or, more problematically, concerns about compliance costs, it is important to keep in mind that the absolute numbers of individuals surrendering citizenship remains relatively small in absolute terms. Moreover, as I have previously observed, “it is not unreasonable to assume that at some point, those who are most likely to renounce citizenship for tax-related purposes will have done so, and the numbers may trend down again.”<sup>119</sup>

## 2. Residence Neutrality Concerns

In contrast to the current CBT regime, which largely eliminates the importance of a citizen’s residence, an RBT regime places significant emphasis on an individual’s residence. Under RBT, the taxation of an individual’s foreign source income (as well as some U.S. source income)<sup>120</sup> generally turns on whether or not the individual is a U.S. tax resident. Accordingly, the use of an RBT regime (and elimination of CBT) for citizens might encourage some citizens to become nonresident individuals for tax purposes, thereby potentially violating residence neutrality principles. Such a regime, however, would be consistent with citizenship neutrality principles, because the nonresident’s citizenship status would not be relevant for U.S. tax purposes, and thus there would be no tax incentive to surrender citizenship.

Some proponents, implicitly relying on the historic lack of tax-driven changes of residence by U.S. citizens, downplay the extent to which an RBT regime would incentive citizens to move abroad.<sup>121</sup> As I have previously noted, however:

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<sup>118</sup> See Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 212–15.

<sup>119</sup> *Id.* at 186–87.

<sup>120</sup> As a general matter, under U.S. tax law a nonresident is not taxed on capital gain from the sale of U.S. corporate stock, or on certain types of U.S. source interest. See *supra* note 110.

<sup>121</sup> See, e.g., Avi-Yonah, *supra* note 38, at 390 n.5 (“in the case of individuals, I believe the decision to move is usually motivated primarily by nontax considerations”); Schneider, *supra* note 42, at 53 (“[i]n most cases . . . individuals choose their residence on the basis of more than just taxation . . . . The United States should not assume that a move abroad is motivated by a desire to decrease U.S. tax liability and therefore should be ignored for tax purposes”).

these appeals to the [current] lack of tax motive for citizens living abroad fail to acknowledge the important role that current citizenship-based taxation, with its limited potential for tax windfalls by moving abroad, plays in this result. The situation might change significantly if the United States were to move to a residence-based tax system for citizens. While many citizens would continue to live abroad primarily for nontax reasons, a residence-based tax system might create significant incentives for many other U.S. citizens to move abroad primarily for tax reasons. After all, under a residence-based tax system, a U.S. citizen residing abroad (unlike a citizen residing in the United States) would no longer be taxed on income arising outside the United States. Indeed, she might not even be taxed on significant types of income arising within the United States, such as interest on U.S. bank accounts or gains from the sale of stock in U.S. companies. In addition, a U.S. citizen residing abroad could significantly reduce or eliminated U.S. gift and estate tax liability.<sup>122</sup>

The precise extent to which citizens at the margin would establish a foreign residence if the United States moved to an RBT-focused regime is difficult to quantify. Much recent writing focuses on the recent increase in labor mobility.<sup>123</sup> While moderate-income individuals whose income depends on selling their labor might not be likely to change residence due to tax changes (due to the modest expected tax savings and the possible difficulty of obtaining similar employment abroad), high-income individuals (particularly those whose income depends largely on returns to capital rather than selling their labor) might have much greater flexibility. Not only do they have greater locational flexibility (given that they can perform their investing activities from anywhere), but the potential amount of tax savings for such an individual could be significant. Even some high-income workers might be induced to establish foreign residence if their potential tax savings are high enough and their profession allows for geographic residence flexibility (e.g., some professional athletes, some medical professionals who can perform their work remotely, etc.).<sup>124</sup>

Of course, a number of non-tax factors would influence a U.S. citizen's decision to move abroad, including "personal and family history, social or cultural connections, nationality status, economic opportunities, and climate preferences."<sup>125</sup> Moreover, the decision might be influenced by the definition of "resident" implemented in the RBT regime—in particular, the extent to which it

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<sup>122</sup> See Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 188–89.

<sup>123</sup> See, e.g., Ruth Mason, *Tax Expenditures and Global Labor Mobility*, 84 N.Y.U. L. REV. 1542 (2009); Michael J. Graetz & Alvin C. Warren, *Income Tax Discrimination: Still Stuck in the Labyrinth of Impossibility*, 121 YALE L.J. 1118 (2012).

<sup>124</sup> Cf. Michael S. Kirsch, *The Role of Physical Presence in the Taxation of Cross-Border Personal Services*, 51 B.C.L. REV. 993 (2010) (discussing the increased geographic flexibility of cross-border services, due to advances in global communication technology, and the resulting tax complications).

<sup>125</sup> Kirsch, *Taxing Citizens*, *supra* note 2, at 489.

would require the individual to limit the amount of time spent in the United States each year. But if the potential income (or, perhaps more importantly, gift and estate) tax savings are sufficient, a significant number of individuals might change residence (at least for a sufficient amount of time to gain significant tax advantages). The experience of individuals moving among the U.S. states (which, admittedly, involves fewer cultural changes than would a foreign move) demonstrates that high-income (and high net worth) individuals are often willing to change residence for significant tax savings.<sup>126</sup> More importantly, the experience of other countries suggests that individuals, under an RBT regime, are willing to change national residence if the tax savings are sufficient.<sup>127</sup> As I have previously observed, if the United States shifted to taxing its citizens only under an RBT regime, thereby creating a market among other countries to attract high-income and high-worth U.S. citizens, it is likely that a number of countries might tailor their tax and immigration regimes to attract these wealthy U.S. citizens.<sup>128</sup>

Some scholars have argued that, from a global welfare perspective, an RBT regime could lead to increased efficiency. Reuven Avi-Yonah suggested that

We should go back to Charles Tiebout's famous conclusion from 1956 that if people are mobile, countries should set tax rates to reflect the taste of their residents, and those residents that do not like the resulting choice (which is established by democratic elections) should be free to move to other countries whose choices they like better. . . . [L]et people who do not like the result [of quadrennial elections in which proper tax rates are debated and decided] move overseas, and stop taxing them there even if they retain U.S. citizenship."<sup>129</sup>

I have previously addressed, and critiqued, this argument, concluding that the Tiebout sorting model cannot be usefully applied to the CBT versus RBT debate.<sup>130</sup> First, a number of Tiebout's assumptions do not exist in this context,

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<sup>126</sup> See Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note 6, at 191–92.

<sup>127</sup> See, e.g., Graetz & Warren, *supra* note 123, at 1136 (“[a]s for mobile, high-income workers, including star soccer players among others, there is ample evidence that Europeans are quite willing to change their residence, specifically in response to lower tax rates” (citations omitted); Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 190–91 (citing examples).

<sup>128</sup> See Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 193–94. Even countries that are not generally considered tax havens might have regimes that would attract U.S. citizens if the U.S. switched to an RBT regime. See, e.g., *infra* note 183 (discussing U.K. non-domiciliary regime that, even if proposed changes are made, could provide significant tax benefits for 15 years for an individual residing in London).

<sup>129</sup> Reuven S. Avi-Yonah, *And Yet It Moves: A Paradigm in the 21<sup>st</sup> Century*, at 10 (U. Mich. L. & Econ. Research, Working Paper No. 12-008), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2055160](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2055160); see also Mason, *supra* note 8, at 157 (citing Tiebout for proposition that “[f]ree movement also may help reveal people’s true preferences for levels of tax and public goods as people vote with their feet by moving to the jurisdiction that provides their desired mix of tax and benefits”).

<sup>130</sup> See Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 197–200.

such as the need for *local* public goods (Tiebout explicitly states that the model does not apply at the federal level), the lack of spillover benefits or costs between communities (at the international level, there may be significant spillover benefits to a citizen living abroad from U.S. expenditures), and the necessity of an individual being a member of only a single community at any given time (in contrast to a U.S. citizen, who could reside in another country, yet simultaneously vote and thereby influence tax and expenditure levels in the United States).<sup>131</sup> As importantly, Tiebout’s model does not address the role of citizenship allegiance (from either the perspective of the individual or the country), and does not consider the “psychic or similar cost to either the individual or a particular community when the individual makes his residence decision based purely on where his expenditure preference patterns are best satisfied.”<sup>132</sup>

### 3. Immigration Neutrality Concerns

Ruth Mason raises an additional decision margin that might be relevant in the CBT versus RBT discussion.<sup>133</sup> She notes that CBT may impact a noncitizen’s decision of whether or not to migrate to the United States and eventually become a U.S. citizen.<sup>134</sup> According to Mason,

[c]itizenship taxation presumably discourages both initial migration and naturalization by marginal migrants from other countries . . . . In deciding whether and where to move, rational marginal migrants calculate the tax for the duration of their anticipated visit. But they also consider the possibility that they will stay permanently. In the United States, unlike in any of the countries with which the United States competes for skilled migrants, the decision to naturalize (or take up permanent legal residence) comes with a hefty price tag: life-long worldwide taxation for the migrant and any of her U.S.-citizen children. . . . For immigrants to the United States who may be contemplating retiring back home or moving to a third country, the citizenship tax stands as a barrier to naturalization and probably also to initial immigration.<sup>135</sup>

To some extent, this concern about immigration neutrality would apply even under an RBT regime. During the time that the would-be immigrant resides in the United States, she would be subject to worldwide taxation even under an RBT regime. Furthermore, given that the RBT proposals generally include some kind of exit tax, she would probably be subject to some type of tax upon

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<sup>131</sup> See *id.* at 198.

<sup>132</sup> *Id.* at 199–200. These concerns are addressed in more detail *infra* Part II.D.

<sup>133</sup> See Mason, *supra* note 8, at 159–63.

<sup>134</sup> See *id.* at 160.

<sup>135</sup> *Id.* at 160–61 (citations omitted).



surrendering her U.S. residence.<sup>136</sup> Accordingly, once a noncitizen immigrant has resided in the United States long enough to be subject to an exit tax under the proposed RBT regimes, the current CBT regime (which has an exit tax upon surrender of citizenship or, in the case of a noncitizen, cessation of long-term lawful permanent resident status) might not provide significant additional disincentives to naturalize.

More importantly, Mason suggests that CBT might discourage highly skilled migrants from coming to the United States in the first place, thereby potentially depriving the United States of individuals who would be very valuable to the economy.<sup>137</sup> While it is possible that CBT would have such an impact, it would occur only if the would-be immigrant satisfied a number of conditions: a very long time-horizon (rather than just looking for the economic opportunity that provides the best chance of short or medium-term success); an expectation of eventual financial success in the United States; an anticipation that, upon having financial success, she would want to become a citizen; an awareness and understanding of the U.S. tax laws; and, finally, a subjective internal calculation that, were she to naturalize, the discounted potential costs of future citizenship-based taxation on foreign source income after someday returning to her home (or a third) country outweigh the more immediate economic benefits of migrating to the United States.

While it is possible that, at the margin, some noncitizens might forego the opportunity to pursue educational or work opportunities in the United States under this calculation, my (admittedly nonscientific) intuition<sup>138</sup> is that, as a practical matter, the number is very limited. If, for a particular individual, moving to the United States (whether for educational or work opportunities) provides the best chance of financial success, she is likely to take that opportunity. To the extent that other factors (including family, cultural, language, visas, etc.) influence the decision, which they certainly would, it is likely that the possibility of eventual citizenship-based taxation (if the individual were fortunate enough to find financial success and eventually chose to become a citizen) would likely be relatively low on the list. Thus, from the perspective of the United States, the future ability to attract these highly skilled immigrants depends much more on non-tax factors—such as a strong economic environment, economic stability, rule of law norms, political stability, educational opportunities, availability of potential venture capital, availability of economic and financial markets; availability of talent to work with, and networking opportunities—to ensure that the country remains attractive for highly-skilled would-be immigrants. As long as the United States remains attractive with respect to these more

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<sup>136</sup> See generally Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 136–39.

<sup>137</sup> See Mason, *supra* note 8, at 160. Presumably, even an RBT regime with an exit tax might have a similar effect, particularly if other countries that the potential migrant was considering did not have such a tax.

<sup>138</sup> Cf. Shaviro, *supra* note 8, at [Draft 44] (noting the need to sometimes fall back on “intuition” in the context of citizenship-based taxation discussions).

fundamental drivers of economic start-up success, the impact of CBT on immigration decisions is likely to remain slight.

This intuition regarding the relatively limited impact of the CBT regime seems to be supported by the actual experience of the United States over the past few decades (and before). While it is not possible to quantify (or identify in any reliable way) those highly skilled noncitizens, if any, who would have immigrated to the United States but for concerns about the CBT regime, it is important to note that significant numbers of highly skilled noncitizens continue to enter the United States each year, despite the existence of the CBT regime. For example, the number of applicants for H-1B visas (for highly skilled technical workers) continues to far exceed the availability of such visas,<sup>139</sup> even though the number of such visas has increased each year.<sup>140</sup> These circumstances certainly suggest that, for vast numbers of educated and highly skilled noncitizens, the existence of the United States' CBT regime (if it is considered at all) is far outweighed by other factors. Moreover, approximately "25% of [U.S.] high-tech companies founded between 1995 and 2005 . . . had at least one immigrant founder,"<sup>141</sup> strongly suggesting that these desired high-skill immigrants apparently were not deterred by the existence of the CBT regime. The fact that one high-profile immigrant high-tech founder—Eduardo Saverin of Facebook—recently surrendered his citizenship for tax purposes and received widespread media attention reinforces the fact that the vast number of such immigrants retain their citizenship<sup>142</sup>

#### 4. Tradeoffs Among These Margins

In summary, distortions might occur with respect to citizenship retention (and, to an even smaller extent, with respect to immigration decisions) under a CBT regime, while distortions might occur with respect to residence location under an RBT regime (in the absence of CBT). As discussed above, from a quantitative perspective, the citizenship distortions under the existing CBT regime have been relatively limited, with only a few thousand individuals surrendering citizenship in each of the past few years, despite the heightened scrutiny on overseas citizens and their reporting obligations. In contrast, given the experience

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<sup>139</sup> For example, applications during the first week of the 2015 application process exceeded the entire annual supply of H-1B visas. See Miriam Jordan, *Applications for H-1B Visas Hit Limit Quickly*, WALL ST. J., Apr. 8, 2015, at A2. Although an H-1B visa is not itself an immigrant visa, it is considered a dual intent visa, so that a holder might in the future apply for permanent resident status.

<sup>140</sup> Between 2010 and 2014, the number of H-1B visas issued increased from 117,409 to 161,369. See DEP'T. OF STATE, *Nonimmigrant Visas Issued by Classification Fiscal Years 2010-2014*, tbl. XVI(B), available at <http://travel.state.gov/content/dam/visas/Statistics/AnnualReports/FY2014AnnualReport/FY14AnnualReport-TablXVIB.pdf>.

<sup>141</sup> Robert Lenzner, *40% of the Largest U.S. Companies Founded by Immigrants or Their Children*, FORBES, Apr. 25, 2013, available at <http://www.forbes.com/sites/robertlenzner/2013/04/25/40-largest-u-s-companies-founded-by-immigrants-or-their-children/>.

<sup>142</sup> Moreover, even Saverin's citizenship surrender occurred many years after he no longer was actively involved with Facebook, and thus had stopped contributing his skills to that company.

of foreign countries as well as U.S. states that rely on RBT, my intuition is that the number of citizens who would establish foreign residence under an RBT regime would be significantly greater (particularly when those who do so for transfer, rather than just income, tax purposes is considered).<sup>143</sup> Even Ruth Mason, who generally supports RBT, has acknowledged that “[c]itizenship is relatively inelastic. That is, taxpayers are less likely to give up their citizenship than their residence in order to save tax, so taxing them based on their citizenship will create fewer distortions than taxing them based on where they reside.”<sup>144</sup> While the absolute number of individuals who would establish foreign residence under an RBT might not be large relative to the entire population, given that many non-tax factors would influence the decision, the amount of lost revenue might be significant, given that those induced to change residence might be very high-income (or, in the case of transfer tax savings, very high net worth) individuals.

In addition to the greater quantitative impact of residence distortions under a RBT regime (compared to citizenship distortions under a CBT regime), a shift to RBT taxation of citizens might create significant qualitative concerns, particularly with respect to its effect on social cohesion. This concern is discussed in Part II.D, *infra*.

### C. Administrability

Several scholars suggest that administrative concerns are the most significant problem with citizenship-based taxation.<sup>145</sup> I, too, have previously noted that significant administrative concerns that can arise with CBT (as well as with RBT).<sup>146</sup> These concerns can arise in a number of contexts, as follows.

#### 1. Determining Who is a Relevant Taxpayer

The question of how to define the relevant taxpayer in the cross-border setting—*e.g.*, based on citizenship or based on residence—raises important compliance and enforcement issues. For most individuals, using citizenship as the touchstone establishes a bright line.<sup>147</sup> Presumably, most individuals living

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<sup>143</sup> See Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 200–05 (discussing the potential U.S. transfer tax savings under an RBT regime, which might be achieved through lifetime gifts, thereby negating the need to continue residing abroad until death). The greater likelihood of changing residence under an RBT regime than citizenship under a CBT regime is reinforced by the fact that residence can be changed while retaining citizenship, but in order to surrender citizenship an individual must generally also change residence (at least if she currently is living in the United States).

<sup>144</sup> Mason, *supra* note 8, at 159.

<sup>145</sup> See, *e.g.*, Blum & Singer, *supra* note 34, at 716; see also Avi-Yonah, *supra* note 38, at 394 (“administrability is perhaps the strongest argument for not taxing nonresident citizens”).

<sup>146</sup> See generally Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**

<sup>147</sup> See generally Zelinsky, *supra* note 32, at 1323–24. Even if the United States retains its citizenship-based test for citizens, a residence-based test will continue to apply to noncitizens, necessitating the

abroad know whether or not they are U.S. citizens. Accordingly, under a citizenship-based test, most individuals with foreign ties will easily be able to determine whether or not they are a U.S. taxpayer. Of course, this assumes that individuals living abroad are aware of the citizenship-based tax rules. As demonstrated by the recent FATCA and FBAR compliance initiatives, many citizens abroad (who know of their citizenship status) may not have known of the general treatment of citizens as taxpayers (and the related filing requirements).<sup>148</sup> This lack of knowledge, however, has likely decreased significantly over the past several years, given the broad publicity that FATCA has received among the overseas citizen community.<sup>149</sup>

The bright-line benefits of a citizenship would be less compelling with one subgroup of overseas citizens—the “unaware” or “unknowing” citizens who might not have knowledge of their U.S. citizenship status.<sup>150</sup> Given that this subgroup is relatively small compared to the total citizenship population (and, by definition, would not generally incur voluntary compliance costs associated with the self-assessment system), there does not appear to be a compelling reason to base the general taxpayer test on them. Rather, to the extent citizenship status may subsequently be discovered (either by the taxpayer or the IRS), special rules could be adopted to address their circumstances and provide appropriate relief. As discussed above,<sup>151</sup> such rules would need to include factors for determining whether the individual was actually an “unknowing” citizen, thereby adding some additional complexity for this subgroup.

In contrast to a citizenship-based test which, for most individuals, would provide a bright-line determination, a residence-based test introduces significant complexities to the threshold determination of taxpayer status. These complexities in determining an individual’s tax residence are problematic not only for purposes of ongoing compliance, but also because a change in residence can trigger significant immediate tax liability under the proposed RBT exit taxes.

As discussed above,<sup>152</sup> RBT proposals contain a broad range of possible tests for determining whether a citizen should be treated as a tax resident, including the use of the existing “substantial presence” test applicable to noncitizens (which applies a 3-year weighted day count, while excluding certain days and excepting some individuals with a subjective “closer connection” to

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continued application of that test by the IRS. *See* Mason, *supra* note 8, at 144. This article, however, focuses on proposals to change the treatment of citizens. Accordingly, any references in the text to the administrative benefits of a citizenship test (or administrative problems with a residence test) are confined to the benefits (or problems) associated with the tax treatment of citizens.

<sup>148</sup> *See id.* at 171 (“even FATCA’s critics acknowledge that one side effect is that many more citizens abroad have become aware of their U.S. tax and reporting obligations”).

<sup>149</sup> *See id.* at

<sup>150</sup> *See supra* notes 89–91 and accompanying text. The other special subgroups of citizens discussed above (*i.e.*, “accidental” or “nominal” citizens), while raising potential ability-to-pay concerns, do not raise these administrative concerns, as members of these subgroups generally know that they are citizens.

<sup>151</sup> *See supra* notes 92–98 and accompanying text.

<sup>152</sup> *See supra* notes 52–58 and accompanying text.

another country); the adoption of a subjective “bona fide” residence test; or the implantation of a multi-factor test, which might use citizenship as creating a rebuttable presumption (and look to a “white list” of countries where a citizen could reside without being subject to U.S. worldwide taxation), or look to the country where the individual has closer personal and economic connections.

Regardless of which of these residence tests is adopted, it will add more complexity to the threshold determination of whether a U.S. citizen is considered a U.S. taxpayer. For example, a number of these proposals rely on a subjective inquiry, such as the individual’s “bona fide residence” or place of closer connections. Prior to 1984, the United States applied a subjective “bona fide residence” test to noncitizens for purposes of determining their residence status. This subjective test, however, was abandoned because it “did not provide adequate guidance with respect to residence status” and “a more objective definition of residence” was needed.<sup>153</sup> Reintroducing this test, or similar tests that rely on subjective inquiries for the threshold jurisdictional determination, is likely to raise many of those same problems.

## 2. Compliance and Enforcement

Once the threshold question of “who” should be taxed is resolved, significant issues can arise regarding that person’s compliance and the IRS’ enforcement efforts. These concerns have plagued CBT since its adoption. After all, “[t]o the extent the tax on citizens living abroad cannot be enforced, the equity and efficiency concerns discussed above may be moot.”<sup>154</sup> More than a century ago Professor Edwin Seligman, who played an important role in the adoption of the modern income tax, observed that it might be “virtually impossible” to reach the foreign income of nonresident citizens.<sup>155</sup> Even to the extent that modern developments might allow for a more enforceable CBT regime, Dan Shaviro notes that the resulting compliance costs, if substantial, create deadweight losses that are objectionable (particularly given the underlying rationale for CBT that considers an overseas citizen to be one of “us”).<sup>156</sup>

I previously addressed in detail many of the enforcement concerns that arise under CBT and, while acknowledging their continued existence, suggested

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<sup>153</sup> STAFF OF JOINT COMM. ON TAX., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984, at 463–64 (Comm. Print 1984). A “bona fide resident” test exists under current law as one of the two possible ways to qualify for the foreign earned income exclusion. See I.R.C. § 911(d)(1)(A). However, due to “its vagueness[,] overseas citizens instead try to meet the 330-day alternative test, if possible, to qualify for the foreign earned income exclusion.” Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 175.

<sup>154</sup> Kirsch, *Taxing Citizens*, *supra* note 2, at 496.

<sup>155</sup> See EDWIN R.A. SELIGMAN, THE INCOME TAX: A STUDY OF THE HISTORY, THEORY OF INCOME TAXATION AT HOME AND ABROAD 517 (1914); see also Kirsch, *Taxing Citizens*, *supra* note 2, at 496 (acknowledging that “concerns about enforcement might provide the strongest argument against taxing the foreign source income of citizens residing abroad”).

<sup>156</sup> Shaviro, *supra* note 8, at [Draft 26].

that recent developments may “strengthen the potential for enforcing U.S. tax laws against overseas U.S. citizens.”<sup>157</sup> These developments include heightened enforcement initiatives, such as the prosecution of Swiss banks and bankers for conspiring to defraud the United States, thereby undermining tax-motivated bank secrecy;<sup>158</sup> heightened enforcement of FBAR reporting requirements regarding foreign bank and financial accounts;<sup>159</sup> and, perhaps most importantly, the Congressional enactment and IRS implementation of the FATCA regime, which indirectly enlists foreign financial institutions into reporting on foreign financial accounts held by U.S. persons (including U.S. citizens living overseas).<sup>160</sup> In conjunction with these increased enforcement efforts, the IRS has implemented several rounds of offshore voluntary disclosure programs in order to bring non-compliant individuals into the system.<sup>161</sup> Moreover, these U.S. developments have had a significant effect on global information sharing and cooperation norms, “strengthening the willingness of other countries to expand information sharing to combat cross-border tax evasion.”<sup>162</sup> While cross-border enforcement of the U.S. tax laws (particularly in the context of CBT) remains a significant concern, the prospects for its viability are significantly greater than they were at the time that Seligman made his pessimistic observation.

With respect to taxpayer compliance burdens, some recent developments have made things easier. For example, prior to the spread of the Internet, some overseas citizens faced significant hurdles obtaining even basic information about U.S. tax rules and access to required forms. The availability of forms and information on the Internet has addressed these basic concerns, at least for those overseas citizens with access to the Internet (although, as I have previously pointed out, the IRS should do a better job of organizing and disseminating this information in a consistent and usable manner).<sup>163</sup>

At the same time, other recent developments have imposed additional compliance costs, which have sometimes been significant, on overseas taxpayers. As I previously observed

[t]he recent expansion in overseas enforcement was not driven by concerns over citizens residing abroad. Rather, its focus is principally individuals living in the United States who are hiding income in foreign accounts. Nonetheless, in a citizenship-based taxing system, enforcement actions targeting foreign accounts will, by their very nature, disproportionately impact citizens living abroad. Whereas it might be relatively unusual for a citizen living

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<sup>157</sup> Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 141.

<sup>158</sup> *See id.* at 141–46.

<sup>159</sup> *See id.* at 146–48.

<sup>160</sup> *See id.* at 148–53.

<sup>161</sup> *See id.* at

<sup>162</sup> *Id.* at 158.

<sup>163</sup> *See id.* at 214.

in the United States to have signatory authority over a foreign bank account such authority is relatively routine for a citizen residing abroad.<sup>164</sup>

As a result, a citizen residing abroad and conducting routine local banking activity will be pulled into the FBAR reporting regime.<sup>165</sup> Similarly, she could be pulled into the PFIC regime merely by investing in a local mutual fund (which presumably would be organized in a foreign country), and might be pulled into the Controlled Foreign Corporation regime if she organizes a corporation in her residence country for routine business operations. Each of these regimes not only raises the possibility of additional U.S. tax liability but, perhaps as importantly, the specter of significant professional fees to ensure proper reporting compliance and the avoidance of potentially significant penalties.<sup>166</sup> Particularly given the communal ties-based rationale for treating overseas citizens as members of the U.S. community for ability-to-pay purposes, these additional and potentially unnecessary additional costs imposed on overseas citizens should be of concern. As Dan Shaviro noted, “insofar as we deem citizens living abroad still to be at least partially among “us” normatively, a bad ratio of [compliance cost-driven] deadweight loss to revenue raised is directly objectionable.”<sup>167</sup>

While these compliance cost concerns are real, many of them are not an inherent feature of a CBT regime. Rather, as I have previously observed, many of them are the result of Congress and the IRS, in their efforts to address abuses by U.S.-resident citizens holding foreign accounts, failing to carefully consider the unique circumstances faced by citizens abroad. For example, the FBAR, PFIC, and CFC rules, and their associated reporting and penalty provisions, generally fail to acknowledge that the types of foreign accounts and entities utilized by U.S.-resident citizens for potential tax avoidance or evasion (as well as legitimate) purposes, might be a part of routine business and investment activity for a citizen living in a foreign country.<sup>168</sup> The IRS has recently begun to take some steps to address the unique circumstances faced by overseas citizens under these regimes but, as I and others have argued elsewhere,<sup>169</sup> both Congress and the IRS must do more to simplify the reporting and other compliance burdens on overseas citizens, particularly those who present relatively low risk of tax

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<sup>164</sup> See *id.* at 161.

<sup>165</sup> See *id.* at 161–65.

<sup>166</sup> In addition, there have been reports that some foreign financial institutions have turned away U.S.-citizen clients due to concerns about FATCA reporting obligations. See *id.* at 166. However, as discussed elsewhere, this concern might be expected to decrease once FATCA has been fully implemented. See *id.* at 167–68.

<sup>167</sup> Shaviro, *supra* note 8, at [Draft p. 26].

<sup>168</sup> Of course, not all uses of foreign accounts and entities by overseas citizens are benign for tax purposes, so some compliance-related concerns about them are warranted.

<sup>169</sup> See, e.g., NATL’ TAXPAYER ADVOCATE, 2012 ANNUAL REPORT TO CONGRESS 262–80, <http://www.taxpayeradvocate.irs.gov/2012-Annual-Report/downloads/Volume-1.pdf> (listing “Challenges Persist for International Taxpayers as the IRS Moves Slowly to Address Their Needs” as one of the “Most Serious Problems” facing the IRS, and including a list of recommendations);

evasion.<sup>170</sup> Others have also suggested steps that Congress could take to lessen the compliance burdens under the existing CBT regime, such as Dan Shaviro's proposal to make the foreign earned income exclusion an "opt-out", rather an "opt-in" provision.<sup>171</sup>

While the elimination of CBT would eliminate some of the more problematic compliance burdens, it would not eliminate all compliance and enforcement costs in a cross-border context. Even under an RBT regime, the IRS would still need to enforce the tax laws with respect to U.S. residents with overseas accounts. Indeed, as mentioned above, FATCA was enacted primarily to address concerns about compliance by U.S.-resident citizens holding offshore financial assets. As long as the United States continues to tax the worldwide income (particularly financial income) of its residents (which all of the RBT-based proposals assume), some significant enforcement and compliance issues will remain (although admittedly to a more limited extent than under CBT).

### 3. Exit Taxes

The mark-to-market "exit taxes" of both the current CBT regime and the proposed RBT regimes create additional enforcement and compliance costs. As discussed above, under the current CBT regime, a U.S. citizen who surrenders her citizenship, and whose average income or net worth exceeds statutory thresholds,<sup>172</sup> is treated as if she sold her assets and must recognize any gain in excess of \$690,000.<sup>173</sup> This regime raises significant enforcement issues when a citizen surrenders citizenship. For example, the United States may have significant difficulties determining the extent of an individual's assets, particularly those held abroad,<sup>174</sup> and may have difficulty collecting the tax from an uncooperative taxpayer.

However, similar enforcement difficulties may arise if the United States adopts an RBT regime for citizens, given that the RBT proposals generally contemplate an exit tax when a citizen ceases to be a U.S. tax resident.<sup>175</sup> Indeed, an exit tax under an RBT regime might create greater aggregate enforcement and compliance burdens than the current CBT exit tax, "given that (unlike citizenship status, which is the triggering consideration under current law and which typically

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<sup>170</sup> See *id.* at 212–13 (describing elimination of FBAR-related penalties for certain low-risk citizens abroad, and increase in FATCA-related reporting thresholds for individuals residing abroad). See also *id.* at 213–14 (describing efforts of the National Taxpayer Advocate in this area).

<sup>171</sup> See Shaviro, *supra* note 8, at [Draft p. 17].

<sup>172</sup> In 2015, an individual generally is subject to this provision if her 5-year average annual net income tax liability is \$160,000, or her net worth is at least \$2 million. See I.R.C. §§ 877A(g)(1)(A) (cross-referencing 877(a)(2)); Rev. Proc. 2014-61, § 3.30. The provision also applies if the individual fails to certify under penalties of perjury that she has complied with her income tax obligations for the past five years. See I.R.C. § 877(a)(2)(C).

<sup>173</sup> See I.R.C. 877A(a)(1); Rev. Proc. 2014-61, § 3.31 (2015 inflation-adjusted exclusion amount).

<sup>174</sup> See generally William L. Dentino & Christine Manolakas, *The Exit Tax: A Move in the Right Direction*, 3 WM. & MARY BUS. L. REV. 341, 416-17 (2012).

<sup>175</sup> See *supra* notes 60–66 and accompanying text.



can be lost only once) residency status might change frequently, resulting in potentially repeated application of the exit tax to certain citizens.”<sup>176</sup> Moreover, to the extent that the test for tax residence under an RBT regime is based on subjective factors,<sup>177</sup> the triggering event itself for the exit tax might cause compliance and enforcement uncertainty.

#### *D. Social Cohesion – An Underappreciated Factor*

A significant, and often under-appreciated, concern raised by the abandonment of CBT (and replacement by some form of RBT for citizens) is its impact on social cohesion within the United States. As I have observed elsewhere,

the creation of a system where significant numbers of U.S. citizens (or even somewhat smaller numbers of athletes, entertainers, or other high-profile citizens) can voluntarily excuse themselves [from U.S. taxation] could further undermine the cohesion of American society, creating the perception that some citizens are exempt from a fundamental obligation of citizenship—the payment of taxes—while others are not.<sup>178</sup>

This concern is exacerbated because, the elimination of CBT would create significant incentives for high-income U.S. citizens, particularly those whose professional or personal lives allowed geographic flexibility,<sup>179</sup> to establish residence abroad. This income-tax driven incentive would be exacerbated if citizenship-based taxation were also eliminated with respect to the federal gift and estate tax. Indeed, as a practical matter, the transfer tax incentives for establishing foreign residence (in the absence of CBT) might significantly outweigh the income tax incentives.<sup>180</sup>

Concerns about tax-driven changes in residence in the absence of CBT are not merely conjecture. Other countries that rely on RBT often experience significant numbers of their high-income citizens establishing residence in a foreign country for tax purposes.<sup>181</sup> For example, media reports cite examples of

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<sup>176</sup> Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 137.

<sup>177</sup> *See supra* notes 51–59 and accompanying text.

<sup>178</sup> Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 196.

<sup>179</sup> *See id.* at 189–90 (discussing the personal and professional factors that might influence a decision to establish foreign residence in the absence of CBT).

<sup>180</sup> *See id.* at 200–05 (discussing the often underappreciated role of the estate tax in the citizenship-based taxation discussion).

<sup>181</sup> *See generally id.* at 190–91; *see also id.* at 191–94 (discussing the somewhat, although not identically, analogous situation of high-income and high-wealth individuals changing U.S. *state* residence for tax purposes).

high-income entertainers, businessmen, and athletes from the United Kingdom, France, and Germany establishing tax residence in tax havens such as Monaco, Andorra, Liechtenstein and the Channel Islands in order to avoid their home countries' residence-based taxation regimes (while still maintaining the nationality of their home country).<sup>182</sup> Moreover, recent reports suggest that tens of thousands of high-income (but lower profile) French and German nationals have established foreign tax residence for these reasons.<sup>183</sup> A number of tax havens exist, such as Monaco, Andorra, Liechtenstein and the Channel Islands, that cater to high-income nationals of other countries and that might welcome high-income U.S. citizens if the United States repeals its CBT regime.<sup>184</sup> Moreover, a number of countries that are not generally viewed as low-tax countries might have favorable regimes that would attract high income U.S. citizens. For example, the United Kingdom's non-domiciliary regime could allow U.K.-resident U.S. citizens to avoid tax on the bulk of their non-U.K. income.<sup>185</sup> Even proposed changes that would place a fifteen-year limit on an individual's use of the U.K. regime would still provide a significant amount of time for individuals to enjoy tax advantages—for example, a wealthy U.S. citizen (in the absence of CBT) could establish non-domiciliary residence in the U.K. long enough to not only enjoy some income tax advantages, but also, perhaps more importantly, to make substantial gifts that would escape the U.S. transfer tax regime.<sup>186</sup> Of course, it is not unreasonable to assume that other countries might attempt to create favorable tax regimes for U.S. citizens once such individuals are “in play” if CBT is repealed.

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<sup>182</sup> See *id.* (discussing the Rolling Stones, Pink Floyd, David Bowie, and Richard Branson).

<sup>183</sup> See *id.* at 190 n.331. The sensitivity of high-income and high-wealth individuals to residence-based taxation has been highlighted more recently during debate over the United Kingdom's proposal to tighten its non-domiciliary tax regime. Under this regime, in exchange for a relatively nominal annual fee, individuals residing in the United Kingdom are not taxed on the foreign income that they do not remit to the U.K. George Osborne, the U.K. Chancellor of the Exchequer, recently proposed that this non-domiciliary regime be eliminated for long-term residents (*i.e.*, those who have lived in the U.K. for more than fifteen of the past twenty years), and also for those who were born in the U.K. to British parents. See Juliette Garside, *Permanent Non-Dom Tax Status to be Abolished, Chancellor Announces*, *The Guardian*, July 8, 2015, available at <http://www.theguardian.com/uk-news/2015/jul/08/non-dom-tax-status-abolished-individuals-born-uk-budget-george-osborne>. In response to this proposal, tax professionals warned that there could be an “exodus of the foreign billionaires whose names now dominate the lists of Britain's wealthiest residents.” *Id.* According to one accountant, “these [billionaires] will probably cease to be UK citizens once they pass 15 years. It's unlikely they are going to volunteer to pay UK tax on their global income. They may retain UK homes and send their children to school here but they themselves will have to spend a reduced numbers of days in the UK.” *Id.* This example, however, is not directly analogous to the U.S. situation, as the high-wealth individuals expected to abandon U.K. residence under the proposal are primarily non-U.K. nationals and, therefore, might not have as strong a connection to the country as U.S. citizens have to the United States.

<sup>184</sup> See Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 190 n.331.

<sup>185</sup> See note 183, *supra*.

<sup>186</sup> See generally Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note **Error! Bookmark not defined.**, at 200–05 (discussing significant opportunities to escape U.S. estate and gift taxes in the absence of CBT). The U.S. estate tax could also be avoided for non-U.S. property if the individual dies while residing abroad. However, given the availability of lifetime gifts, it is possible that the individual could make U.S.-tax-free gifts during the relatively brief period residing abroad and then return to the United States, particularly if the United States repeals I.R.C. § 2801, as some opponents of CBT have suggested. See *supra* at 202–05 (discussing the limited impact that proposed anti-abuse provisions would have in preventing this problem).

To the extent that the repeal of CBT results in significant numbers of U.S. citizens living abroad and not paying U.S. (or potentially any) income or transfer tax, regardless of whether those individuals live abroad for non-tax reasons or were induced to move abroad for tax reasons, there could be significant impacts on U.S. society. First, “if a significant number of high-income individuals did so (or even a smaller number of extremely high-income individuals did so), there could be some direct revenue impact.”<sup>187</sup> More importantly, such circumstances could have a troublesome impact on social cohesion in the United States. It is likely that there would be widespread news reports of wealthy U.S. citizens residing abroad and escaping U.S. taxation, just as there has been widespread coverage of U.S. domestic corporations engaging in inversion transactions to escape U.S. taxation.<sup>188</sup> As I previously observed, this publicity might lead those citizens living in the United States to “conclude that citizens abroad are ‘getting away with something,’”<sup>189</sup> which might lead not only to a loss of confidence in the tax system (and the social norm of tax compliance), but more importantly might lead U.S. citizens to lose confidence in the U.S. social and political system. After all, it would create the appearance of two classes of citizenship—one for the extremely wealthy who could remain U.S. citizens and yet not pay their perceived “fair share” to support the country, and one for everyone else who continued to financially support the country. Such a result is often alluded to in those countries that rely on RBT and, consequently, have periodic news reports of high-income individuals establishing foreign tax residence to avoid paying taxes. It should be noted that such a reaction would also reinforce the ability-to-pay justification discussed above, by demonstrating that, at least from the perspective of citizens remaining in the United States, citizens living abroad remain part of the larger community that is expected to support the country financially.

It could be argued that, if social cohesion concerns were a significant concern, they already would have arisen under the current CBT regime, given that the foreign earned income exclusion and foreign tax credit allow many U.S. citizens living abroad to pay no (or reduced) U.S. income taxes. However, two distinguishing considerations may explain why there are only limited social cohesion concerns with the existing regime. First (and of lesser importance), the extent to which a particular person may not be paying (or is paying a reduced amount of) U.S. taxes due to the foreign earned income exclusion or foreign tax credit may not be evident to the public. After all, individual tax returns are not disclosed, so the public (and media) have no way of knowing the extent to which a particular individual invoked these provisions.<sup>190</sup> In contrast, as illustrated by the European examples discussed above, under an RBT regime the media is likely to learn of high-income (or high wealth) U.S. citizens who move abroad, and is

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<sup>187</sup> *See id.* at 195.

<sup>188</sup> *See id.* As with the inversion phenomenon, such news reports are likely to lead to calls for congressional hearings on the matter. *See id.* at 196.

<sup>189</sup> *See Kirsch, Taxing Citizens, supra* note 2, at 502.

<sup>190</sup> By itself, of course, an argument that “the public wouldn’t know about it” is not a strong justification for an otherwise objectionable tax policy.

likely to infer, merely based on the foreign residence, that they will no longer be paying U.S. taxes.

Second (and more importantly), even to the extent the public currently is aware of individuals utilizing the foreign tax credit and foreign earned income exclusion, they might not have strong visceral objections. My intuition is that most resident-citizens understand (or could be made to understand if it became part of a larger debate) that a U.S. citizen living abroad will face tax obligations in more than one country. Thus, the public might understand, at least on a general level, that the foreign tax credit serves as a rough-justice way to split taxing jurisdiction. While the U.S. public might not understand (or care) about the details of that splitting—e.g., the foreign tax credit limitations—their understanding would probably be sufficient to prevent any reduced U.S. taxation from implicating social cohesion concerns. While the foreign earned income exclusion might not be justified under the same double-taxation-related arguments (especially if the citizen resides in a no- or low-tax country), it too would probably not raise significant social cohesion concerns even if the domestic public were aware of it. In particular, the amounts involved are capped, and thus would not raise the specter of abusive individuals moving abroad merely to obtain (relatively) limited U.S. tax savings. In contrast, under an RBT regime, citizens with millions of dollars of income (and millions or billions of dollars of wealth) moving abroad (particularly to a location identified in the press as a potential tax haven) are much more likely to raise public concerns about abuse.

#### *E. Is There Something Exceptional about American Exceptionalism*

Some critics of CBT suggest that the United States' outlier status may be an independent justification to move to an RBT regime.<sup>191</sup> For example, Bernard Schneider asks “[w]hat is the justification for U.S. exceptionalism on this point? Why should political allegiance to the United States be any more demanding and costly than to any other country?”<sup>192</sup> Similarly, Reuven Avi-Yonah asks “[i]f the other democracies do not impose worldwide taxation on their nonresident citizens because of the benefits they provide, it is unclear why we should exact such a high price for our benefits.”<sup>193</sup>

Several considerations suggest that concerns about American exceptionalism in this context do not, of themselves, justify the abandonment of CBT. As noted above,<sup>194</sup> despite the formal difference between the United States and other countries, the substantive gap between the United States' treatment of citizens' foreign income and other countries treatment may be narrowing.<sup>195</sup> In

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<sup>191</sup> See generally Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note 6, at 206–10.

<sup>192</sup> Schneider, *supra* note 42, at 51.

<sup>193</sup> Avi-Yonah, *supra* note 38, at 392.

<sup>194</sup> See *supra* notes 11–12 and accompanying text.

<sup>195</sup> See also Shaviro, *supra* note 12, at [Draft p. 17] (“the United States could reasonably viewed as not in substance a dramatic outlier”).

addition, as I have previously observed, “[c]ountries implement tax policies based on a broad range of considerations, including cultural, political, historical, institutional, and economic factors.”<sup>196</sup> These considerations might explain and justify a country adopting a tax provision that differs from other countries.

Accordingly, “the United States’ (partial) outlier status is relevant only to the extent it creates problems whose costs (in connection with other potential problems raised by citizenship-based taxation) outweigh the benefits.” In other words, exceptionalism is a relevant factor not of itself, but only to the extent it creates potential problems. For example, it might undermine harmonization among countries’ tax regimes. However, “this would hardly be the only area in which countries take different approaches.” Even other countries that have RBT regimes “do not use a uniform definition of tax residence, thereby creating the possibility that an individual could be treated as a tax resident of two or more countries.”<sup>197</sup> Having rejected this and similar concerns elsewhere,<sup>198</sup> there do not appear to be significant problems uniquely generated by the United States’ formal reliance on citizenship that justify treating its outlier status as an independent normative consideration. Moreover, while other countries may sometimes express concern with the United States’ use of CBT, the regime does not appear to be so far outside the international norms that it creates significant practical problems for relations with the United States.<sup>199</sup>

Ruth Mason generally agrees that the “uniqueness of U.S. citizenship taxation is not enough to condemn it. Jurisdictional conflicts may be an acceptable cost of arriving at the right tax policy” (although she concludes that CBT is bad policy).<sup>200</sup> She then raises an interesting question at the opposite end of the spectrum—what if, instead of the United States remaining an outlier, a significant number of countries adopted CBT. She suggests that it might lead to absurd and unworkable results.<sup>201</sup> My inclination is that the results would not be as dire as she suggests. First, a significant number of countries might not be willing to adopt CBT. As noted above, countries base their tax policies on a broad range of considerations, and these non-tax policy considerations might weigh against CBT. For many countries—particularly countries that, unlike the United States, have a long history of citizens emigrating—cultural norms might view a citizen as having an important right to move abroad and not remain fettered by continuing obligations to that “home” country.

More importantly, unlike the demand for retaining U.S. citizenship, which Ruth Mason acknowledges is relatively inelastic,<sup>202</sup> the demand for some other

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<sup>196</sup> Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note 6, at 206.

<sup>197</sup> Kirsch, *Revisiting the Tax Treatment of Citizens Abroad*, *supra* note 6, at 207.

<sup>198</sup> *See id.* at 206–10.

<sup>199</sup> Indeed, all United States income tax treaties include a saving clause that generally allows the United States to exercise its citizenship-based taxing rights notwithstanding the treaty.

<sup>200</sup> Mason, *supra* note 8, at 170.

<sup>201</sup> *See id.* at 171.

<sup>202</sup> *See id.* at 159.

countries' citizenship may be relatively elastic. For at least some countries, if a citizenship-based tax was imposed on nonresident citizens, some of those citizens might choose to surrender citizenship rather than pay the tax. Of course, such a decision would depend on other non-tax factors, including whether or not the individual had citizenship in another country (a necessary condition before surrendering home country citizenship), whether the individual intends to eventually return to the home country, and the existence of any other consequences for abandoning citizenship.

In addition, a foreign country might not enact CBT because of the significant enforcement problems it raises. Indeed, the Philippines previously abandoned CBT largely because of enforcement difficulties.<sup>203</sup> Even the United States, which might have as broad an enforcement reach as any country, has difficulties in this regard. While the United States might be able to improve enforcement with efforts such as FATCA, many other countries would not be in a position to attempt a similar approach.

Accordingly, it is unlikely that CBT will gain widespread adoption. Nonetheless, it is certainly possible that a number of countries could adopt it. This expansion would, admittedly, create some administrative complications, as it would increase the number of jurisdictions claiming the right to impose worldwide taxation. Of course, this would only be expanding a problem that already exists to some extent, given that countries have different, and sometimes overlapping, definitions of resident. We currently deal with this problem in the context of multiple residents through tax treaties, which contain tie-breaker provisions to assign residence to a single country. If the number of countries ultimately adopting CBT were relatively modest (as I expect it would be), the problem of overlapping citizenship and residence jurisdiction could be dealt with similarly by treaty. Admittedly, it is possible (although I think unlikely) that a sufficient number of countries could adopt CBT to make the treaty resolution unworkable. If that were the case, I suppose it would create a significant argument against CBT. However, as things currently exist (and I expect are likely to remain) this argument seems to be outweighed by the other justifications in favor of CBT.

### III. BALANCING THE COMPETING VALUES

The preceding Part illustrates that the CBT vs. RBT debate raises a number of sometimes-competing normative values. As with most tax policy debates, there is no meta-principle that automatically elevates one of these competing values above the others, thereby dictating a single correct answer.<sup>204</sup>

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<sup>203</sup> See Kirsch, *Taxing Citizens in a Global Economy*, *supra* note 2, at 496 (describing Philippines abandonment of CBT in 1997).

<sup>204</sup> Cf. Steven J. Burton, *Normative Legal Theories: The Case for Pluralism and Balancing*, 98 Iowa L. Rev. 552 (2013).

Instead, the “best” approach depends on the extent to which each value is implicated (in either a positive or negative way), and one’s views of the relative importance of each value in this context. For the following reasons, I believe that, on the whole, the normative case for taxing the foreign source income (and foreign situs transfers) of citizens using CBT principles outweighs the normative case for taxing that income (and those transfers) using RBT principles. This Part first summarizes the key normative strengths and weaknesses of each approach (discussed in greater detail in Part II), and then considers the relative importance of these factors.

Given that citizenship creates a strong communal tie to the United States, even for most citizens living abroad, ability-to-pay principles support the use of CBT (even though the current CBT system does not implement a pure form of these principles). These communal ties are implicitly acknowledged even by RBT proponents, to the extent they would impose greater potential tax burdens on nonresident citizens than on nonresident noncitizens. Admittedly, ability-to-pay arguments grounded in communal ties have less traction in the case of certain groups of overseas citizens (in particular, unknowing or unaware citizens, and, to a lesser extent, accidental or nominal citizens). However, as discussed above, rather than using the concerns faced by these groups as justification to eliminate all CBT, the concerns raised for these groups could be addressed with objective and enforceable exceptions, targeted to their particular circumstances.

Competing efficiency-based arguments focus on different margins. CBT raises concerns regarding both citizenship neutrality and immigration neutrality, while RBT raises concerns regarding residence neutrality. As discussed above, the experience of the last decade suggests that citizenship neutrality concerns, while real, are relatively limited in magnitude. Even with the recent spike in citizenship renunciations, the absolute numbers (just under 3,500 in 2014, and a similar rate through the first half of 2015) are relatively small compared to the total number of U.S. citizens.<sup>205</sup> Moreover, these numbers might be expected to taper off once those citizens with the most tenuous subjective connections to the United States have done so in reaction to the implementation of the FATCA regime, and may also decrease if the IRS takes additional steps to ease the compliance burdens experienced by overseas citizens.<sup>206</sup> As for the immigration neutrality concerns associated with CBT, for the reasons discussed above I believe that they are of only limited practical concern.<sup>207</sup> In particular, the many non-tax related factors that influence a potential highly skilled immigrant’s decision to enter the United States (and subsequently naturalize) seem to outweigh (both in theory and practice) the *ex ante* concerns, if any, the individual may have about the future U.S. taxation of foreign source income if the individual were eventually to return to her home country.

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<sup>205</sup> See *supra* notes 112–113 and accompanying text.

<sup>206</sup> See *supra* notes 114–115 and accompanying text.

<sup>207</sup> See *supra* notes 138–142 and accompanying text.

In contrast, the impact of RBT on residence neutrality may be significant. The experience of foreign countries and U.S. states that rely on RBT suggests that high income individuals (and, perhaps more importantly, high wealth individuals who are concerned about transfer taxes) may be willing to relocate if the potential tax savings are high enough. The magnitude of residence changes under RBT is likely to be greater than the magnitude of citizenship losses under CBT, given that an individual can establish residence outside the United States without surrendering citizenship, while an individual can only surrender citizenship if she has a residence outside the United States.<sup>208</sup>

As (or perhaps more) important than the magnitude of tax-driven residence changes under an RBT regime, such changes might cause significant social cohesion-related concerns if they result in a permanent class of wealthy U.S. citizens living abroad and openly not paying taxes (yet entering the United States periodically, potentially for relatively long stretches of time under some proposed residence tests). As discussed above, such concerns might not only implicate tax compliance (*e.g.*, undermine voluntary compliance by domestic citizens who perceive that overseas citizens are “getting away with something”), but more importantly might generate broader domestic social problems by reinforcing concerns that wealthy citizens receive more favorable treatment than the rest of society.

Administrative concerns exist with respect to both CBT and RBT. Regarding the threshold question of who is taxed, a CBT regime creates a relatively bright line, given that most (although not all) citizens abroad are aware of their citizenship status, whereas RBT proposals may require more complicated inquiries, particularly if residence tests include subjective standards in order to prevent potential abuses. With respect to compliance and enforcement concerns, an RBT regime may impose greater complexities with respect to the exit tax associated with a change in residence (given that the definition of resident is less clear than the definition of citizen, and residence changes are more likely to occur than citizenship losses). However, once a citizen resides outside the country, an RBT regime is likely to involve significantly lower enforcement and compliance costs, given that the nonresident citizen generally will not be subject to ongoing U.S. tax (other than on U.S. source income). While recent developments—most notably, the implementation of FATCA and changes in international information sharing norms—might make enforcement more viable under a CBT regime, these developments have imposed significant compliance burdens on overseas citizens. As discussed above, these compliance costs are likely to be reduced to a reasonably acceptable level only to the extent the IRS (and Congress) make a greater effort to consider the unique compliance circumstances faced by overseas citizens, particularly with respect to reporting requirements that originally were

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<sup>208</sup> This observation may not be as strong during the current spike in citizenship renunciations to the extent that a number of the recent citizenship losses may have involved individuals who already resided abroad and had relatively tenuous connections to the United States.



crafted to address potential concerns about resident citizens holding foreign accounts.

Ultimately, the case for CBT may depend on the ability of the IRS (and Congress) to craft reasonably acceptable compliance rules for overseas citizens. As the foregoing summary suggests, the other normative values—ability-to-pay principles, efficiency concerns, and, perhaps most importantly, social cohesion principles—tend to favor CBT over RBT. Despite the weight of these considerations, a compliance regime that does not consider the unique circumstances of overseas citizens, imposes substantial compliance costs, and raises the possibility of significant penalties even for non-intentional reporting failures, undermines the otherwise-strong case for CBT. Addressing these compliance concerns not only will reduce the compliance-cost advantage that a RBT regime would otherwise have over CBT, but would also reduce efficiency concerns to the extent that at least some citizens at the margin might otherwise decide to surrender citizenship rather than incurring the potentially significant compliance costs.

While this Article has focused on the binary choice of CBT versus RBT for taxing (or not taxing) the foreign income of nonresident citizens, it is important to acknowledge that there are other possibilities. For example, Ayelet Shachar, in an informal discussion at a recent symposium,<sup>209</sup> asked whether an intermediate approach might be used, under which citizens residing abroad would continue to be taxed, but their tax rate would be reduced if they remained abroad for an extended period. For example, once a citizen resides abroad for 10 years, she might have to pay only 50% of the U.S. tax that would otherwise be owed, and after 20 years she might have to pay only 25% of the otherwise applicable tax. Perhaps the strongest justification for such an approach relates to ability-to-pay principles. It could be argued that the longer a citizen resides abroad, the more tenuous are her communal ties to the United States. The phasedown in tax liability might serve as a (somewhat arbitrary) proxy for that diminishing connection, consistent with Dan Shaviro's observation that "we are inclined to care somewhat less about our own people when they are abroad for extended periods."<sup>210</sup> To the extent it reduces an individual's tax liability, this proposal might also be supported by citizenship neutrality concerns because it decreases the tax cost of retaining citizenship (although, as discussed above, the number of tax-induced citizenship losses is already relatively limited, so the number of individuals whose decision ultimately would have turned on the marginal difference between full taxation and 50% or 25%-of-normal taxation may be extremely limited).

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<sup>209</sup> This possibility was raised by Ayelet Shachar during a question and answer period at the Tax Citizenship and Income Shifting Symposium in London, England, in May 2015.

<sup>210</sup> Shaviro, *supra* note 8, at [Draft p. 23]. It might also serve as a rough proxy for the reduction in some direct benefits received by a citizen abroad, although many important benefits of citizenship—in particular, the right to enter and move to the United States at any time—would remain in full as long as citizenship was retained.

Despite these potential arguments for a time-based phasedown of CBT, such an approach would not be supported by other normative considerations. For example, the administrative costs of enforcement and compliance would remain, given that the same general CBT compliance structure presumably would remain. Indeed, the compliance costs might be viewed as more problematic under the phasedown approach, given that the decreased tax revenue would increase the ratio of compliance costs to revenue raised.<sup>211</sup> The phasedown approach might also raise residence neutrality concerns (compared to full CBT), as it would create potential incentives for high-income citizens to move abroad. Such incentives, however, would not be as great as those raised by RBT, as the phasedown approach would not yield U.S. tax benefits until the partial taxation percentages kicked in (*e.g.*, 10 years) and, unlike RBT, the phasedown approach would not completely eliminate U.S. tax.

Perhaps the most significant concern, yet the most difficult to predict, relates to a phasedown approach's effect on social cohesion. In particular, would the domestic community view reduced taxation on (potentially high-income) citizens living abroad as legitimate (*e.g.*, similar to the potential sympathy for the foreign tax credit discussed above),<sup>212</sup> or would they view it as an illegitimate loophole for the wealthy? Perhaps it might depend on the extent to which high-profile, high-income individuals were identified as being eligible for this regime. My (admittedly uncertain) inclination is that significant social cohesion concerns might arise under this approach (although not as bad as those under an RBT regime). To the extent most U.S. citizens probably view citizenship as a binary status (you either are or you are not a U.S. citizen), they would view citizens living abroad as part of the citizenship community (obligated to support it) regardless of the amount of time spent abroad. Accordingly, they would object to a tax regime that enacted gradations of citizenship. If this inclination is true, a phasedown approach would raise many of the same social cohesion-related objections as RBT.

## CONCLUSION

The various academic articles on citizenship-based taxation over the past several years have highlighted the numerous, sometimes conflicting arguments for citizenship-based or residence-based taxation. For the reasons detailed above—in particular, concerns about residence neutrality under RBT and the resulting social cohesion concerns—a strong case exists for the United States to retain citizenship-based taxation, provided that the IRS and Congress address the significant compliance concerns faced by citizens abroad.

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<sup>211</sup> *Cf. id.* at [Draft p.26] (noting the importance of the ratio of compliance cost deadweight loss to revenue raised).

<sup>212</sup> *See supra* note 190 and accompanying text.

It should be noted, however, that just as there is no single tax policy that is necessarily best for all countries at a given time,<sup>213</sup> there is no single tax policy that is necessarily best for a given country over time. As a country's cultural, political, historical, institutional, and economic circumstances change, so too might its tax policies. The conclusions in this Article are based on how the relevant normative considerations currently apply, and how they might be expected to apply in the foreseeable future. If, however, these considerations change—for example, there is a significant change in the elasticity of demand for U.S. citizenship, how citizens abroad or citizenship more generally is viewed, or how effective FATCA and other compliance initiatives are—the relative balance might change. But until such time, if ever, there does not appear to be a convincing case to eliminate CBT in favor of RBT for the foreign income of U.S. citizens.

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<sup>213</sup> See *supra* note 196 and accompanying text.