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## Tax Symposium: Introduction

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## **SPECIAL FEATURE TAX SYMPOSIUM**

### **INTRODUCTION**

*Reuven S. Avi-Yonah\**

This issue of MJIL features four out of the many outstanding papers that were presented at a conference on Taxation and Citizenship held at Michigan Law in October 2015 and co-organized by Allison Christians and myself. The impetus for the conference was the realization that the unique U.S. practice of taxing its citizens on worldwide income, regardless of where they reside, has become a major flashpoint in the relationship between the United States and its citizens living overseas, and sometimes also between the United States and the country those citizens resided in.

The U.S. rule dates back to the income tax enacted during the Civil War, but until recently has aroused relatively little controversy for the simple reason that it was generally not enforced on U.S. citizens living permanently overseas and lacking a U.S. passport.<sup>1</sup> Temporary expatriates were subject to the rule, but a combination of the U.S. foreign tax credit and section 911 of the Internal Revenue Code (IRC) (exempting approximately the first \$100,000 of earned income of expatriates from tax) meant that most of them had no U.S. tax liability. Permanent expatriates could generally avoid the rule if they did not need a U.S. passport.

This benign neglect changed with the enactment of the Foreign Accounts Tax Compliance Act of 2010 (FATCA).<sup>2</sup> Under FATCA, foreign financial institutions were required to report accounts held by U.S. citizens directly to the Internal Revenue Services (IRS), or in some cases indirectly to the IRS via their local jurisdiction. A financial institution that neglected its FATCA requirements was subject to a 30% withholding tax on its own U.S. source income.

The object of FATCA was to address situations like UBS in which the Swiss Bank actively sought out rich Americans living in the United States and aided and abetted their tax evasion by setting up shell corporations for them in tax havens and then routing any income from U.S. and foreign investments to those shell corporations while claiming that it had no obligation to report the true identity of the beneficial owners of the income to the IRS.<sup>3</sup> FATCA effectively prevents such behavior by subjecting banks

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1. See generally Reuven S. Avi-Yonah, *The Case Against Taxing Citizens*, 58 TAX NOTES INT'L 389 (2010).

2. I.R.C. §§ 1471-1474 (2010).

3. See Reuven S. Avi-Yonah, *What Goes Around Comes Around: Why the US is Responsible for Capital Flight (and What It Can Do About It)* (Univ. of Mich. Pub. Law Re-

like UBS (which has a massive presence in the United States) to drastic penalties if it does not reveal the true identity of its account holders to Switzerland, which is then obligated to reveal it to the IRS.

FATCA was never intended to apply to U.S. citizens living permanently overseas. However, no exception was included in the legislation. As a result, permanent expatriates found themselves for the first time required by their local bank to file tax returns and Report of Foreign Bank and Financial Accounts (FBAR) disclosures. Many were subject to interest and penalties for many years of noncompliance. In some cases, these expatriates were not even aware that they were U.S. citizens (having been born in the United States and left it at a very young age).

Predictably, this led to massive complaints, as well as a wave of U.S. citizens relinquishing their citizenship. The situation was exacerbated by the different conceptions of privacy in different countries. In the United States, Americans are used to not having financial privacy vis a vis the IRS, since their banks and brokers routinely report their income to the IRS. No such tradition exists in many other countries where financial information is generally regarded as private from the government. FATCA has been compared in some quarters to the type of NSA surveillance revealed by Edward Snowden.

In this context, this volume of MJIL includes four articles that discuss the current situation from a variety of perspectives. Peter Spiro's article "Citizenship Overreach and the U.S. Tax Regime" addresses the question from an international law of citizenship perspective. Spiro argues that the benefits of U.S. citizenship, while significant, "will not be worth anything close to the cost of complying with the new overseas tax regime" as enhanced by FATCA. Spiro "examines international law limitations on the ascription of citizenship in light of the FATCA experience." He points out that while "[t]he United States is exceptionally generous in its extension of citizenship", "U.S. citizenship is sticky at the back. Termination of citizenship on the individual's part can involve substantial fees. Expatriation is contingent on tax compliance, and in some cases will implicate the recognition of capital gains. There are substantial barriers to expatriation. In other words, it is possible to get stuck in a citizenship one never wanted in the first place. In light of the continuing obligations of U.S. citizenship, is it possible that the U.S. birthright citizenship and expatriation regimes violate international norms?"

Spiro argues:

They may. Even in the context of extremely relaxed historical constraints on state nationality practice, there were acknowledged 19th century limitations on the extension of citizenship to individuals with insufficient connection to a state – citizenship overclaiming, as it were. Naturalization has been understood to have a volitional predicate, that is, citizenship acquired after birth cannot

be forced on an individual against her will. Citizenship on the basis of territorial birth has always been accepted as a legitimate basis for extending citizenship even though it involves no choice on the part of the individual to whom citizenship is ascribed. That may reflect received notions of common law, even feudal, approaches to nationality, and the assumption that most people lived out their lives in the countries in which they were born. That no longer comports with a world in which mobility has reached unprecedented levels. There is a greater probability than ever before that a person's birthplace will not coincide with the place in which she makes her life. The same can be said of citizenship by descent, through which citizenship can pass automatically on the basis of tenuous social membership ties. The mismatch between citizenship and actual community draws birthright citizenship into question, at least where citizenship obligations follow an individual regardless of place of residence.

Spiro argues that “[t]he history suggests at least a provisional individual right to expatriate.” He then applies these background norms to current U.S. practice. Spiro contends that “[a]bsolute birthright citizenship and automatic *jus sanguinis* citizenship may now be problematic from a rights perspective to the extent the regime allocates citizenship to individuals with no social attachment to the United States, associates substantial obligations with external citizenship, and maintains high barriers to expatriation.”

Spiro then develops possible solutions. From a citizenship law perspective, these include opt-in and opt-out mechanisms for birthright citizenship. But, he argues, “[t]he better solution may lie in frictionless exit for those with nominal ties to the national community. Though reform is more likely to be accomplished through the tax regime, the moment highlights the over-inclusiveness of U.S. citizenship, which may undermine its utility as a platform for redistribution.” He therefore proposes abolishing citizenship-based taxation in favor of residence-based taxation, as practiced by every other country in the world.

Allison Christians focuses her critique more specifically on FATCA. She describes how, across the globe banks are flagging accounts with indicia indicating their owners may be “U.S. Persons”, making it possible for the United States to enforce its taxation of nonresident citizens extraterritorially for the first time in history. Christians argues that the indicia method constitutes a mining expedition for U.S. citizens carried out by foreign banks and governments. In her opinion, establishing a tax jurisdiction in this manner is unprecedented and has significant practical and normative consequences. In the case of so-called “accidental Americans,” it violates one of the most fundamental and universally-acknowledged tenets of taxpayer rights, namely, the right to be informed about what the law requires. Christians maintains that third party indicia-searching should be universally rejected as a means of identifying a taxpayer population. Instead, she argues, the United States itself must be responsible for catalog-

ing, informing, and educating its global population of taxpayers, and those who don't belong in the system should be allowed to opt out without cost.

Wei Cui approaches the question from a broad international tax perspective. The debate about citizenship taxation, he argues, raises questions about the meaning of the concepts of "residence" and "source" as the defining elements of jurisdiction to tax. He argues that many economists and legal scholars claim that the traditional conceptual and policy framework for international taxation is defunct. The examples they offer most often to support such claims are failures of residence- or source-based taxation to achieve a variety of normative objectives. Cui suggests that there is a very different way of seeing why international taxation has become intellectually controversial. In his opinion, the key problem is not that the globalization of economic activities makes the traditional policy tools outdated; instead, it is that scholars and policymakers have more frequent occasions to disagree about the normative goals of international taxation. Thus, he claims, most current controversies (including the one about FATCA and citizenship taxation) are actually about the articulation of ends and not the adequacy of means. To illustrate this perspective, this article offers a minimalist account of the meanings of the concepts of source and residence. The account, Cui argues, successfully deflects most skeptical arguments about residence and source and shows that the purported inadequacy of the two concepts are consequences, not causes, of inadequate normative criteria for the design of international income taxation. The article also offers a novel analysis illustrating the inadequacy of the principle of avoiding double taxation: by ignoring the economic incidence of tax, devices purportedly mitigating double taxation in fact produce double non-taxation.

Finally, Ed Zelinsky offers a defense of the U.S. practice of citizenship-based taxation. He argues that the states' income tax systems are important repositories of experience that confirm the administrative benefits of citizenship-based taxation. According to Zelinsky, domicile today plays an important role in state tax systems as a gap-filler when more objective statutory residence laws fail to assign any state of residence to the taxpayer. Citizenship, in his opinion, is an administrable proxy for domicile and serves a similar gap-filling role in the federal taxation of individuals whose income and activities straddle national boundaries. The states' difficulties enforcing domicile-based taxation highlight the administrative benefits of citizenship-based taxation. In Zelinsky's opinion, as long as residence is understood for tax purposes in terms of domicile, citizenship is an efficient proxy for such domicile. The states' experience defining residence supports the United States' citizenship-based approach to federal income taxation. Under the Internal Revenue Code, citizenship serves as an administrable proxy for domicile and fulfills the same gap-filling function played by domicile under the states' income taxes.

Overall, these four articles give a good introduction to the current state of the debate. We would like to thank MJIL for publishing them, and

we hope that this volume will be a useful resource to those who want to learn more about both sides of this issue and potential legislative changes.<sup>4</sup>

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4. Revision of the current U.S. tax regime for citizens living overseas may be included in the forthcoming tax reform proposed by the U.S. House Republican majority. See A BETTER WAY, OUR VISION FOR A CONFIDENT AMERICA: TAX 29 (June 24, 2016), [https://abetterway.speaker.gov/\\_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf](https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf) (“In addition to these important reforms that will create a modern international tax system for businesses, the Committee on Ways and Means will consider the appropriate treatment of individuals living and working abroad in today’s globally integrated economy.”).