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

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

PRESENTED
BY
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I. INTRODUCTION

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

I will provide a summary of the findings of the Joint Committee study on this matter, describe the pending proposals, and discuss the revenue estimates with respect to these proposals.

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

In the course of analyzing the expatriation proposals, the Joint Committee staff reached the following findings and conclusions in its June 1, 1995, report:

- Since 1980, an average of 781 U.S. citizens expatriated each year. Although there is some anecdotal evidence that a small number of U.S. citizens may be expatriating for tax avoidance purposes, the Joint Committee staff found no evidence that the problem is either widespread or growing.

- The study identified certain problems with the present-law expatriation provisions. Specifically, there are legal methods to avoid some or all taxation under the current law provisions.

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

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

    - Second, a number of practical problems are raised by the Administration proposal to tax unrealized gains upon expatriation. These issues may be summarized as (1) identifying the owner of the interest in property -- identity problems, (2) raising sufficient funds from the interests in property to pay the tax -- liquidity problems, and (3) valuing the interests in property -- valuation problems. These problems are often related -- something that makes it difficult to determine who owns an interest in property often makes that interest very illiquid, which, in turn, may make valuing the interest more difficult. These problems are especially difficult in the case of interests held through trusts because expatriating beneficiaries would be subject to a tax liability determined by reference to the unrealized appreciation in

value of the trust's assets notwithstanding the fact that the beneficiary has no access to the assets of the trust. This particular aspect of the proposal raises potential constitutional issues at least under certain circumstances. Moreover, under certain circumstances, the tax might inappropriately interfere with the right to expatriate which is recognized by U.S. and international law and could result in substantial double and triple taxation possibilities.

- Third, the Administration proposal may retroactively impose tax on former U.S. citizens who lost their U.S. citizenship years ago. It is unclear whether the U. S. would have any legal basis for attempting to collect tax in such a case since the individual has lost all rights and responsibilities of U.S. citizenship many years earlier.

- Finally, enactment of the Administration proposal may create an incentive to expatriate which does not exist under current law for individuals who either have recently inherited wealth or who expect to inherit wealth in the near future.

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

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

In general

Under the Administration proposal, individuals who expatriate would be treated as having sold all of their property at fair market value immediately prior to expatriation. Gain or loss from the deemed sale would be recognized at that time.

The Administration proposal also changes the date as of which an individual ceases being subject to the worldwide tax system of the United States, which under current law coincides with the date that an individual is treated as losing their U.S. citizenship for all other purposes. The Administration proposal would generally treat an individual as ceasing to be subject to the worldwide tax system only when the loss of citizenship by the individual is confirmed by an action of a U.S. governmental entity, for example, through the issuance of a certificate of loss of nationality by the State Department. As a result, individuals could be subject to the U.S. worldwide tax system for a substantial period of time following the event by which they have lost their U.S. citizenship for all other purposes. This aspect of the proposal could have substantial retroactive effect.

Effective date

The Administration proposal would be generally effective for U.S. citizens who obtain a CLN on or after February 6, 1995, regardless of when the individual actually lost his or her U.S.

citizenship, and for long-term residents who terminate their U.S. residency on or after February 6, 1995.

B. Senate Amendment to H.R. 831

The Senate amendment to H.R. 831 modified the Administration proposal in several ways. First, it applied the expatriation tax only to U.S. citizens who relinquish their U.S. citizenship, not to long-term resident aliens who terminate their U.S. residency. Second, it modified the date when an expatriating citizen is treated as relinquishing U.S. citizenship, such that most expatriating citizens are treated as relinquishing their citizenship at the time a CLN is applied for rather than when the CLN is issued as under the Administration bill. The result of this change in the effective date was to exempt at least 183 individuals from the potential effects of the legislation as compared to the effective date of the Administration proposal.

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

Senator Moynihan introduced S. 700 on April 6, 1995. Congressman Gibbons has introduced an identical bill. These bills make several changes to the Administration proposal as incorporated in the Senate amendment to H.R. 831 as follows:

First, the modified bills would apply the tax on expatriation to "long-term residents" who terminate their residency in a manner similar to the provision in the Administration proposal.

Second, a nonresident alien individual who becomes a citizen or resident of the U.S. would be required to utilize a fair market value basis, rather than an historical cost basis, in determining any subsequent gain or loss on the disposition of any property held on the date the individual became a U.S. citizen or resident. The fair market value basis would apply for all purposes of computing gain or loss on actual or deemed dispositions not just for purposes of the tax on expatriation.

Third, the modified bills would allow an expatriating individual to irrevocably elect, on an asset-by-asset basis, to continue to be taxed as a U.S. citizen with respect to such assets.

Fourth, tax on expatriation would not apply to an individual who relinquishes U.S. citizenship before attaining the age of 18-1/2 years, if the individual lived in the United States for less than five taxable years before the date of relinquishment.

Effective date

The effective dates of the modified bills generally are identical to the effective date of the Senate amendment.

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

In general

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

Effective date

The expatriation tax provisions of H.R. 1812 generally would apply to any individual who loses U.S. citizenship on or after February 6, 1995, and any long-term residents whose U.S. residency is terminated on or after June 13, 1995. For citizens, the determination of the date of loss of citizenship would remain the same as under present law.

IV. REVENUE ESTIMATES AND ESTIMATING METHODOLOGY

Estimates of the proposals

Administration proposal

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

Fiscal Years
[Billions of Dollars]

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

* Gain of less than $50 million.

Senate amendment to H.R. 831

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

Fiscal Years
[Billions of Dollars]

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

* Gain of less than $50 million.

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

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

Fiscal Years
[Billions of Dollars]

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

* Gain of less than $50 million.

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

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

Fiscal Years
[Billions of Dollars]

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

* Gain of less than $50 million.

Variations between Joint Committee on Taxation estimates and Treasury Department estimates

I would now like to discuss our revenue analysis of the pending proposals. One principle guiding the Joint Committee staff revenue estimates with respect to the expatriation proposals is that potential expatriates tend to each have relatively unique profiles. A second principle is that an individual who desires to sever direct economic ties to the U.S. would be able to circumvent all of the expatriation proposals advanced to date. The final principle is that there will be no enforcement of present law section 877 in the current budget baseline.

There are significant disparities between the revenue estimates of the proposals by the Joint Committee and the Treasury Department. We have been able to identify several differences between the Joint Committee and Treasury Department analysis. Those are as follows:

- First, we believe that our assessment of the scope of the expatriation problem is somewhat smaller than that which has been assumed by the Treasury Department.

- Second, our early analysis of the expatriation proposals assumed that expatriating individuals incurred no U.S. tax liability following the act of expatriation. As a result of our study, we have concluded that expatriating individuals in certain circumstances continue to incur U.S. tax liabilities. We believe that the Treasury Department may assume that expatriating individuals incur little or no U.S. tax following the act of expatriation.

- Third, the Joint Committee did not account for estate tax effects of any of the proposals because of the lack of reliable data on expatriate wealth, the inaccuracy inherent in applying general mortality tables to a small group of expatriates, and the complexity of forecasting the outcomes of estate settlements. It is the understanding of the Joint Committee staff that the estimates made by the Treasury Department do incorporate changes in estate and gift tax receipts.

- Fourth, we believe that the analysis of the Treasury Department of H.R. 1812 does not adequately take into account the various items of income which would be

subject to tax under H.R. 1812 that would not be reached by either the Administration proposal or the other pending proposals. The categories of income which would be taxed only under H.R. 1812 include all income from U.S. property for the ten year period after expatriation which the expatriate owned at the time of expatriation and all future acquired U.S. property for the same ten year period.

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

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

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

Under the Administration proposal, a former U.S. citizen would be subject to the estate tax provisions for expatriates only if tax avoidance was a principal purpose for the individual's loss of citizenship. Under the Ways and Means Committee bill, former wealthy citizens generally would be subject to the estate tax provisions for expatriates without regard to their motive for expatriating. Accordingly, a wealthy expatriate who transfers all of his or her assets to a foreign corporation he or she controls and who dies within ten years of expatriation generally would pay no estate tax under the Administration proposal but generally would be subject to the estate tax under the Ways and Means Committee bill.

I will be happy to answer any questions.