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by Helen S. Cheng and Dina Y. Nam

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SPECIAL REPORT

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In this report, Cheng and Nam discuss the expatriation tax regime and propose changes that could help the IRS implement and enforce section 877A.

This report is one in a series of proposals sponsored by the California Bar Association and presented to various policymakers and government officials. However, the comments in it reflect the individual views of the authors and not the position of the State Bar of California or the Los Angeles County Bar Association.

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I. Executive Summary

Section 877A sets forth the current expatriation tax regime for U.S. citizens and long-term residents who relinquish their U.S. citizenship or terminate their long-term U.S. residency status. Although individuals expatriate for different reasons, some of which could be construed as tax-motivated, the purpose of section 877A is to provide an objective system for collecting what is colloquially called an "exit tax" for those wanting to cut ties with the United States.

The current regime imposes a one-time tax liability on expatriating individuals who meet specific income, asset, or reporting requirements. These individuals, who are considered "covered expatriates" under the law, are subject to a mark-to-market tax when they relinquish their citizenship or long-term residency status. In effect, a covered expatriate is treated as having sold all his worldwide assets as of the date of expatriation and is subject to tax on the deemed gain. Further, any gift or bequest from the covered expatriate to a U.S. person is considered a "covered" gift or bequest, and the U.S. transferee must pay transfer tax on this covered gift or bequest at the highest gift or estate tax marginal rate.

There are major challenges in implementing and enforcing the provisions of section 877A because the expatriating individual is required to affirmatively file a Form 8854, "Initial and Annual Expatriation Statement," and fully disclose worldwide assets. If an expatriating individual does not comply with this requirement, the IRS might not even know about the expatriation. Even if it were aware, enforcement is nearly impossible once the expatriate leaves the United States. This report offers proposals to enhance the implementation and enforcement of section 877A, including methods for putting individuals on notice of the requirements under section 877A; coordinating communication between Treasury, the State Department, and the Department of Homeland Security; and providing for continued jurisdiction over expatriating individuals even after they renounce their U.S. citizenship or terminate their long-term U.S.-residency status.

II. Introduction

Section 877A sets forth the current expatriation tax regime for U.S. citizens and long-term residents who plan to expatriate, applying an exit tax to persons deemed to be covered expatriates under the law.

For U.S. tax purposes, an expatriate generally includes U.S. citizens who renounce their citizenship and U.S. long-term residents who have terminated their permanent resident status in the United States. An expatriate who is a "covered expatriate" is subject to an exit tax in which all of her assets are deemed to have been sold for fair market value as of the date of expatriation. Further, any gift or bequest from the covered expatriate to a U.S. person is considered a "covered" gift or bequest, and the U.S. transferee must pay transfer taxes on this covered gift or bequest at the highest gift or estate tax marginal rate.

A "covered expatriate" is defined as (1) an expatriate who has a five-year average net income tax liability of more than $124,000, as indexed for inflation ($162,000 as of 2017); (2) an expatriate who has a net worth of $2 million or more at the time of expatriation; or (3) an expatriate who fails to certify under penalty of perjury that he has not met the tax or net worth thresholds described above or fails to submit evidence of compliance.[1] Form 8854 is the required evidence of compliance, and if an individual fails to file that form, he will automatically be considered a covered expatriate regardless of his asset base or net income tax liability.[2]

Despite multiple attempts over the past decades to apply an income tax on expatriating individuals, the implementation and enforcement of an expatriation tax, including the most recent iteration under section 877A, remains problematic. First, significant communication gaps create challenges both in providing proper notice to expatriating individuals of section 877A requirements and in sharing information on expatriating individuals among governmental agencies. Second, under the section 877A mark-to-market regime, if the individual is considered a covered expatriate, either because of the income tax or asset tests or because she did not file Form 8854, it is almost impossible for the IRS to enforce the exit tax.

We believe that effective implementation and enforcement of the section 877A exit tax cannot occur until it is a priority among government agencies. However, small administrative or legislative changes could provide incremental change.

III. Brief History of the Expatriation Tax

A. Pre-2004 Law

1. Legislative history.

The basic infrastructure of the modern U.S. tax regime was created after 1913, after ratification of the 16th Amendment gave Congress the power to levy and collect taxes on income, from whatever source derived. The 16th Amendment also paved the way for the United States to subject U.S. citizens to income tax reporting and liability on their worldwide income regardless of their country of residency. Thus, the only way for a U.S. citizen to avoid being subject to the income tax regime is to give up her citizenship.

[1] Sections 877(a)(2) and 877A(g)(1)(A).

[2] Notice 2009-85, 2009-45 IRB 598.

There has been a long history of individuals expatriating to avoid U.S. tax liability, and although the legislature has recognized an individual's right to leave the United States, it has also sought to ensure that it can collect its share of taxes from those expatriates. "The Congress does not believe that the Internal Revenue Code should be used to stop U.S. citizens and residents from relinquishing citizenship or terminating residency; however, the Congress also does not believe that the Code should provide a tax incentive for doing so. In other words, to the extent possible, an individual's decision to relinquish citizenship or terminate residency should be tax neutral."[3]

The tension brought about by linking U.S. income tax to citizenship increased in 1966 when Congress passed the Foreign Investors Tax Act, in which some interest payments that were taxable to U.S. citizens became tax-free for nonresident non-U.S. citizens. In that same year, Congress enacted the first iteration of tax rules targeting expatriating individuals. In that first round of expatriation taxes, U.S. citizens who relinquished their citizenship, and whose "primary motive" was tax avoidance, were subject to special tax rules for the 10-year period following expatriation (referred to as the "alternative tax regime"). In practical terms, however, it was difficult and cumbersome to demonstrate the intent of tax avoidance, and the IRS was often unaware of the expatriating act. Then-commissioner of the IRS Margaret Milner Richardson said the alternative tax regime required monitoring an expatriate's activities for 10 years to ensure compliance but that such monitoring was difficult because it "required the cooperation of taxpayers who no longer lived in the United States and who generally are no longer otherwise subject to U.S. law."[4]

In 1995, the issue again came to the forefront when several wealthy U.S. citizens elected to give up their citizenship to avoid the long arm of the U.S. income tax regime.[5] Congress responded by providing that when any individual had a net worth of at least $500,000, or had an average income tax in the five years before expatriation exceeding $100,000, the assumption was that tax avoidance was the principal motivation for expatriation. The new law expanded the definition of expatriating individuals included in the alternative tax regime to long-term resident aliens defined as "lawful permanent residents" (otherwise known as green card holders) and required the IRS to publish a list of ex-citizens in the *Federal Register*, effectively serving as a form of public shaming.

2. Enforcement issues.

A 2003 Joint Committee on Taxation report stated that several fundamental problems undermined the ability of the IRS to effectively implement the expatriation regime.[6] It concluded, "There is little or no enforcement of the special tax and immigration rules applicable to tax-motivated citizenship relinquishment and residency termination,"[7] and the IRS made "no attempt to monitor and enforce" the alternative tax regime.[8]

a. Identifying expatriates potentially subject to alternative tax regime.

An obvious but critical first step in enforcing the alternative tax regime was to identify those individuals who relinquish citizenship or long-term residency and thus might be subject to the alternative tax regime. The IRS relied on the expatriating individuals themselves or other government agencies to supply this information.[9] "In many cases, the necessary information was not always being supplied by the former citizen or former long-term resident or requested by the appropriate agencies responsible for providing such information to the IRS."[10]

The most common method to identify an expatriating individual is when he renounces U.S. citizenship. In such instances, a Certificate of Loss

[3] Joint Committee on Taxation, "General Explanation of Tax Legislation Enacted in the 110th Congress," JCS-1-09 (Mar. 2009).

[4] JCT, "Appendix G of JCT Report on Tax Treatment of Expatriation; JCT-Administration Correspondence," JCS-17-95 (June 1, 1995).

[5] *See, e.g.*, Karen de Witt, "Some of Rich Find a Passport Lost Is a Fortune Gained," *The New York Times*, Apr. 12, 1995.

[6] JCT, "Review of the Present-Law Tax and Immigration Treatment of Relinquishment of Citizenship and Termination of Long-Term Residency," JCS-2-03 (Feb. 2003).

[7] *Id.* at 5.

[8] *Id.* at 6.

[9] *Id.* at 85.

[10] *Id.*

of Nationality (CLN) was issued to the State Department, which would then forward a copy to the Treasury secretary.[11] According to the IRS, no monitoring or compliance efforts were made regarding these individuals, perhaps because the information required in the CLN contains little information required to enforce the alterative tax regime, including the Social Security number of the expatriating individuals.[12] Further, not all U.S. citizens obtained a CLN when they relinquished their citizenship.

Even more, the CLN database did not apply to long-term residents who were giving up long-term residency status in the United States. Although the Immigration and Naturalization Service provided information to the IRS identifying whether a permanent resident's status had been revoked, the IRS did not use that information, which in part might have been because the information did not distinguish former long-term residents from other green card holders and was, therefore, not a useful identification tool.[13]

b. Determining whether expatriating act is tax motivated.

The second step in the enforcement process was to determine whether the expatriating individual was doing so for tax-motivated reasons. Although this determination was primarily based on the monetary thresholds in section 877, the IRS also permitted some individuals wishing to avoid such treatment to submit their request via a private letter ruling process to obtain a favorable ruling that their expatriation was not for tax reasons.

Even then, if the information was provided, the IRS still had to make a factual determination whether the primary purpose of the expatriation was tax avoidance. The IRS's ruling practice was recognized as subjective and difficult to implement.[14] Despite having this process in place, the IRS did not have any "special procedures in place to further investigate" if the expatriating individual was issued an unfavorable ruling, therefore giving the private letter ruling process very little enforcement teeth.[15]

c. Monitoring, assessing, and collecting under the alternative tax regime.

Even if an expatriate was determined to be subject to the alternative tax regime, the final step in the alternative tax regime enforcement required continued monitoring of former citizens and long-term residents. An expatriated individual was required to file a Form 1040NR annually for 10 years following the year of expatriation if a tax liability existed. Form 1040NR further required the expatriated individual to include all items of U.S.- and foreign-sourced gross income. Moreover, the estates of such individuals were subject to this alternate tax regime if they died within the 10-year monitoring period and were generally required to file Form 706 or Form 706-NA if they were subject to U.S. gift or estate tax.

However, problems continued to mount because the IRS did not have any "special procedures for monitoring former citizens' or former long-term residents' tax compliance during the 10-year period."[16] The 2003 JCT report implicitly recognized that enforcement efforts could be further hindered by a lack of coordination between the IRS and the various governmental departments involved in the immigration process.[17]

B. 2004 Legislative Change

Congress responded to the 2003 JCT report by creating an objective rule that any person who met the income or asset test would be subject to the 10-year alternative tax regime. It also tried to bridge the information gap by stating that any individual who renounced citizenship or long-term residency for immigration purposes would be considered a U.S. person until she informed the IRS using Form 8854.

The second provision was intended to provide the IRS with a way to obtain information on expatriating individuals and provide additional

[11] *Id.* at 86.

[12] *Id.* at 86-87.

[13] *Id.* at 91.

[14] *Id.* at 93.

[15] *Id.* at 94.

[16] *Id.* at 96.

[17] *Id.* at 100.

enforcement authority. Regardless of when an individual expatriated with notification to the secretaries of State or Homeland Security, she would be treated as a U.S. person for tax purposes until she notified the IRS. Even if the person was no longer resident in the United States and did not file returns, the IRS could still file substitute income tax returns on that person's behalf and enforce the taxes through liens on any U.S. situs assets.[18]

IV. Current Law

In 2008 Congress overhauled the alternative tax regime and enacted the Heroes Earnings Assistance and Relief Tax (HEART) Act of 2008. The HEART Act created a simple and objective rule for the taxation of some covered expats under the newly created section 877A.

The section 877A expatriation tax applies to U.S. citizens and long-term residents.[19] Long-term residents include noncitizens who have been lawful permanent residents for at least eight of the last 15 tax years, ending with the tax year that includes the expatriation date.[20] These expatriating individuals will be deemed covered expatriates if they meet any of the following criteria[21]:

1. the average annual net income tax of the individual for the last five tax years ending before the date of expatriation is greater than $124,000, as adjusted for inflation ($162,000 for 2017) (the income tax test);
2. the net worth of the individual is $2 million or more as of the date of expatriation (the asset test); or
3. the individual fails to certify under penalty of perjury that he has complied with all federal tax obligations for the preceding five tax years or fails to submit such evidence of compliance as the IRS may require (the compliance test); certification must be made on Form 8854 and must be filed by the due date of the taxpayer's federal income tax return for the tax year that includes the day before the expatriation date.[22]

Some individuals are exempted from the income tax test and the asset test, but not from the compliance test. The first exception applies to an individual who was born a dual citizen of the United States and another country, if, as of the expatriation date, the individual continues to be a citizen of the other country; and the individual has been a resident of the United States under the substantial presence test for no more than 10 of the last 15 tax years.[23] The second exception applies to a U.S. citizen who relinquishes citizenship before reaching age 18½ and has been a resident of the United States under the substantial presence test for no more than 10 tax years before such relinquishment.[24]

Section 877A effectively implemented what is called a mark-to-market tax on covered expatriates. In other words, covered expatriates are subject to income tax on the net unrealized gain on their worldwide assets as if the assets had been sold for fair market value on the day before the date of expatriation. Any net gain on the deemed sale is generally reduced by $600,000, adjusted for inflation ($699,000 in 2017), to determine the amount that would be includable in the gross income of a covered expatriate.[25] The mark-to-market tax applies to most assets, with special rules for deferred compensation items, tax-deferred accounts, and interests in nongrantor trusts.[26]

Any gift or bequest that exceeds the annual exclusion amount ($14,000 for 2017) from a covered expatriate to a U.S. citizen or resident is considered covered, and the U.S. transferee is subject to transfer tax at the highest gift or estate tax marginal rate.[27]

[18] Former section 7701(n), repealed in 2008.

[19] Section 877A(g)(2).

[20] Section 877A(g)(2) and (5).

[21] Sections 877(a)(2) and 877A(g)(1)(A).

[22] Notice 2009-85.

[23] Section 877A(g)(1)(B)(i). Under the substantial presence test, an individual is generally considered to be a U.S. resident for income tax purposes if he is physically present in the United States for at least 31 days during the calendar year and satisfies a physical presence test under the three-year lookback rule. Section 7701(b)(3)(A).

[24] Section 877A(g)(1)(B)(ii).

[25] Section 877A(a)(3).

[26] Section 877A(c).

[27] Section 2801(a).

Under section 877A, the date of expatriation is pegged to the date that the individual relinquishes citizenship or long-term residency for immigration purposes, rather than the date that the individual notifies the IRS that she is expatriating.

On one hand, these new rules are relatively easy to understand and straightforward. They are objective rules that provide for a one-time, mark-to-market tax, resulting in a step-up in basis for the assets. Moreover, this expatriation tax is similar to that imposed on the transfer of assets from a U.S. person to a foreign trust under section 684, and it is arguably similar to the estate tax. In turn, the United States gets its share of the taxes it would have received had the covered expatriate continued to be a U.S. person until her death.

However, problems remain in implementation and enforcement.

V. Gaps in Knowledge and Communication

A. Lack of Knowledge by Individual

A primary problem with the practical application of section 877A is the informational gaps in the reporting process. Under section 877A, every expatriating individual must file Form 8854 to avoid becoming a covered expatriate even if he does not meet the income tax test or the asset test. However, many individuals do not know that they are required to file Form 8854 and simply leave the United States without filing in compliance with the law. For example, neither the Homeland Security Form I-407, "Record of Abandonment of Lawful Permanent Resident Status," nor its accompanying instructions state that an individual giving up long-term permanent resident status must complete Form 8854. Likewise, the State Department's forms DS-4080 and DS-4081 regarding the relinquishment or renunciation of U.S. citizenship do not state that the expatriating individual must complete Form 8854 to avoid being classified as a "covered expatriate" under section 877A. Similarly, the officials who oversee the expatriation process might not know about or inform the expatriate of this requirement. This causes many individuals to become covered expatriates, even though they are well below the income tax or net asset thresholds.

B. Lack of Knowledge by the IRS

If an expatriating individual does not file Form 8854, the IRS would likely never know. There are no set methods of communication between the State Department, Department of Homeland Security, and Treasury to ensure compliance with filing Form 8854. Further, the information that is provided to the IRS is not necessarily relevant to the application of section 877A. For instance, although the IRS may receive some information about expatriating permanent residents, it has no automatic process in place to determine whether those individuals are long-term or short-term residents.

If an expatriating individual files Form 8854, the IRS has no ability to ensure the accuracy of the form. Generally, the IRS ensures accurate income tax reporting and filing by its citizens and residents by requiring that all U.S. employers and financial institutions issue to the payee and the IRS consistent informational statements, such as a W-2 or 1099. The IRS can then compare these amounts with those reported by the payee to ensure consistent and accurate reporting. In this situation, however, there are few to no parallel reporting requirements for expatriating individuals: Even if an expatriating individual files Form 8854, the IRS has no way to confirm what is stated on the return.

C. Limited Enforcement Remedies

Section 877A places an affirmative reporting obligation on the expatriating individual to supply the IRS with Form 8854. This form requests information regarding the expatriating individual's worldwide assets and income tax liabilities for the last five years. However, if an expatriating individual fails to file Form 8854, thus becoming a covered expatriate, the IRS would have almost no ability to determine the covered expatriate's assets located outside the United States. Further, Form 8854 is not due until the individual expatriates. Thus, if the individual does not file the form, it is likely that the IRS will not even learn about the citizenship relinquishment or residency termination until after the individual has physically left the country. Because the expatriating individual has already left the country, it is unclear whether the IRS could effectively claim personal jurisdiction over that individual.

In those instances in which an expatriating individual files Form 8854, the IRS might want to challenge some items on the return, such as the ownership or valuation of the assets listed. Again, however, because the expatriating individual has already left the country, it is unclear whether the IRS can effectively claim personal jurisdiction over that individual.

Even assuming the IRS could determine with specificity the worldwide assets owned by the covered expatriate, there are additional problems with enforcement once physical separation has occurred. Further, even if assets were located offshore, the IRS might have to initiate an original action in a foreign court to enforce the taxes. The challenge is that international laws may limit the IRS's ability to litigate abroad to enforce U.S. tax laws in a foreign jurisdiction. This enforcement issue is exacerbated when the expatriating individual has minimal contacts or assets that remain onshore. For example, even if the IRS can identify noncompliant expatriating individuals, it may not have the ability to collect any owed taxes from an uncooperative taxpayer whose assets are offshore.[28] Although there may be treaties that aid in IRS enforcement, generally foreign governments lack any incentive to aid enforcement of U.S. tax laws that serve only to benefit the U.S. government.

As stated succinctly in the 2003 JCT report, which analyzed the possibility of a mark-to-market tax, "Enforcement of the tax may not be successful."[29]

VI. Effective Information Gathering

Below we describe some processes and procedures that could help the IRS more effectively implement and enforce the provisions of section 877A.

A. Coordinate the Expatriation Forms

The simplest solution would be to make small changes to the official documents that are used during the expatriation process for both the renunciation of U.S. citizenship and the abandonment of lawful permanent resident status.

The simplicity of the change is that expatriation documents already exist, namely, the various forms expatriating individuals must complete to give up their citizenship or permanent resident status. In each case, the proposed change is that all of the documents should contain an allegation that the individual has filed Form 8854 (along with proof of submission) and that he allows and consents to Treasury maintaining jurisdiction over him solely regarding compliance with section 877A, Form 8854, and related taxes.

As an example, Form I-407, used to abandon permanent resident status, could be modified so that a box is added to check off that Form 8854 has been submitted to the IRS. As a belt and suspenders approach, the form could also contain another provision requesting that the expatriating individual consent to personal jurisdiction for a period of five years following expatriating for the limited purpose of determining compliance with the expatriation tax regime. There are minimal due process concerns with personal jurisdiction as it is well established that consent to jurisdiction does not offend due process.[30]

We believe this change would result in greater communication and integration between the immigration and tax authorities and would provide Treasury with a clearer method of informing all parties involved of the tax requirements associated with expatriation. It would also provide notice to the expatriating individual of the Form 8854 filing requirement, thus shifting more of the burden of administration and reporting to the expatriating individual.

Further, many individuals who meet the income tax or asset test are able to expatriate without filing Form 8854 because Treasury is unable to assert jurisdiction over them once they

[28] The IRS may request help from its treaty partners under the Exchange of Information and Administrative Assistance Article of an applicable income tax treaty. *See* Treasury, "United States Model Income Tax Convention of November 15, 2006," at art. 26 (2006).

[29] 2003 JCT report, *supra* note 6, at 198.

[30] *See, e.g., Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 472 n.14 (1985).

leave the United States — to ensure compliance with the filing of Form 8854 or to enforce any taxes owed. Changes to the expatriation forms would not only provide a path for ensuring compliance with filing Form 8854 but also increase Treasury's ability to enforce payment of these bona fide taxes, thus raising revenue.

An IRS official, however, has stated that Treasury has tried to collaborate with the other agencies regarding the expatriation issue, with little success. Thus, it is possible that legislative change would be required to permit greater coordination and information sharing between the agencies that oversee expatriation and tax enforcement.

B. Coordination Between Agencies

There is a concern that the IRS lacks statutory authority or jurisdiction over immigration officials overseeing the expatriation process and therefore has no power to coordinate with them regarding the expatriation process. Specifically, title 26 of the Code of Federal Regulations states: "The Internal Revenue Service is a bureau of the Department of the Treasury under the immediate direction of the Commissioner of Internal Revenue. The Commissioner has general superintendence of the assessment and collection of all taxes imposed by any law providing internal revenue. The Internal Revenue Service is the agency by which these functions are performed." On the other hand, immigration and the expatriation process are generally within the province of the Department of Homeland Security and the State Department, depending on whether the individual is a citizen. Thus, it is possible that Congress would need to legislate the coordination of the expatriation process among agencies because, absent such mandate, the powers of each department are limited.

The legislature has tried to coordinate intergovernmental agency cooperation in the past. For example, the Reed Amendment was enacted as part of the Illegal Immigration Reform and Immigrant Responsibility Act of 1996.[31] The Reed Amendment empowers the attorney general to declare inadmissible to the United States former "citizens who renounced citizenship to avoid taxation."[32]

Section 7345 is another relatively new example of legislative coordination between the IRS and the State Department. Specifically, section 7345 provides that if the secretary "receives certification by the Commissioner of Internal Revenue that an individual has a seriously delinquent tax debt, the Secretary shall transmit such certification to the Secretary of State for action with respect to denial, revocation, or limitation of a passport pursuant to section 32101 of the FAST Act." "Seriously delinquent tax debt" is further defined as "an unpaid, legally enforceable Federal tax liability of an individual" which has been assessed and which is greater than $50,000.[33] Although this section 7345 applies solely to U.S. citizens, the directive is clear that if there are serious tax deficiencies as defined by statute, the IRS and State Department can take coordinated action.

It is clear that the expatriation process, by its nature, involves different branches of the government — one overseeing tax compliance and another overseeing physical separation. The legislature could direct the State Department, the Department of Homeland Security, and the Department of Treasury to work together to unify and coordinate the expatriation process. For example, the IRS could be given the authority to work with the State Department and Department of Homeland Security on preparing the forms an expatriated individual will use to expatriate. Further, the IRS could be given specific statutory authority to disclose to the State Department and Department of Homeland Security whether the expatriated individual has filed a Form 8854 or other qualifying information in compliance with section 877A. In other words, the IRS's ability to disclose taxpayer information would be solely for making that determination, so it would not conflict with the statutory restrictions preventing disclosure of return information.

[31] 8 U.S.C. section 1182(a)(10)(E).

[32] *Id.* ("Former citizens who renounced citizenship to avoid taxation. Any alien who is a former citizen of the United States who officially renounces United States citizenship and who is determined by the Attorney General to have renounced United States citizenship for the purpose of avoiding taxation by the United States is inadmissible.")

[33] Section 7345(b)(1)(A) and (B).

Moreover, because expatriating individuals will first interface with officials at the State Department or Department of Homeland Security (depending on whether the individual is a U.S. citizen or a long-term resident) before expatriation can become official, the IRC could be amended to provide that until those officials received a "tax clearance certificate" or other certification from the IRS, the expatriating individual is deemed not to have renounced U.S. citizenship or long-term residence status. This certification would effectively say that tax liabilities under section 877A has been satisfied; that the expatriating individual has made arrangements to pay or defer such payment as permitted under the law; or he is not a "covered expatriate" under the law because he does not meet the asset or income tests.

In fact, the IRS already has a procedure for nonresident aliens departing the United States to obtain a tax clearance certificate before departure that could be used as a template for the proposed expatriation tax clearance certificate.[34] In this way, the IRS can more effectively capture those who would have already cut ties with the United States by having their expatriation paperwork completed without having their tax liabilities cleared. For example, in section 877A(g)(4), regarding the definition and timing of relinquishment of U.S. citizenship, a provision could be added that a citizen is treated as relinquishing his U.S. citizenship "on the earliest of" having obtained a tax clearance certificate from the Internal Revenue Service and "(A) the date the individual renounces his United States nationality before a diplomatic or consular officer of the United States pursuant to paragraph (5) of section 349(a) of the Immigration and Nationality Act (8 U.S.C. 1481(a)(5))." Each corresponding subsection regarding relinquishment of citizenship, as well as those in the relinquishment of long-term residency status, would be subject to this same condition.

The tax clearance certificate would give expatriating individuals an incentive to coordinate their expatriation with the IRS because, without it, they would not be defined as having relinquished their citizenship or residence status for tax purposes. This would also give the IRS the opportunity to review assets, challenge valuations, and settle disputes before the individual's physical separation from the United States.

C. Revise the Date of Expatriation

Under the current regime, an individual is considered to have expatriated as of the date that the individual relinquished citizenship or long-term residency for immigration purposes. This is problematic from an enforcement perspective because once the individual has expatriated for immigration purposes, he is no longer subject to the U.S. income tax regime, even if he has not informed the IRS or filed Form 8854.

Congress may consider legislation that would prohibit an individual from expatriating for immigration purposes until the individual has filed Form 8854. Alternatively, Congress may consider re-enacting a prior provision of the expatriation act, under which, regardless of whether an individual renounces citizenship or long-term residency for immigration purposes, he would continue to be considered a U.S. person until he informed the IRS of the expatriating act using Form 8854.

The small legislative change described above would have strong enforcement consequences because an expatriating individual would be treated as a U.S. person for tax purposes until Form 8854 was filed. Even if she no longer resided in the United States and did not file returns, the IRS could still file substitute income tax returns on her behalf and enforce the taxes through liens on any U.S. situs assets.

VII. Anticipated Consequences

The themes of notice of the section 877A requirements and the gathering of sufficient information from the expatriating individuals appear to be at the core of the problems surrounding the implementation and enforcement of section 877A. If these changes can successfully be implemented, it could result in the exclusion of a category of expatriating individuals who would not otherwise be covered under the law. In other words, it would correct the potentially overinclusive effect of the requirement

[34] IRS, "Topic 858."

that all expatriating individuals, regardless of net worth or income tax liability, file a Form 8854. Moreover, it may prompt more individuals to file a Form 8854. The second part of the proposal, again, speaks to greater information sharing and communication that will allow for more effective enforcement and monitoring of those leaving the United States before complete physical separation has happened. To that end, it is expected that the IRS response time would be more proactive rather than reactive.

VIII. Conclusion

Recognizing that a simple change to the forms used for the expatriating process is not necessarily within the jurisdiction of the IRS, we propose that there first be a legislative change to permit greater coordination between the departments of State and Treasury of the expatriation process, from both an immigration standpoint and a tax perspective, much like what has been done under section 7345 regarding the denial, revocation or limitation of a passport for those U.S. citizens with seriously delinquent tax debt. After that authority is granted, the forms should be modified such that they put the expatriating individual, as well as those overseeing the immigration process, on notice of the Form 8854 submission requirements. ■