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RESOLVING THE CONFLICTS OF CITIZENSHIP TAXATION: TWO PROPOSALS

by

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ABSTRACT

The United States is the only country in the world to exercise taxing jurisdiction over the income of its citizens and long-term permanent residents, even when they reside abroad. This citizenship-based taxation (CBT) is controversial, especially among tax scholars, though there appears to be only limited political appetite for realigning U.S. tax jurisdiction to reach only domestic-source and domestic-resident income, as peer countries do. After reviewing the normative value of CBT and the existing multiple taxation mitigation measures, this Article presents two alternatives to the current U.S. regime. First, I propose the U.S. tax only the incomes of current-year residents and recent expatriates but exempt the foreign-source income of nonresident citizens after a five-year extended residency period in order to more closely correlate tax jurisdiction and nonresidents' meaningful connections to the American taxing community. Recognizing that this may be politically infeasible, however, I propose that Congress uncap the existing foreign earned income exclusion in IRC § 911 for American expatriates living in high-tax countries, reducing their substantial compliance burdens without sacrificing revenue that would effectively be eliminated by the foreign tax credit or creating new opportunities for tax-motivated expatriations.

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INTRODUCTION

National governments exercise taxing jurisdiction over income in two primary ways.¹ First, governments may (and most do) tax income

1. Ruth Mason, *Tax Expenditures and Global Labor Mobility*, 84 N.Y.U. L. REV. 1540, 1553 (2009) [hereinafter Mason, *Mobility*].

produced within their borders no matter where the ultimate recipient of that income is located. International tax rules refer to this *in rem*-flavored jurisdiction as source taxation.² Source-based taxation is relatively uncontroversial and easy to enforce.³ Income produced in a country may reasonably be taxed to support that country's infrastructure, which in turn enables production of the taxed income. And a government clearly has jurisdiction over income-producing activities within its territory and can enforce tax compliance "using the credible threat of seizure of property."⁴ Source taxation can thus reach nonresident foreign nationals, as, for example, a Japanese citizen residing in Tokyo who owns Apple stock and must therefore pay U.S. federal income taxes on dividends where applicable.⁵

Second, governments may also exercise *in personam* taxing jurisdiction over individuals on the basis of their connections to the country no matter where that income is produced.⁶ All countries may tax their individual residents, regardless of nationality, on all income they earn anywhere in the world.⁷ For example, and temporarily moving into a fictitious world without international tax treaties, in the case of a resident citizen of Country A who rents out an apartment in Country A's capital city, holds dividend-paying stock in a Country B corporation, and runs a bakery Country C, international law allows Country A's government to exercise jurisdiction over her rental, dividend and business income—all on the basis of her residency in Country A. Like source-based taxation, residence-based taxation (RBT) is relatively

2. See Edward A. Zelinsky, *Citizenship and Worldwide Taxation: Citizenship as an Administrable Proxy for Domicile*, 96 IOWA L. REV. 1289, 1293 (2011) (qualifying source-based taxation as an exercise of *in rem* jurisdiction).

3. Allison Christians, *A Global Perspective on Citizenship-Based Taxation*, 38 MICH. J. INT'L L. 193, 204 (2017) [hereinafter Christians, *Global Perspective*].

4. *Id.*

5. See § 871. However, nonresident aliens generally do not owe capital gains tax in the U.S. See *id.* Unless otherwise stated, all statutory citations are to the Internal Revenue Code of 1986, as amended (the "Code"), and all regulation citations are to Treasury regulations promulgated thereunder (the "Regulations").

6. See Zelinsky, *supra* note 2, at 1294.

7. See, Mason, *Mobility*, *supra* note 1, at 1554.

uncontroversial.⁸ Modern income taxation demands that each individual member of a taxing community contribute according to her ability to pay, no matter where that income arises.⁹ After all, the resident citizen of Country A above can certainly spend her Country B-source dividend and Country C-source business income in Country A just as easily as she can spend her rental income from the Country A apartment.

The United States' approach to *in personam* taxing jurisdiction makes it an outlier. Nearly alone in the world,¹⁰ the U.S. taxes its citizens and lawful permanent residents (LPRs) on their worldwide income even if they do not live in the United States.¹¹ If the Country A citizen described above moved permanently to Country C to manage her bakery, she would not have to pay taxes on her Country B dividend income or Country C business income to Country A. But if she happened to also hold an American passport, the U.S. would continue

8. See, e.g., Christians, *Global Perspective*, *supra* note 3, at 204.

9. J. Clifton Fleming, Jr. et al., *Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income*, 5 FLA. TAX REV. 299, 311 (2001) ("The source of net income is simply irrelevant to ability-to-pay.").

10. Michael S. Kirsch, *Taxing Citizens in a Global Economy*, 82 N.Y.U. L. REV. 443, 445 (2007) [hereinafter Kirsch, *Taxing Citizens*]. Some scholars and advocates have cited Eritrea and North Korea as other countries that tax nonresident citizens' worldwide incomes. See, e.g., *id.* at 445–46, n.5. But the Eritrean "[d]iaspora tax," see S.C. Res. 2023, ¶ 10 (Dec. 5, 2011), "has met with little success," and North Korea's nominal CBT regime "has little practical effect." See Kirsch, *Taxing Citizens*, *supra*, at 446 n.5.

11. See, e.g., Ruth Mason, *Citizenship Taxation*, 89 S. CAL. L. REV. 169, 171–72 (2016) [hereinafter Mason, *Citizenship*]; Bernard Schneider, *The End of Taxation Without End: A New Tax Regime for U.S. Expatriates*, 32 VA. TAX REV. 1, 3 (2012). The U.S. exercises worldwide taxation of lawful permanent residents' (green card holders') worldwide income no matter where they live in the world by making them "residents" for tax purposes regardless of physical presence. See § 7701(b)(1)(A)(i) ("An alien individual shall be treated as a resident of the United States with respect to any calendar year if . . . [s]uch individual is a lawful permanent resident of the United States at any time during such calendar year."); see also Schneider, *supra* note 11, at 17–18. For simplicity, this Article generally uses "citizenship-based taxation" and "citizens" to cover the worldwide taxation of both U.S. citizens and LPRs. Of course, should an LPR move abroad for an extended period and lose her green card, she would no longer be subject to U.S. worldwide income taxation, and she would instead be taxed like any other nonresident alien. See § 7701(b)(1)(B).

to exercise its taxing jurisdiction over each income source, wherever she lived in the world. (Of course, the American citizen earning income in Countries A and B would find the bite of U.S. citizenship-based taxation (CBT) mitigated by a foreign tax credit and earned income exclusion regime, discussed below.)¹²

Citizenship taxation is hotly debated, both in the scholarly community and for the nonresident American citizens who are subject to it. This Article wades into the debate, proceeding in five parts. Part I describes the historical development of the U.S. CBT regime and its current contours. Parts II and III evaluate, respectively, the current scholarship regarding citizenship taxation broadly and then one of the more controversial features of the current CBT regime, the Foreign Earned Income Exclusion (FEIE). Parts IV and V introduce two proposals that, I believe, strike a reasonable balance between equity and complexity concerns: the U.S. should move toward a residence-based taxation regime with a lookback period of extended residency, or, as a more feasible alternative, adjust the current FEIE to greatly reduce compliance requirements for U.S. citizens residing in high- and peer-tax countries.

I. INTERNATIONAL TAXING JURISDICTION OVER INDIVIDUALS: RESIDENCY OR CITIZENSHIP?

Scholars are sharply divided on the merits of CBT, even though its roots as positive law date to the nineteenth century. This Part recounts the history of citizenship taxation in the U.S. and describes the current mechanisms nonresident citizens may use to reduce, and in some cases completely eliminate, their U.S. tax liability on foreign-source income.

A. American CBT: A Brief History

Rightly or wrongly, the U.S. has taxed its nonresident citizens' incomes before it could constitutionally tax incomes at all. In a scramble to raise funds to support the Civil War, Congress developed the first income tax, which by its third iteration expressly reached the worldwide income of all U.S. citizens, even those living abroad.¹³ The Civil War-era income

12. *Infra* Section I.B.

13. Kirsch, *Taxing Citizens*, *supra* note 10, at 449–51; Reuven S. Avi-Yonah, *The Case Against Taxing Citizens*, 58 INT'L TAX NOTES 389, 390–91 (2010) [hereinafter Avi-Yonah, *Case Against*].

tax was, like its early twentieth-century successor, a class tax: it only applied to the wealthy.¹⁴ Congress apparently believed that Americans abroad had abandoned the U.S. “in this day of its extremity” by avoiding the draft so “ought to pay a higher income tax.”¹⁵ Civil War-era CBT raised almost no revenue—only \$230,470 of \$84,015,918 total income tax revenue between 1863 and 1865, or less than 0.3%¹⁶—but it was an important “symbolic gesture,”¹⁷ albeit an “essentially punitive” one.¹⁸

The Civil War income tax lapsed in 1871, but when Congress attempted to resurrect the income tax in 1894, the law applied to “every citizen of the United States, whether residing at home or abroad.”¹⁹ The 1894 income tax was struck down as unconstitutional the next year, and that unconstitutionality was cured only by ratification of the Sixteenth Amendment in 1913.²⁰ But Congress decided to keep taxing the worldwide incomes of all citizens, regardless of residency, when it crafted the 1913 federal income tax, and it has continued to do so in “[a]ll subsequent versions of the federal tax laws.”²¹

14. See Avi-Yonah, *Case Against*, *supra* note 13, at 390.

15. Kirsch, *Taxing Citizens*, *supra* note 10, at 451 (quoting CONG. GLOBE, 38th Cong., 1st Sess. 2661 (1864) (statement of Sen. Collamer)).

16. *Id.* at n.32.

17. Avi-Yonah, *Case Against*, *supra* note 13, at 390.

18. Montano Cabezas, *Reasons for Citizenship-Based Taxation?*, 121 PENN ST. L. REV. 101, 112–13 (2016).

19. Kirsch, *Taxing Citizens*, *supra* note 10, at 452 n.31, 453.

20. *Pollock v. Farmers’ Loan & Trust Co.*, 158 U.S. 601, 637 (1895); U.S. CONST. amend. XVI.

21. Kirsch, *Taxing Citizens*, *supra* note 10, at 454 (citing relevant historical statutes). One recent article argued that Treasury has both the “moral” and the legal authority to end U.S. worldwide CBT *without Congress* via a regulatory fix by creating a new category of taxpayers (“qualified non-residents”) who would be exempt from U.S. taxation on foreign-source income (FSI). See generally John Richardson et al., *A Simple Regulatory Fix for Citizenship Taxation*, 169 TAX NOTES FED. 275 (2020). The authors, Richardson, Snyder, and Alpert, reason that because section 1 of the Code does not expressly tie citizenship status to U.S. tax jurisdiction, Treasury can unilaterally uncouple nationality and tax citizenship by changing the regulatory definition of “individual” subject to U.S. tax—currently “every individual who is a citizen or resident of the United States,” see Reg. § 1.1-1(a)(1)—to exclude nonresident nationals. However, from an institutional perspective, this recasting seems dramatic enough to warrant congressional input, especially since

Although CBT is controversial among modern tax scholars, Congress does not appear to agree—at least as grounds for taxing jurisdiction. And the Supreme Court has expressly ratified CBT, albeit nearly a century ago.²² Instead, the legislative debate has focused on the

most scholars appear to disagree with Richardson, Snyder, and Alpert's reading of *Cook*, described *infra* at note 22

Moreover, while the authors point out that *Cook* was decided at a time when “the IRC was far less complex, dual citizenship was uncommon, [and] there was less global mobility,” worldwide citizenship taxation seems baked into key sections of today's Code. Richardson et al., *supra*, at 278. For example, section 901 specifically authorizes a foreign tax credit for taxes paid by “a citizen of the United States” to “any foreign country.” § 901(b)(1). For section 901(b)(1)'s FTC to make sense under Richardson, Snyder, and Alpert's proposal, it would have to be read as only applying to the FSI of U.S. *resident* citizens to the exclusion of nonresidents. Section 901, however, makes no such distinction. Sections 61(a) and 872(a), read together, seem to operate in a similar way. Section 61(a) includes “all income from whatever source derived” in the gross income of all taxpayers, regardless of residency, and FSI certainly comes within § 61(a)'s broad sweep. Section 872(a) then excludes from gross income the FSI of “nonresident *alien* individual[s]”—income that is not “effectively connected with the conduct of a trade or business within the United States.” § 872(a) (emphasis added). If the FSI of “nonresident alien[s]” is specifically exempted from U.S. taxation by statute, this implies that removing the FSI of *all* non-“aliens” from “gross income” would require a similar specific exemption. Instead, sections 61(a) and 872(a) together create a statutory default rule that includes all citizens' FSI, regardless of their residency. While analyzing Richardson, Snyder, and Alpert's proposal under the Supreme Court's agency deference cases is outside the scope of this Article, it is not immediately clear that redefining section 1's “individual” to exclude nonresident citizens via rulemaking would pass muster under *Chevron* and its progeny given this statutory context. *Cf. generally* *Chevron U.S.A., Inc. v. Nat. Res. Def. Couns., Inc.*, 467 U.S. 837 (1984).

22. *Cook v. Tait*, 265 U.S. 47, 56 (1924) (“[T]he basis of the power . . . was not and cannot be made dependent upon the domicile of the citizen, that being in or out of the United States, but upon his relation as *citizen* to the United States and the relation of the latter to him as citizen.” (emphasis added)). *But see* Richardson et al., *supra*, at 278–80 (arguing that the 1924 *Cook* case was decided under meaningfully different conceptions of citizenship and sovereign allegiance and that, especially after the 1954 Immigration and Nationality Act and the increasing rise in multiple citizenship, U.S. “tax-citizenship” no longer maps neatly onto U.S. nationality law).

ways in which the U.S. should mitigate the effects of overlapping taxing jurisdictions.

B. Mitigating Multiple Taxation

Source, residence and citizenship taxation can create multiple overlapping jurisdictions. For example, our non-treaty Country A citizen and resident—let’s temporarily take back her U.S. passport—will likely be subject to source-based taxation in Country A on her apartment rental income, in Country B on her dividend income, and in Country C on her bakery business income. This would be true whether she lived in the Country A, Country B, Country C, or even a tax haven country that imposes no personal income tax based on residency or citizenship. Moreover, if she lives in Country A, international law allows Country A to tax her worldwide income on the basis of residency.

As a matter of course, countries cede the right to the first bite at the tax jurisdiction apple to the source country, so the country of residence will generally either exempt all foreign-source income or grant the taxpayer a credit for taxes paid to the source country.²³ Assuming that (1) Country A grants a simple foreign tax credit, (2) the Country A citizen-resident paid taxes to Country B on the Country B-source dividend income, and (3) she paid taxes to Country C on her Country C-source bakery income, she would likely be eligible for a credit equal to her combined Country B and Country C tax liabilities against her total Country A tax liability on all three sources of income.

Things become more complicated for U.S. citizen taxpayers, however, who may be subject to three overlapping tax jurisdictions: source, residency, and citizenship. If the Country A resident-citizen also holds an American passport, she will likely be subject to source taxation in Countries B and C, residence taxation in Country A, and worldwide citizenship taxation in the U.S.—at least as matter of jurisdiction (and thus filing requirements), if not as a matter of taxes ultimately owed. This is because the U.S. has employed two mechanisms to mitigate the potentially distortive and unfair results of these overlapping taxing

23. Daniel Shaviro, *Taxing Potential Community Members’ Foreign Source Income*, 70 TAX L. REV. 75, 98 (2016).

jurisdictions since the early days of the modern income tax: the foreign tax credit (FTC)²⁴ and the FEIE.²⁵

1. The Foreign Tax Credit (FTC)

At a high level, the FTC gives both individual citizens and domestic corporations the option to claim a credit for foreign income taxes paid against their U.S. income tax liability.²⁶ The credit is almost as old as the modern income tax itself. Congress first adopted the FTC in 1918 out of “concern[] about the ‘very severe burden’” of multiple taxation on U.S. citizens.²⁷ The credit replaced a deduction scheme, which only permitted U.S. citizens to subtract the cost of foreign income taxes paid in calculating their net incomes, and thus did not fully offset the foreign tax burden.²⁸

The FTC, on the other hand, can fully wipe out the U.S. tax liability of an American citizen residing abroad, especially if he lives in a country with high income tax rates. To illustrate using an admittedly simplistic example, let us assume an American citizen moves to high-tax Country X, which taxes residents in his tax bracket at an average rate of 45%. His only income for the year is the equivalent of \$100,000 USD in Country X-source income. His total Country X tax liability is equal to \$45,000 USD, which he gladly pays to fund the country’s first-rate healthcare and parental leave policies. Suppose his average tax rate under U.S. revenue laws is 35%, so his U.S. tax liability on the basis of citizenship is \$35,000 USD. He may claim a credit for taxes paid to

24. §§ 901–904.

25. § 911.

26. §§ 901–904. The nuances of cross-crediting and the Code’s basket limitation rules are outside the scope of this Article. For an in-depth analysis of the mechanics of and normative basis for these rules, see J. Clifton Fleming, Jr. & Robert J. Peroni, *Reinvigorating Tax Expenditure Analysis and Its International Dimension*, 27 VA. TAX REV. 437, 542–47 (2008).

27. *Report of the Task Force on International Tax Reform*, 59 TAX LAW. 649, 756 (2006) (quoting H.R. Rep. No. 65-767, at 11 (1918)) [hereinafter *ABA Task Force Report*]. The contemporary FTC regime is significantly more complex than its predecessor. See Fleming & Peroni, *supra* note 26; *ABA Task Force Report*, *supra*, at 756–57 (describing changes to FTC regime between 1918 and 2006).

28. *ABA Task Force Report*, *supra* note 27, at 756, 756 n.265.

Country X up to his \$35,000 USD tax liability, and he therefore owes no taxes to the U.S. Treasury.

	U.S.	Country X
Average Tax Rate	35%	45%
Tax Liability (USD)	\$35,000	\$45,000
FTC Against U.S. Tax Liability	< \$45,000 > in taxes paid to Country X	
Effect of FTC	\$35,000–\$45,000 < \$0 U.S. Tax	

On the other hand, if a U.S. citizen moves to a jurisdiction with lower income tax rates, he will likely owe residual tax to the U.S. on the basis of his citizenship alone, even on his income that arises in the residency country. That means if the citizen above moved to Country Z, which only taxes residents in his bracket at the low average income tax rate of 7%, and he enjoys \$100,000 USD in Country Z-source income, he will owe taxes to the U.S. Treasury even after he has paid his Country Z tax bill (apart from the FEIE, discussed below). Before the credit, he will still owe \$35,000 USD in U.S. income taxes on the basis of its citizenship taxation regime, but he will only owe \$7,000 USD to Country Z. The FTC for the Country Z income taxes paid means he still owes the U.S. \$28,000 USD in taxes.

	U.S.	Country Z
Average Tax Rate	35%	7%
Tax Liability (USD)	\$35,000	\$7,000
FTC Against U.S. Tax Liability	< \$7,000 > in taxes paid to Country Z	
Effect of FTC	\$35,000–\$7,000 = \$28,000 U.S. Tax	

The upshot of these simplified examples is that the FTC is extremely helpful to the many U.S. citizens living abroad who have foreign-source income in jurisdictions with higher (and even comparable) income tax rates.²⁹ U.S. citizens living in low-income tax countries,

29. Mason, *Citizenship*, *supra* note 11, at 236. Note that the FTC would still be available if he lived in the U.S. and all his income arose in

however, still owe post-credit U.S. tax in the absence of other mitigating provisions. As discussed below in Section II.B, scholars debate whether this is the normatively correct outcome, but at least for now, the FTC is one key way many—but not all—U.S. citizens abroad are able to avoid multiple taxation.³⁰

2. *The Foreign Earned Income Exclusion (FEIE) and Foreign Housing Exclusion (FHE)*

In 1926, eight years after Congress adopted the first iteration of the FTC, it also adopted an exclusion that would apply to income earned by Americans living and working abroad, apparently in an effort to promote U.S. exports by making it less expensive for U.S. employers to send Americans abroad for work.³¹ So long as a U.S. citizen could show he—and in the legislative imagination, the taxpayer was a *he*³²—was a bona fide nonresident for more than half of the taxable year, he could exclude all foreign-source earned “wages, salaries, professional fees, and other amounts received as compensation for personal services” in calculating his income for U.S. tax purposes.³³ Unlike the FTC, the exclusion was available whether or not the income was subject to source-country taxation. And, importantly, the exclusion did not cover foreign-source investment income like rents, royalties, interest, or dividends, since the ultimate intended beneficiaries were not the nonresident citizen employees themselves, but their U.S. multinational employers, who bore the after-tax cost of foreign salaries.³⁴ Only *earned* income counted.

The FEIE remained uncapped until 1962, meaning that qualifying citizens resident abroad could exclude all their foreign-source earned income—whether that was \$1,000 or \$1,000,000.³⁵ Since then, the exclusion has endured mostly intact with varying exclusion limits,³⁶

Country X, for example, from investments, and was taxed there. However, the focus of this analysis is the worldwide income taxation of U.S. citizens living *abroad*, not resident U.S. citizens with FSI.

30. *See id.*

31. *See* Kirsch, *Taxing Citizens*, *supra* note 10, at 457–58.

32. *Id.* at 458 (describing the legislative record that envisioned Americans abroad as “an army of hardworking salesmen”) (emphasis added).

33. *Id.* at 457–58 (quoting Revenue Act of 1926 § 209(a)(1)).

34. *See id.* at 458.

35. *See id.* at 459 n.72.

36. *See id.*

except for a brief hiccup in the 1970s when Congress unsuccessfully attempted to switch to a normatively sound but administratively complex and politically infeasible deduction regime.³⁷

Today, the FEIE in section 911, permits “qualified individuals” to choose to exclude “foreign earned income . . . attributable to services” up to around \$100,000 with annual inflation adjustments.³⁸ A U.S. citizen qualifies for the FEIE if her “tax home”—the home from whence she could deduct business travel expenses³⁹—is in a foreign country and she meets one of two foreign residency tests:

1. She “has been a bona fide resident of a foreign country or countries for an uninterrupted period” that includes an entire tax year,⁴⁰ *or*
2. She was “present in a foreign country or countries during at least 330 full days” during a period of twelve consecutive months, regardless of whether

37. See CHARLES H. GUSTAFSON ET AL., *TAXATION OF INTERNATIONAL TRANSACTIONS: MATERIALS, TEXT AND PROBLEMS* 165 (4th ed. 2011) (“The 1978 [Foreign Earned Income Act] created a general deduction for a cost-of-living differential and other deductions for children’s primary and secondary school expenses, home and leave travel expenses and excess housing costs. The linkage of tax benefits to actual additional cost burdens would seem appropriate tax policy. . . .”); Renée Judith Sobel, *United States Taxation of Its Citizens Abroad: Incentive or Equity*, 38 VAND. L. REV. 101, 138 (1985) (“The response to the Foreign Earned Income Act was unanimous—no one liked it.”).

38. § 911(a)–(b); Reg. § 1.911-3; IRS, *Figuring the Foreign Earned Income Exclusion*, <https://www.irs.gov/individuals/international-taxpayers/figuring-the-foreign-earned-income-exclusion> [<https://perma.cc/Q5HZ-4SXR>] (last visited Aug. 4, 2020). The cap was set at \$80,000 in 2005, but the statute provides an inflation adjustment mechanism. § 911(b)(2)(D). The inflation-adjusted 2019 FEIE amount was \$105,900, and the 2020 amount is \$107,600. IRS, *supra*. Note that the FEIE expressly does not include money an employee working abroad receives under a pension or annuity, even though such amounts could reasonably be construed as “attributable to services performed by the individual,” § 911(b)(1)(A), (B)(i), or other types of deferred compensation “received after the close of the taxable year following the taxable year in which the services to which the amounts are attributable are performed.” § 911(b)(1)(B)(iv).

39. § 911(d)(3).

40. § 911(d)(1)(A).

those twelve months map neatly onto the individual's taxable year.⁴¹

Any income earned beyond the cap is taxed at the nonresident citizen's applicable rates as if the exclusion did not apply. If an unmarried American taxpayer living and working abroad earned \$150,000 in foreign-source income in 2021, she could thus exclude the first \$108,700 from her income but would be taxed on the remaining \$41,300 at the applicable marginal rate of 24%.⁴²

In addition to the foreign earned *income* amount, since 1981, nonresident citizens can exclude a "*housing* cost amount," too—the foreign housing exclusion (FHE).⁴³ Often, employers find they must reimburse or otherwise compensate their U.S. citizen employees for extra costs they incur working abroad, including housing, to entice those workers to relocate.⁴⁴ Even if the employer pays these extra costs on the employee's behalf rather than raising the employee's salary, they are effectively extra compensation so are normally treated as taxable income to the employee.⁴⁵ Nevertheless, section 911 provides an additional housing cost exclusion for the "reasonable expenses paid or incurred during the taxable year by or on behalf on an individual

41. § 911(d)(1)(B). Note that for tax years 2019 and 2020, the IRS waived these residency requirements for individual taxpayers who "reasonably expected to meet the eligibility requirements of section 911(d)(1)" but were forced to return to the U.S. because of the COVID-19 pandemic. Rev. Proc. 2020-27.

42. See § 1(j)(2)(C) (setting unmarried individual income tax brackets for 2018–25); Rev. Proc. 2020-45, at 6 (announcing 2020 tax rate tables for unmarried individuals) and 19 (announcing 2020 inflation adjustment for section 911); see also *infra* notes 212–15 for an explanation of the "stacking rule" that means the remaining \$41,300 of income would be taxed at the marginal rate for the earner's total \$150,000 in income.

43. § 911(a)(2) (emphasis added); GUSTAFSON ET AL., *supra* note 37.

44. U.S. GOV'T ACCOUNTABILITY OFF., GAO-14-387 ECONOMIC BENEFITS OF INCOME EXCLUSION FOR U.S. CITIZENS WORKING ABROAD ARE UNCERTAIN 26–27 (2014) [hereinafter GAO, ECONOMIC BENEFITS].

45. See §§ 61, 119; see also *Old Colony Trust Co. v. Comm'r*, 279 U.S. 716 (1929) (holding that costs incurred by an employee but paid by the employer on the employee's behalf must be treated as income to the employee).

for housing . . . in the foreign country,” including “utilities and insurance.”⁴⁶

Unlike the FTC, the FEIE and FHE provide the same U.S. tax benefit—at least in real dollar terms—to Americans living in high- and low-income tax jurisdictions. To return to the example of a U.S. citizen living in Countries X or Z above, so long as he met the other eligibility criteria for section 911, he could exclude the same amount of foreign-source income whether he earned it while working in low-tax Country Z or high-tax Country X. This means the FEIE⁴⁷ actually provides a larger tax benefit to U.S. citizens living and working in low-income tax countries, since the FTC alone is unlikely to wipe out their U.S. tax liability.

II. THE SCHOLARLY DEBATE OVER CITIZENSHIP-BASED TAXATION

Before addressing the merits of the FEIE, we should pull back to consider the “threshold question of citizenship-based jurisdiction,” since many prominent international tax scholars advocate the end of CBT altogether.⁴⁸ This Part will accordingly evaluate the strengths and

46. § 911(c)(3)(A). The housing cost amount is available as an above-the-line deduction for self-employed taxpayers. § 911(c)(4). The exact amount of the housing cost exclusion is pegged to the income exclusion amount—excludable above 16% and below 30% thereof—and is prorated for the number of days the taxpayer spends in the foreign country. § 911(c)(1)–(2). The Treasury Secretary also has discretion to adjust the exclusion amount for specific countries “on the basis of geographic differences in housing costs” under section 911(c)(2)(B). The Secretary has exercised that discretion and made adjustments for a large number of countries with high costs of living; they are identified in a list that is updated annually. *See, e.g.*, Notice 2020–13. However, some commentators have criticized this list as unfairly underinclusive. *See generally, e.g.*, Melissa Driver, Student Note, *Examining the Burdens to U.S. Citizens Abroad Relating to the Current Housing Exclusions Under § 911*, 8 PITT. TAX REV. 231 (2011).

47. Going forward, for simplicity this Article uses “FEIE” and “foreign earned income exclusion” to refer to both the income and housing cost exclusions.

48. *See, e.g.*, Avi-Yonah, *Case Against*, *supra* note 13, at 389 (“Rather than continuing the long argument over section 911, Congress should therefore reexamine the basic premise: Should the U.S. continue to tax its citizens who live permanently overseas? In my opinion, the answer is no.”);

weaknesses of the various arguments for and against CBT in general before turning to the merits of the FEIE.

A few caveats are in order.

First, this Article will mostly limit the discussion here to income taxes on labor, not capital.⁴⁹ After all, the FEIE applies only to “earned income attributable to services performed.”⁵⁰ However, this Article will treat taxation of investment income as needed.

Second, although the U.S.’s exercise of taxing jurisdiction over citizens abroad makes it an outlier in principle, it may be closer to peer countries in practice.⁵¹ The U.S.’s legal definition of who belongs to the taxable community (all citizens and LPRs, wherever they live in the world) is much broader than other countries’ (residents *only*). But the mitigation mechanisms described above in Section I.B and many peer countries’ extended definitions of “residency” described below in Part IV mean that the substantive gap between the American CBT regime and other countries’ RBT regimes may be less dramatic than it first appears.⁵² And that gap may be narrowing, too. One French tax scholar notes that while the North American academy has mostly criticized American CBT, the debate is moving in the opposite direction

Schneider, *supra* note 11, at 66 (arguing that the U.S. tax regime should not apply to citizens abroad); Christians, *Global Perspective*, *supra* note 3, at 202 (qualifying the U.S. CBT regime as poor tax policy).

49. Note that a few scholars have discussed the implications of CBT and proposed changes to a U.S. RBT regime in the estate and gift tax context. *See, e.g.*, Zelinsky, *supra* note 2, at 1296; Michael S. Kirsch, *Revisiting the Tax Treatment of Citizens Abroad: Reconciling Principle and Practice*, 16 FLA. TAX REV. 117, 200–205, 203 (2014) (“In the absence of [CBT-related restraints such as] section 2801, residence-based taxation could open the spigot for U.S. citizens to avoid the U.S. transfer tax system.”) [hereinafter Kirsch, *Revisiting*]. Discussion of U.S. transfer taxes is outside the scope of this Article.

50. § 911(b)(1)(A) (emphasis added).

51. Shaviro, *supra* note 23, at 79–83; *see also id.*, at 79 (“Sometimes, however, American exceptionalism is more apparent than real, reflecting greater commonality in actual practice. . . .”).

52. *See id.* at 79–83; Michael S. Kirsch, *Citizens Abroad and Social Cohesion at Home: Refocusing a Cross-Border Tax Policy Debate*, 36 VA. TAX REV. 205, 210, 253 (2015) [hereinafter Kirsch, *Social Cohesion*].

in Europe, where high-tax RBT have experienced high-profile, tax-motivated expatriations.⁵³

Moreover, simply pointing out that CBT is an “outlier in the international community”⁵⁴ isn’t, on its own, a sufficient critique.⁵⁵ If CBT is ultimately fair, efficient, and administrable, other countries should follow the U.S.’s lead.⁵⁶ If it is not, the U.S. should revise its approach, not for the sake of conforming to international tax norms, but because it would be sound policy.⁵⁷

Third, as is true in any discussion of American statutory law, peering into the minds of legislators to deduce the rationale underlying positive law is a fraught exercise. Although one scholar has called on the U.S. government to publicly articulate why it continues to tax its citizens living abroad,⁵⁸ “a legal rule may persist after its initial rationale has ceased to be compelling.”⁵⁹ CBT is more than 150 years old.⁶⁰ The U.S. government is not in the habit of formally explaining its rationale for other kinds of longstanding jurisdictional exercises. The American legal system is not about rationales or intent—it is ultimately about language.⁶¹ And the U.S. “government” is not unitary—it is composed of three distinct branches, each with its own institutional concerns—and its composition and preferred policies change over time.

The U.S.’s unique citizenship taxation regime may have endured because, like other longstanding legal principles, “it serves a new, if as yet unrecognized, function” different from that when it was first

53. Daniel Gutmann, *La lutte contre “l’exil fiscal”: du droit comparé à la politique fiscale*, 21 REVUE DE DROIT FISCAL 27, 27 (2012) (Fr.).

54. Kirsch, *Taxing Citizens*, *supra* note 10, at 445.

55. Shaviro, *supra* note 23, at 80 (“It thus is worth briefly assessing, even though the ultimate question of interest, regarding the U.S. rules, is whether (and in what ways) they are good as opposed to bad—not how unique they are.”).

56. *See id.*

57. *See id.*

58. Cabezas, *supra* note 18, at 121 (“[I]t would be helpful if the U.S. government publicly stated [its] rationale.”).

59. Zelinsky, *supra* note 2, at 1350.

60. *See text accompanying supra* notes 13–18.

61. *See, e.g.*, Harvard Law Today, *The 2015 Scalia Lecture: A Dialogue with Justice Kagan on the Reading of Statutes* at 8:28, YouTube (Nov. 17, 2015), <https://today.law.harvard.edu/in-scalia-lecture-kagan-discusses-statutory-interpretation/> [<https://perma.cc/TS4B-TJLB>].

adopted.⁶² Or, more cynically, maybe CBT has endured because it has been “[p]ropped up by history, politics, ill-formed sentiments of patriotism and widespread indifference to the affected population.”⁶³ Nevertheless, evaluating the competing and overlapping justifications for CBT can be helpful to the extent it illuminates the debate around international income tax reform.

This Part proceeds by examining the primary arguments for and against taxation on the basis of citizenship: (A) the benefits rationale and consent theory, (B) ability-to-pay norms and national community membership, (C) horizontal equity concerns, (D) potential distortions of taxpayer choices, and (E) administrative complexity and compliance burdens.

A. Benefits and Consent Theories

One of the oldest justifications for American CBT is that taxes are the price for government-provided benefits and thus “buy” citizens—wherever they live in the world—certain protections, rights, services and the like from the U.S. government.⁶⁴ In fact, when the Supreme Court endorsed the constitutionality of CBT in *Cook v. Tait* (1924), it expressly did so by reasoning that “the government, by its very nature, benefits the citizen and his property wherever found.”⁶⁵

The benefits rationale is closely related to the Tiebout model of taxation, which envisions taxing jurisdictions competing “in the marketplace for residents and capital”:

Each competing jurisdiction . . . offers a package of public services at a price in the form of the taxes levied

62. Zelinsky, *supra* note 2, at 1350.

63. Christians, *Global Perspective*, *supra* note 3, at 202.

64. See, e.g., *Cook v. Tait*, 265 U.S. 47, 56 (1924); Kirsch, *Social Cohesion*, *supra* note 52, at 211–12; Mason, *Citizenship*, *supra* note 11, at 189–90; Mason, *Mobility*, *supra* note 1, at 1585. Of course, while “[c]itizenship status carries with it both obligations, such as the duty to pay taxes, and benefits, . . . [t]he benefits of citizenship generally are not tied to compliance with the obligations.” Michael S. Kirsch, *Conditioning Citizenship Benefits on Satisfying Citizenship Obligations*, 2019 U. ILL. L. REV. 1701, 1702 (2019) [hereinafter Kirsch, *Conditioning*].

65. *Cook*, 265 U.S. at 56.

by that jurisdiction. . . . The jurisdiction sells services. Residents purchase those services via their tax payments. Households and firms, continually assessing their locational choices, sort themselves into different jurisdictions, depending upon their respective service and tax preferences.⁶⁶

Applied to international taxation, the Tiebout model would treat citizenship as “a public service like any other, which individuals freely purchase (and change) with their tax payments.”⁶⁷

Americans living within the U.S. clearly receive concrete benefits from their citizenship. They may receive federal support through welfare programs like food assistance, unemployment and healthcare benefits and disability income.⁶⁸ They “send their children to public schools, drive on public roads, [and] make use of police or fire protection, . . . all of which are funded in part through federal grants.”⁶⁹ But Americans abroad do not receive these more direct benefits, at least not in the same ways domestic citizens do.⁷⁰

On the other hand, Americans abroad can vote in U.S. elections.⁷¹ They have access to personal and property protections while abroad—government services which, like insurance, have value whether or not citizens abroad ever actually need to use them.⁷² Those protections include emergency evacuations,⁷³ which American citizens abroad used during the early days of the COVID-19 pandemic,⁷⁴ and bilateral

66. Zelinsky, *supra* note 2, at 1311.

67. *Id.* at 1312.

68. Mason, *Citizenship*, *supra* note 11, at 193–94.

69. *Id.*

70. *Id.* Of course, proponents of CBT might argue that American citizens abroad benefit indirectly from the kind of stable and productive society such domestic programs foster.

71. *Id.* at 189; Kirsch, *Taxing Citizens*, *supra* note 10, at 474.

72. Kirsch, *Taxing Citizens*, *supra* note 10, at 471–73 (comparing governmental protection of citizens abroad to an insurance policy); *see also* Mason, *Citizenship*, *supra* note 11, at 189.

73. Mason, *Citizenship*, *supra* note 11, at 189; Kirsch, *Citizenship Taxation*, *supra* note 13, at 472–73 (describing U.S. evacuation of citizens from Lebanon in 2006, among other personal protection benefits).

74. *See* CONG. RSCH. SERV. IF11548, HELPING U.S. CITIZENS ABROAD DURING THE COVID-19 PANDEMIC AND OTHER INTERNATIONAL CRISES: ROLE OF

investment treaties, which protect citizens' "business and investment operations in other countries" by forbidding "discriminatory treatment, restrict[ing] expropriation" and guaranteeing "the right to transfer funds into and out of the host country."⁷⁵ They can travel on a U.S. passport,⁷⁶ "long seen as a golden ticket to visa-free travel in much of the world."⁷⁷ And perhaps most importantly, American citizens

THE DEPARTMENT OF STATE (May 13, 2020); Anna Gawel, *As Coronavirus Spread, State Department Evacuated Over 100,000 Americans Abroad*, WASH. DIPLOMAT (July 6, 2020), <https://washdiplomat.com/as-coronavirus-spread-state-department-evacuated-over-100000-americans-abroad/> [<https://perma.cc/7442-TYPB>]. Note that when the State Department evacuates citizens abroad during a crisis, the law requires individuals to reimburse the government for the costs, 22 U.S.C. § 2671, but even pro-CBT scholars like Michael Kirsch have argued that this is poor policy and should be changed. *See* Kirsch, *Revisiting*, *supra* note 49, at 220 ("Federal law should be amended so that a reimbursement requirement is not the default approach when citizens must be evacuated from a foreign country. Instead, the reimbursement requirement should either be eliminated or should be confined to those circumstances where the U.S. citizen's presence in the foreign country might be viewed as involving recklessness or some other elevated level of risk-taking.").

75. Kirsch, *Taxing Citizens*, *supra* 10, at 473.

76. Mason, *Citizenship*, *supra* note 11, at 189. However, a 2015 law, the Fixing America's Surface Transportation (FAST) Act, prevents the State Department from issuing—and permits the agency to revoke—passports to citizens with "seriously delinquent tax debt." *See* § 7345 (regarding the "revocation or denial of passport in case of certain tax delinquencies" in excess of \$50,000, adjusted annually for inflation); *see generally* Kirsch, *Conditioning*, *supra* note 64 (criticizing the 2015 law). Despite some hiccups in implementing the FAST Act's provisions, a 2019 TIGTA report found that in the law's first two years of operation, fewer than 400 taxpayers "could have been denied a passport" under the new law. *See* INSPECTOR GEN. FOR TAX ADMIN., IMPLEMENTATION OF THE PASSPORT PROVISIONS OF THE FAST ACT WAS GENERALLY SUCCESSFUL, AND THE INTERNAL REVENUE SERVICE IS WORKING ON OBJECTIVE CRITERIA FOR PASSPORT REVOCATIONS (2019), <https://www.treasury.gov/tigta/auditreports/2019reports/201930068fr.pdf> [<https://perma.cc/LX3Y-WQJC>] (emphasis added).

77. Megan Specia, *Travel Restrictions on Americans Erode a Sense of Passport Privilege*, N.Y. TIMES (July 7, 2020), <https://www.nytimes.com/2020/07/07/world/europe/american-passport-privilege-coronavirus.html> [<https://perma.cc/4F35-5HS2>] (explaining that in 2020, other countries

abroad have the right to return to the U.S. at any time without obtaining a visa.⁷⁸

However, the benefits rationale has several major shortcomings. First, it does not justify a redistributive income tax system.⁷⁹ The U.S. taxes those under its tax jurisdiction according to their relative ability to pay, not according to their level of need for government services.⁸⁰ On the contrary, “taxpayers receiving the largest government benefits may be those who, due to their needy circumstances, pay the least taxes.”⁸¹ For example, a jet-setting American billionaire who splits her time equally between a ski chalet in Aspen, a town home London and a beach house in Saint-Tropez each year might use fewer direct U.S. government services than a single father of four in Ohio making \$40,000 per year, but she is much better able to bear the burden of U.S. income taxation.

The benefits rationale raises a second related problem of price discrimination. The mechanisms that mitigate countries’ overlapping tax jurisdictions—especially the FTC—mean the level of U.S. tax paid by citizens abroad is tied to the “nature and level of taxes assessed” by the citizen’s foreign residence country, but is not rationally correlated with the level of benefits they receive from the American government.⁸² In the examples illustrating the FTC’s effect above in Section I.B.1, the U.S. citizen would have “paid” \$28,000 in residual federal taxes for his U.S. citizenship had he lived in the low-tax jurisdiction of Country Z, but that same citizenship would have been “free” had he lived in the high-tax jurisdiction of Country X.

have imposed coronavirus-related travel restrictions, perhaps eroding U.S. citizens’ “passport privilege”).

78. Kirsch, *Taxing Citizens*, *supra* note 10, at 476; Mason, *Citizenship*, *supra* note 11, at 189. The same is true of U.S. long-term permanent residents. *See, e.g.*, Mason, *Citizenship*, *supra* note 11. However, the 2015 FAST Act, discussed *supra* note 75, complicates this argument.

79. *See, e.g.*, Fleming et al., *supra* note 9, at 333–34.

80. *See, e.g., id.* Michael Kirsch has suggested that tying citizenship benefits—like access to a passport—directly to “tax compliance” risks “shifting the income tax toward a ‘user fee’ perspective, undermining the ‘ability to pay’ rationale that traditionally underlies the progressive income tax.” Kirsch, *Conditioning*, *supra* note 64, at 1703–04, 1732–33.

81. Mason, *Mobility*, *supra* note 1, at 1585.

82. Zelinsky, *supra* note 2, at 1318–19 (describing this as “haphazard price discrimination”).

Third, if permanent tax jurisdiction is the ongoing price of U.S. citizenship, as the Tiebout model would presume, we might suppose that citizens abroad who retain their citizenship believe it confers ongoing benefits that are worth the trouble of taxation.⁸³ Indeed, some individuals have concluded that they “cannot afford” the ongoing *burden* of U.S. taxation so formally renounce their American citizenship.⁸⁴ However, this consent-based theory presupposes that Americans abroad can actually choose to “stop buying” that citizenship.⁸⁵ But relinquishing U.S. citizenship is expensive and complicated,⁸⁶ and Americans abroad may not have a “genuine alternative”—they must already have another passport in hand or be able to obtain citizenship elsewhere.⁸⁷ This points to a broader flaw with the Tiebout model’s application in the international context: for an individual’s “choice” of *national* residency or citizenship to be a meaningful one, she must be able to make that choice freely.⁸⁸ However, “significant legal and economic barriers prevent free human migration,” and the transaction costs of changing residency or citizenship are too high for many individuals.⁸⁹

Still, at the end of the day, American citizens abroad do receive some benefits from their citizenship, which may justify the U.S.’s exercise of taxing *jurisdiction*. But the benefits theory does not, on its own,

83. Kirsch, *Taxing Citizens*, *supra* note 10, at 493; *see also* Mason, *Citizenship*, *supra* note 11, at 187–88.

84. Mason, *Citizenship*, *supra* note 11, at 195. *But see* Schneider, *supra* note 11, at 62 (“From the rhetoric about individuals renouncing their U.S. citizenship, one could be forgiven for assuming that the number of pernicious tax-motivated renunciations and relinquishments is large and rising steadily. Contrary to this perception, the number of renunciations and relinquishments is small, and there is no reason to assume that most are tax-motivated or have a significant impact on U.S. tax revenues.”).

85. *See* Mason, *Citizenship*, *supra* note 11, at 195; Christians, *Global Perspective*, *supra* note 3, at 214.

86. *See* Christians, *Global Perspective*, *supra* note 3, at 214.

87. *See* Mason, *Citizenship*, *supra* note 11, at 187–88.

88. *See* Mason, *Mobility*, *supra* note 1, at 1564–65; Zelinsky, *supra* note 2, at 1312; Reuven Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1626 (2000) [hereinafter Avi-Yonah, *Globalization*].

89. Mason, *Mobility*, *supra* note 1, at 1564–65; Zelinsky, *supra* note 2, at 1312.

seem to dictate any particular *level* of taxation.⁹⁰ The current “price” of citizenship for nonresidents is not sufficiently correlated to the product.

B. National Community Membership: Whose Ability to Pay?

Taxation on the basis of citizenship might be more soundly justified if citizens belong to the American national community, regardless of where they live. As described above, the U.S. federal income tax system is fundamentally redistributive: taxpayers contribute to fund the costs of government on the basis of their ability to pay, not on the level of services they receive.⁹¹ The fundamental questions of ability-to-pay taxation are concerned with equity. Are similarly situated taxpayers treated alike (“horizontal equity”) and are taxpayers who are better able to bear the cost of taxation asked to contribute more (“vertical equity”)?⁹²

The American ability-to-pay community should include all individuals whose “connection with U.S. society is so substantial that fundamental fairness requires their net incomes be compared with the net incomes of other U.S. residents for the purposes of making an equitable allocation of the tax burden.”⁹³ That taxing community uncontroversially includes those who live within its borders, regardless of citizenship status; that is simply RBT.⁹⁴ And for American citizens living anywhere in the world, CBT is arguably “fair as long as citizenship serves as a good proxy for national community membership.”⁹⁵

However, not all citizens have the same *quality* of connections to the American community.⁹⁶ While citizenship is a simple, bright-line binary—you’ve either got it or you haven’t—genuine community membership may be significantly more “subjective”⁹⁷ and exists on “a continuum” determined by a taxpayer’s “meaningful contacts” with the taxing country.⁹⁸ For example, an American who marries an Italian citizen and settles permanently in Europe, with no intent to return, might

90. Kirsch, *Taxing Citizens*, *supra* note 10, at 471, 478.

91. *See, e.g.*, Fleming et al., *supra* note 9, at 301–02, 309.

92. *Id.* at 301 n.1.

93. *Id.* at 309.

94. *See id.*

95. Mason, *Citizenship*, *supra* note 11, at 198.

96. *See, e.g., id.* at 188–189.

97. Kirsch, *supra* note 52, at 212–13.

98. Mason, *Citizenship*, *supra* note 11, at 199.

have a more tenuous connection to the U.S. than an American who moves to Hong Kong for a two-year work assignment. And since the Fourteenth Amendment grants citizenship to “[a]ll persons born . . . in the United States,”⁹⁹ an individual born while her Pakistani parents spent six months in the U.S. for education might spend the rest of her entire life outside the country and hold U.S. citizenship without even knowing it, and likely without realizing she is subject to U.S. taxing jurisdiction.¹⁰⁰ It seems unclear, to say the least, that Americans on the “accidental, nominal, and unaware” end of the continuum have the kind of significant, meaningful connections to the country that would justify full membership in the American ability-to-pay community.¹⁰¹ And at the same time, an individual may plausibly belong to multiple national communities.¹⁰² It might be difficult to determine, for example, where the globetrotting billionaire with homes in Aspen, London and San Tropez described above maintains her strongest national connections. Moreover, “fundamental fairness” could mean, depending on the circumstances, that she is genuine member of the American, British *and* French national taxing communities.¹⁰³

Compounding this line-drawing problem is the fact that little reliable data exists to help scholars draw conclusions about the makeup of the extremely diverse group of American citizens living abroad.¹⁰⁴ In fact, it is not at all clear “how many overseas Americans there are” or “where they live,”¹⁰⁵ let alone how close their subjective connections to the United States might be. On the contrary, the available data on the

99. U.S. CONST. amend. XIV, § 1.

100. See Christians, *Global Perspective*, *supra* note 3, at 193–94.

101. See, e.g., Schneider, *supra* note 11, at 45; see generally Christians, *Global Perspective*, *supra* note 3 (arguing that “Accidental Americans” should not be subject to a new international reporting regime, the Foreign Account Tax Compliance Act (FATCA) (2010), designed to catch American tax evaders). But see Kirsch, *Social Cohesion*, *supra* note 52, at 225–29.

102. Shaviro, *supra* note 23, at 94–95.

103. See text accompanying *supra* notes 92–94.

104. Mason, *Citizenship*, *supra* note 11, at 183–84; Kirsch, *Taxing Citizens*, *supra* note 10, at 498.

105. Mason, *Citizenship*, *supra* note 11, at 184; see also GAO, ECONOMIC BENEFITS, *supra* note 44, at 15 (“[R]eliable population figures are not available.”); U.S. GOV’T ACCOUNTABILITY OFF., GAO-98-106, TAX ADMINISTRATION: NONFILING AMONG U.S. CITIZENS ABROAD 5–9 (1998) [hereinafter GAO, NONFILING].

American population abroad compiled by the U.S. government itself is “too uncertain” to reliably estimate whether those citizens even comply with their tax obligations under current law.¹⁰⁶

Fixing clear boundaries to define a country’s ability-to-pay community is clearly complicated. But efficient, administrable tax systems should be designed with bright-line rules wherever possible. Nevertheless, pegging taxing jurisdiction to the bright line of citizenship alone—perhaps by arguing it is an “administrable proxy” for “permanent political allegiance” and thus national community membership¹⁰⁷—creates an overbroad rule that would reach some unfair results, such as the case of accidental Americans described above. On the other hand, excusing nonresident citizens from taxation the way France and Germany have done may result in tax-motivated expatriations by wealthy citizens who game the residency rules while still maintaining significant familial, social, professional, property, and other connections to their true “home” country.¹⁰⁸ Creating a third way that more accurately captures genuine national community membership by accounting for an individual’s meaningful contacts with the country would result in a multifactor test that will be costly and complicated for the IRS to administer and for taxpayers to comply with.

Still, it seems at least some U.S. citizens abroad do maintain the kind of substantial connections that justify membership in the American ability-to-pay taxing community on substantially the same terms while they reside abroad. I believe my first proposal, described in Part IV below, may begin to address the problem of tax fairness to Americans who reside abroad for extended periods—those for whom citizenship may be more “expensive” than the benefits rationale can justify—by at least roughly correlating a citizen’s level of community membership to the level of taxation she bears.¹⁰⁹

106. GAO, NONFILING, *supra* note 104, at 5.

107. Zelinsky, *supra* note 2, at 1350.

108. See text accompanying *supra* note 53.

109. Reuven Avi-Yonah has argued also that the FTC undermines the ability-to-pay rationale for citizenship taxation because it means nonresident citizens are not actually taxed by *the United States* on a true ability-to-pay basis. See Avi-Yonah, *Case Against*, *supra* note 13, at 393. This argument is closely related to the “price discrimination” problem described above. See text accompanying *supra* note 82. However, while the FTC may “involve[] a compromise with the ability-to-pay principle,” that compromise is a

C. Horizontal Equity: Compared to Whom?

National community membership, however, answers only part of the ability-to-pay question. Assuming at least some citizens abroad have the kinds of substantial connections to the U.S. that justify inclusion in the taxing community, we still must decide *how* to draw appropriate comparisons between taxpayers on the basis of horizontal and vertical equity.¹¹⁰ That is, to whom should we compare Americans abroad to determine what tax is appropriate?

First, although Congress and scholars have sometimes compared Americans abroad with foreign nationals outside the U.S., this comparison is only relevant to an international tax competition or tax efficiency analysis—not to U.S. domestic tax *fairness*.¹¹¹ I will discuss the competition rationale below as it applies to the FEIE below in Section III.A, since the competitiveness of U.S. workers (and the U.S. multinational companies that employ them) is the prevailing justification for the exclusion.

Second, then, and following the ability-to-pay rationale for U.S. national community members, the most important comparison for fairness concerns is between resident and nonresident U.S. citizens. Are Americans abroad and Americans at home similarly situated? The short

“reasonable” one that “give[s] ground to” the “important, but conflicting, value” of mitigating the inequities and inefficiencies that overlapping tax jurisdictions can cause. Fleming et al., *supra* note 9, at 330–31 (emphasis added).

110. See Fleming et al., *supra* note 9, at 309.

111. See, e.g., Sobel, *supra* note 37, at 123–24 (“In enacting the 1951 [international tax reform] legislation, Congress compared the American expatriate with similarly situated third country nationals whose own countries would not tax expatriates working abroad. . . .”); *id.* at 108–09; JOINT COMM. ON TAX’N, JCX-68-03, THE U.S. INTERNATIONAL TAX RULES: BACKGROUND AND SELECTED ISSUES RELATING TO THE COMPETITIVENESS OF U.S. BUSINESSES ABROAD 44 (2003) (arguing that section 911 puts “Americans working abroad on an equal footing with their foreign counterparts”) [hereinafter JCT, COMPETITIVENESS]. But see Driver, *supra* note 46, 243 (2011) (“Now, in our increasingly globalized society, not only should the U.S. Congress be concerned with tax equity between U.S. citizens, but it should also be concerned with realizing tax equity between U.S. citizens and citizens of other nations.”).

answer is that it depends, but often the answer is no.¹¹² “Americans abroad may face significantly different wage rates and costs of living compared to resident Americans,” so “[i]f the same dollar amount of income buys less (or more) than it does in the United States”—like Switzerland or, on the other hand, Thailand—then the two groups are not similarly situated as a matter of their ability to bear the burden of U.S. taxation.¹¹³ It is “difficult to generalize regarding these potential burdens” because, to state the obvious, “abroad” isn’t a single place.¹¹⁴

However, it is unclear how relevant these wage and cost of living differences should be to calculating a taxpayer’s ability to pay. The cost of living and prevailing wage rates in San Francisco are substantially different from costs and wages in a small town in Texas.¹¹⁵ All else being equal, U.S. resident taxpayers use the same deductions, credits, exclusions, and exemptions to calculate their taxable income, regardless of where they live *within* the United States. Why should international tax provisions account for disparate costs of living when domestic provisions do not?

Beyond wages and cost of living, though, Americans abroad and at home may not be similarly situated as a matter of *tax* costs, either.¹¹⁶ Not only do citizens abroad live in countries with different levels of income taxation, but those residence countries may also fund their governments through a substantially different mix of taxes, which, as residents, those American citizens abroad must pay. For example, the U.S. federal government is primarily funded by payroll taxes (36%)

112. GUSTAFSON ET AL., *supra* note 36, at 168 (“U.S. workers abroad face higher living costs, face less favorable living conditions and receive fewer services from the U.S. government. . . .”); Mason, *Citizenship*, *supra* note 11, at 208–10; Brainard L. Patton, Jr., *United States Individual Income Tax Policy As It Appears to Americans Resident Overseas: Or, If I’m Paying Taxes Equal to 72 Percent of My Gross Income, I Must Be Living in Sweden*, 1975 DUKE L.J. 691, 695–98 (1975).

113. Mason, *Citizenship*, *supra* note 11, at 208–09.

114. Kirsch, *Taxing Citizens*, *supra* note 10, at 505.

115. See, e.g., Erin McDowell, *The 25 U.S. Cities with the Lowest Cost of Living*, BUS. INSIDER (June 17, 2020, 10:58 AM), <https://www.businessinsider.com/us-cities-with-the-lowest-cost-of-living-2016-7> [<https://www.businessinsider.com/us-cities-with-the-lowest-cost-of-living-2016-7>].

116. J. Richard Harvey, *Worldwide Taxation of United States Citizens Living Abroad: Impact of FATCA and Two Proposals*, 4 GEO. MASON J. INT’L COM. L. 319, 329.

and corporate (7%) and individual (50%) income taxes.¹¹⁷ U.S. state and local governments collect the overwhelming majority of consumption taxes. However, many other countries raise substantial revenue through national consumption taxes, like value-added taxes (VATs), which are not creditable under the FTC in I.R.C. § 901.¹¹⁸ But U.S. state-imposed consumption taxes are only subject to limited deductibility against federal income taxes.¹¹⁹ So again, why should consumption or other non-income taxes paid abroad be fully deductible or creditable for citizens abroad when citizens at home do not receive the same benefits? On the other hand, given that some employers abroad must pay an American citizen higher wages to leave them in the same place financially after tax and other higher living costs, maybe it makes sense to permit some adjustments, if, say, an employee lives in a jurisdiction where “housing costs are significantly higher than those in the highest cost city in the United States.”¹²⁰

A third point of comparison might be other U.S. citizens abroad. Beyond cost of living differences between foreign countries, CBT can be extremely difficult to enforce, so compliance with U.S. taxing jurisdiction by citizens abroad may be more “voluntary” than compulsory.¹²¹ Americans working for U.S. companies abroad see their U.S. federal income taxes withheld from their paychecks, but Americans working

117. TAX POL’Y CTR., WHAT ARE THE SOURCES OF REVENUE FOR THE FEDERAL GOVERNMENT?, <https://www.taxpolicycenter.org/briefing-book/what-are-sources-revenue-federal-government> [https://perma.cc/LBC8-XLN6] (last visited Sept. 15, 2021).

118. § 901(a) (“The credit shall not be allowed against any tax treated as a[n income] tax. . . .”); see Mason, *Citizenship*, *supra* note 11, at 209; Cabezas, *supra* note 18, at 116–17; Zelinsky, *supra* note 2, at 1297–98.

119. See § 164(b)(5)–(6); Kirsch, *Taxing Citizens*, *supra* note 10, at 488.

120. Kirsch, *Taxing Citizens*, *supra* note 10, at 507; see also GAO, ECONOMIC BENEFITS, *supra* note 44, at 26–27 (describing employers’ practice of raising U.S. workers’ wages abroad, though noting that experts are divided on whether employers really consider a workers’ extra tax costs in hiring decisions).

121. Christians, *Global Perspective*, *supra* note 3, at 208. At least, this is the case if citizens abroad are unconcerned with accruing the kind of “seriously delinquent tax debt” that could prevent them from renewing their U.S. passport. See text accompanying *supra* note 76.

for foreign entities do not.¹²² Since withholding and reporting drive compliance,¹²³ U.S. citizens working for foreign employers may be significantly more likely to opt out of U.S. taxation. Noncompliance by Americans abroad not only places a heavier tax burden on U.S. residents, but also places a heavier burden on their tax-compliant expatriate peers. And the current U.S. CBT regime favors *working* Americans abroad over those who live off investment income, since employees may exclude their first \$100,000 or so of income under the FEIE, but no equivalent exclusion for capital income exists.¹²⁴

Still, similar points can be made about purely domestic taxation. Noncompliance in general shifts the burden of taxation onto those who pay, although rates of noncompliance by citizens abroad may be far greater than for U.S. residents.¹²⁵ Further, the U.S. income tax system as a whole treats income from capital and labor differently, albeit by favoring investment income by taxing capital gains at a favorable rate.¹²⁶

In sum, even when citizens abroad should fairly belong to the American taxing community, it can be difficult to determine the proper points of comparison for determining how to distribute the tax burden across that community. On balance, the most relevant standard is probably resident U.S. taxpayers, although substantial differences in wages and costs—both costs of living and tax costs—might justify some adjustments beyond the operation of the foreign tax credit alone.

122. Rev. Rul. 92-106, 1992-2 C.B. 258.

123. See *infra* Section II.E.

124. § 911; Kirsch, *Taxing Citizens*, *supra* note 10, at 511. Treating labor income more generously than passive income might be justified, however, since shifting the tax burden from capital to labor tends to increase wealth gaps and violate vertical equity. See Avi-Yonah, *Globalization*, *supra* note 87, at 1624–25.

125. Compare INTERNAL REVENUE SERV., FEDERAL TAX COMPLIANCE RESEARCH: TAX GAP ESTIMATES FOR TAX YEARS 2011–2013 7, Rev. 9-2019, Pub. 1415 (2019) (estimating the voluntary compliance rate at 83.6%), with GAO, NONFILING, *supra* note 105, at 21 (“The extent and impact of nonfiling abroad remain largely unknown, due to uncertainties in the data. . . . However, some evidence suggests that nonfiling may be relatively prevalent in some segments of the U.S. population abroad. And the revenue impact, while unknown, could be significant even though it would be reduced by available exclusions and credits.”).

126. See § 1.

D. Distortions and Neutrality

One of the primary goals of sound tax policy is to minimize the tax system's effects on taxpayer choices. A provision that artificially makes certain economic choices more appealing for tax reasons alone distorts taxpayer behavior and can create deadweight losses—"instances in which someone loses and no one gains."¹²⁷ In the broader international tax context, many scholars select a particular efficiency benchmark (capital export neutrality, capital import neutrality, capital ownership neutrality, etc.) "and then simply appl[y] it without further inquiry into tradeoffs or underlying objectives."¹²⁸ "There is," however, "no consensus on what form of neutrality is in the overall U.S. interest," and I will not attempt to resolve the question here.¹²⁹

The debate over the U.S.'s exercise of taxing jurisdiction over individuals on the basis of citizenship essentially boils down to the problem of overlapping tax jurisdictions: double taxation or, as the case may be for other countries that only exercise jurisdiction on the basis of residency, double *nontaxation*.¹³⁰ Of course, "double taxation" isn't always inefficient.¹³¹ Most of us would prefer to be taxed twice at a rate of 7% than once at a rate of 35%. But to the extent overlapping tax jurisdictions impose a heavier burden on American citizens—say, to the extent the mitigation measures described above in Section I.B. do not

127. DANIEL SHAVIRO, *FIXING U.S. INTERNATIONAL TAXATION* 103 (2014).

128. *Id.* at 103–04; see e.g., Robert J. Peroni, *Back to the Future: A Path to Progressive Reform of the U.S. International Income Tax Rules*, 51 U. MIAMI L.R. 975, 977 (1997) (applying capital export neutrality norms); Michael J. Graetz, *Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies*, 54 TAX L. REV. 261, 270–72 (2001) (comparing capital export neutrality and capital import neutrality); Hebert Lazerow, *Criteria of International Tax Policy*, 41 SAN DIEGO L. REV. 1123, 1129–30, 1134 (2004) (applying capital export neutrality and capital import neutrality); Mihir A. Desai & James R. Hines, Jr., *Evaluating International Tax Reform*, 56 NAT'L TAX J. 409 (2003) (introducing capital ownership neutrality and national ownership neutrality).

129. *Cf. ABA Task Force Report*, *supra* note 26, at 661.

130. See, e.g., Mason, *Citizenship*, *supra* note 11, at 224 ("[C]itizenship taxation burdens free movement by double taxing Americans abroad. . .").

131. Shaviro, *supra* note 22, at 98.

offer a complete remedy—the effect may be to distort taxpayers’ choices by disincentivizing Americans from moving abroad.¹³² If, for example, a U.S. citizen knew her effective tax rate will be 45% if she moved abroad but 35% if she stayed home in Indiana, she might be disinclined to leave the Midwest even if she earned a slightly higher income abroad.

Likewise, “double nontaxation, which occurs when cross-border income is taxed *nowhere*,” can artificially make certain taxpayer decisions cheaper than they would be in the absence of the tax system.¹³³ For example, since France only exercises taxing jurisdiction on the basis of residency, a French citizen may decide it makes economic sense to move to neighboring Monaco, which imposes no personal income tax on its residents, even if the cost of living were 10% or even 20% higher in Monaco than in France.¹³⁴ By escaping France’s relatively high income tax rates, the French citizen may be able to afford to pay more for housing, food and other living expenses because neither France nor Monaco taxes her income. Likewise, given the operation of the FEIE under the U.S. federal income tax, Americans subject to CBT may actually experience double nontaxation if they move to a tax haven country.¹³⁵ An American who moves to Monaco and only has \$90,000 of income, all from labor, would fall under the FEIE cap, so her income would be untaxed in Monaco and exempt from tax in the U.S.

These citizenship-specific double (non)taxation arguments center around two types of tax neutrality: residence neutrality and citizenship neutrality.¹³⁶ Citizenship-based taxation is said to be “residence neutral,” in that Americans abroad—at least, in the absence of the FEIE¹³⁷ and before the operation of the FTC—will owe the same amount of income tax to the U.S. Treasury regardless of their country of

132. *Id.*

133. SHAVIRO, *supra* note 126, at 5 (emphasis added).

134. See Craig Anthony, *Why is Monaco Considered a Tax Haven?* INVESTOPEDIA (Jan. 31, 2020), <https://www.investopedia.com/ask/answers/060316/why-monaco-considered-tax-haven.asp> [<https://perma.cc/B898-WFNM>].

135. See Mason, *Citizenship*, *supra* note 11, at 224 (“[T]he current citizenship taxation is not residence neutral in all cases. For example, the foreign-earned-income exclusion provides a tax incentive for Americans who earn income abroad to move to lower tax countries.”).

136. See, e.g., Kirsch, *Social Cohesion*, *supra* note 51, at 238.

137. Mason, *Citizenship*, *supra* note 11, at 224.

residence.¹³⁸ This means that, in general, the U.S. does not experience the kind of tax-motivated expatriations high-tax RBT jurisdictions like France and Germany have seen, unless those nonresident U.S. citizens are ignorant of their ongoing U.S. tax obligations (or, worse, committing fraud),¹³⁹ and, to be fair, “many overseas taxpayers have [honest] misconceptions about the requirement to file returns when overseas.”¹⁴⁰

On the other hand, CBT can distort taxpayer choices about whether to keep or renounce their citizenship. “Worldwide taxation of, and the ever-increasing compliance burden on, nonresident U.S. citizens constitute a real and increasing *citizenship penalty*. As the cost of U.S. citizenship rises . . . , many are likely to see the U.S. passport as a passport of inconvenience.”¹⁴¹ In fact, the number of annual U.S. citizenship renunciations has generally grown since the 1990s, although the numbers remain relatively low, in the hundreds or thousands, and it unclear how many of those renunciations were tax motivated.¹⁴² CBT “has not precipitated mass renunciations,” in part because “[c]itizenship is relatively inelastic.”¹⁴³ That is, U.S. citizens do not generally see their passport as an asset to be bought and sold. Rather, it has strong emotional and political weight, and as mentioned above, many Americans may not have a second passport to fall back on.¹⁴⁴ That said, an entire

138. See, e.g., *id.* at 175 (“Americans cannot escape the tax grasp of the United States merely by moving abroad. . . .”); Kirsch, *Taxing Citizens*, *supra* note 10, at 490. Of course, the FTC will reduce an individual’s U.S. income tax liability to the extent she pays qualifying source- and residency-based taxes abroad, permitting that individual to avoid distortionary double taxation.

139. See Kirsch, *Taxing Citizens*, *supra* note 10, at 490.

140. Cynthia Blum & Paula N. Singer, *A Coherent Policy Proposal for U.S. Residence-Based Taxation of Individuals*, 41 VAND. J. TRANSNAT’L L. 705, 712 (2008).

141. Schneider, *supra* note 11, at 65 (emphasis added).

142. Kirsch, *Social Cohesion*, *supra* note 51, at 232–33.

143. Mason, *Citizenship*, *supra* note 11, at 227; see also Kirsch, *Social Cohesion*, *supra* note 51, at 232–33.

144. See text accompanying *supra* note 86. In addition, Ruth Mason has argued that CBT may discourage inbound migration to the U.S., especially of highly skilled and sophisticated workers, since they may not wish to naturalize or gain long-term permanent residence status when they will continue to be taxed on the basis of that status even if they leave the U.S.

industry has grown up to help Americans “buy” a foreign passport before renouncing their U.S. citizenship—the first step toward “creat[ing] a tax-free lifestyle.”¹⁴⁵

On the other hand, the residence-based taxation practiced by peer countries is said to be “citizenship neutral[,]” since foreign citizens will not be subject to taxation in their home countries while they live abroad, eliminating any “tax incentive to surrender citizenship.”¹⁴⁶ However, RBT regimes are not *residence* neutral—citizens may have a strong incentive to move abroad to avoid taxation by their country of citizenship, even when, as discussed above, they continue to maintain some meaningful connections to their home taxing community.¹⁴⁷ Of course, residency decisions are informed by myriad non-tax factors, too: “[m]igrants face significant legal restraints and considerable costs in moving, including both monetary costs and costs caused by differences in language, culture, and professional standards.”¹⁴⁸ But the wealthy are often better able to bear these non-tax costs, meaning RBT regimes can potentially lead to an unequal “opt-out” system for those who can afford to move to a low- or no-tax jurisdiction.

To be fair, most American expatriates appear to live abroad for non-tax reasons like family or romantic relationships, education or employment.¹⁴⁹ And at least one scholar has argued that the fact that most American expatriates live abroad for non-tax reasons is good evidence the residence neutrality advantage of a CBT regime is largely irrelevant.¹⁵⁰ This seems unlikely, however, given the experience of high-tax European countries discussed above, which “suggests that high income individuals . . . may be willing to relocate if the potential tax savings are

for home or a third country. Mason, *Citizenship*, *supra* note 11, at 228–29. At least at the margins, this “puts the United States at a competitive disadvantage in attracting the world’s talent.” *Id.* at 230. Nevertheless, as Michael Kirsch has pointed out, tax is probably not the motivating factor for most immigrants to the U.S., and the U.S. has no shortage of high-skilled visa applicants. Kirsch, *Social Cohesion*, *supra* note 51, at 240.

145. See, e.g., NOMAD CAPITALIST, *Citizenship by Investment*, <https://nomadcapitalist.com/citizenship-by-investment/> [<https://perma.cc/5MGV-2GFW>] (last visited Aug. 9, 2020).

146. Kirsch, *Social Cohesion*, *supra* note 51, at 231–32, 235.

147. See text accompanying *supra* note 107.

148. Mason, *Mobility*, *supra* note 1, at 1547.

149. Mason, *Citizenship*, *supra* note 11, at 183.

150. Schneider, *supra* note 11, at 53.

high enough.”¹⁵¹ Moreover, “[t]he 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.”¹⁵²

In sum, although a pure CBT system can lead to innocent non-compliance (or willful evasion), a pure RBT regime is probably too easy for sophisticated, wealthy taxpayers to game. Again, I believe my first proposal, discussed below at Part IV, begins to strike a more appropriate balance between the concerns of residence and citizenship neutrality.

E. Administration and Compliance Costs

Beyond fairness and efficiency concerns, U.S. citizenship taxation raises the practical questions of administration and compliance. It can be exceptionally difficult for the U.S. to enforce its taxing jurisdiction over citizens abroad, and those citizens may struggle to comply even if they understand that they should file in the U.S. while living outside the country. Given the operation of the FTC and FEIE, which can substantially reduce or even completely eliminate nonresident citizen taxpayers’ tax liability, are the complexity costs of CBT worth the revenue raised?¹⁵³

1. U.S. Tax Authorities: Administrative Complexity

The U.S. struggles to enforce its taxing jurisdiction over nonresident citizens. To effectively enforce federal tax laws, authorities need accurate data.¹⁵⁴ One of the primary reasons Americans are generally so income

151. Kirsch, *Social Cohesion*, *supra* note 51, at 256.

152. *Id.*

153. Cf. Shu-Yi Oei, *The Offshore Tax Enforcement Dragnet*, 67 EMORY L.J. 655, 717 (“[I]n situations when costs are well in excess of benefits generated, it might be advisable to allow some level of evasion to exist, given costly enforcement and finite resources.”).

154. See, e.g., Leandra Lederman & Joseph Dugan, *Information Matters in Tax Enforcement*, 2020 B.Y.U. L. REV. 145, 146 (2020) (“Economists and legal experts have long recognized that the government needs information about taxpayers’ transactions in order to determine whether their

tax compliant is our robust withholding and reporting system, and compliance drops off sharply for income not subject to third-party reporting.¹⁵⁵ For example, U.S. employers must withhold federal income and payroll taxes from employees' paychecks,¹⁵⁶ and many payments made "in the course of [a] trade or business to another person" are subject to third-party reporting.¹⁵⁷

Cross-border reporting systems, however, have historically been weak or nonexistent. The 2010 Foreign Account Tax Compliance Act (FATCA), which was designed to develop stronger cross-border reporting rules, requires foreign financial institutions to report certain data on accounts held by Americans to the U.S. or face a 30% withholding tax on all U.S. source payments they receive.¹⁵⁸ While FATCA and the new OECD Common Reporting Standard¹⁵⁹ may make cross-border data sharing easier and thus make administering citizenship taxation more practical,¹⁶⁰ FATCA has also been criticized as coercive and poorly targeted to catch the worst evaders.¹⁶¹ Although U.S. law does require U.S. employers with American workers abroad to withhold U.S. income taxes from those employees' wages, it does not (and probably *could not*) require withholding by foreign entities.¹⁶² And, as mentioned above, it is extremely difficult to get an accurate picture of the American citizen population living abroad because it is unclear who they are and where

reporting is honest. Tax experts have likewise long recognized that third-party information reporting . . . is an important tool to promote compliance with the tax law."); Avi-Yonah, *Globalization*, *supra* note 87, at 1584 ("Even in the case of sophisticated tax administrations like the IRS, tax compliance substantially depends upon either withholding at the source or information reporting.").

155. Lederman & Dugan, *supra* note 153, at 147–48 (citing IRS tax compliance estimates).

156. §§ 3101–02, 3401–06.

157. § 6041.

158. Oei, *supra* note 152, at 682.

159. ORG. ECON. CO-OP. & DEV., STANDARD FOR AUTOMATIC EXCHANGE OF FINANCIAL ACCOUNT INFORMATION IN TAX MATTERS (2014).

160. See Kirsch, *Revisiting*, *supra* note 48, at 141–46, 171.

161. See generally Oei, *supra* note 152; Christians, *Global Perspective*, *supra* note 3; Allison Christians, *Could a Same-Country Exception Help Focus FATCA and FBAR?*, 67 TAX NOTES INT'L 157, 157–59.

162. Rev. Rul. 92-106, 1992-2 C.B. 258; Mason, *Citizenship*, *supra* note 11, at 212–13.

they live in the first place. This means the IRS cannot draw reliable conclusions about their level of compliance with U.S. tax laws.¹⁶³

Even if U.S. tax authorities could determine which citizens abroad were out of compliance, however, they couldn't do anything about it without help from those citizens' residence countries.¹⁶⁴ For example, "[m]any countries will not enforce foreign governments' tax claims or tax judgments,"¹⁶⁵ and those that will enforce tax liens only do so under a bilateral tax treaty.¹⁶⁶ Between reporting gaps and collection problems, the U.S. depends significantly on the voluntary cooperation of other countries to catch noncompliant citizens abroad.

That said, if the U.S. were to move away from CBT and toward a taxing regime focused solely on domestic residency, the result would be to put pressure on the definition of "tax residency."¹⁶⁷ If the U.S. decided to simply define tax residency as "183 or more days spent in-country in a given year," an American citizen could spend January 1st through June 30th in the U.S. and July 1st through December 31st in Luxembourg and avoid U.S. taxation on her foreign-source income. Congress, in its wisdom, would likely anticipate this result and define "residency" both by days spent in country *and* a "facts-and-circumstances" test showing a citizen's meaningful subjective connections to the country, much as countries like the United Kingdom do.¹⁶⁸ As noted above, despite the accuracy advantages of such a test, it would place a substantial burden on the U.S. tax administration.¹⁶⁹ For this very reason, at least one scholar has argued that citizenship is a reasonable basis for taxation because it often approximates "permanent political allegiance," if not present-year residency.¹⁷⁰ In short, both citizenship and residence taxation can be complicated (and therefore costly) for tax authorities to administer.

163. See generally GAO, NONFILING, *supra* note 104.

164. Mason, *Citizenship*, *supra* note 11, at 212; Christians, *Global Perspective*, *supra* note 3, at 201.

165. Mason, *Citizenship*, *supra* note 11, at 212.

166. See GAO, NONFILING, *supra* note 104, at 14.

167. Kirsch, *Taxing Citizens*, *supra* note 10, at 491, 510.

168. See Zelinsky, *supra* note 2, at 1335.

169. See *supra* Section II.B.

170. Zelinsky, *supra* note 2, at 1350.

2. *Taxpayer Compliance Costs*

Just as CBT can be extremely difficult for tax authorities to administer, it also places substantial compliance burdens on citizens abroad. Many nonresident citizens, especially those who left the United States at a young age and grew up in a foreign country, may be genuinely unaware that they are subject to U.S. taxation on the basis of citizenship alone.¹⁷¹ This may be partly the U.S.'s own fault: it has historically done a poor job publicizing citizenship taxation and communicating with citizens abroad.¹⁷² Since the enactment of FATCA in 2010, many long-term nonresident citizens have discovered *for the first time* that they are out of compliance with U.S. tax laws when they attempt to open a bank account in the country where they live, work and perhaps plan to remain.¹⁷³

Even citizens abroad who do understand their tax obligations to the U.S. may struggle to meet them. The IRS offers only limited help to nonresidents, and the FTC and FEIE can be difficult to understand and correctly claim.¹⁷⁴ This means tax compliant citizens abroad often rely on professional advice from accountants and lawyers, which can be expensive¹⁷⁵ and, worse, inaccurate.¹⁷⁶ While improvements to the IRS website and professional firms' increasing capacity deliver their services remotely might help temper those costs,¹⁷⁷ internet access certainly does not eliminate them.

3. *Cost-Benefit Analysis*

Taken together, the administrative and compliance costs of CBT appear to be relatively high, especially since the FTC and FEIE substantially

171. See Christians, *Global Perspective*, *supra* note 3, at 193–94.

172. *Id.* at 199.

173. *Id.* at 240 (qualifying this phenomenon as “a ‘gotcha’ with life-altering financial impact”).

174. See Jacqueline Bugnion, *Concerns About the Taxation of Americans Resident Abroad*, 148 TAX NOTES 861, 863; Mason, *Citizenship*, *supra* note 11, at 218.

175. Mason, *Citizenship*, *supra* note 11, at 218.

176. Richardson et al., *supra* note 20, at 284 (discussing confusing tax reporting obligations of nonresident U.S. citizens in the trust reporting context, which have led to errors by both IRS personnel and tax advisors).

177. Kirsch, *Taxing Citizens*, *supra* note 10, at 467.

reduce the revenue Treasury actually collects. CBT's opponents have argued that it "is at best the equivalent of a minimal source of revenue, . . . and at worst a money loser."¹⁷⁸ Indeed, many of those who qualify for the FEIE may owe no U.S. income tax but pay thousands of dollars for tax preparation services.¹⁷⁹ Although it is hard to say for sure, given the lack of good data on the number of Americans abroad and their compliance with U.S. tax laws,¹⁸⁰ administration and compliance costs may cut significantly into the revenue raised by CBT, thus creating dead-weight losses: the taxpayers and the IRS may spend significant time and resources trying to comply without a corresponding significant gain for Treasury.

III. THE NORMATIVE VALUE OF THE FOREIGN EARNED INCOME EXCLUSION

The U.S. citizenship taxation regime's proponents and its sharpest critics are generally united in their dislike of section 911.¹⁸¹ For CBT's supporters, "[i]f the worldwide taxation of nonresidents is justified," it is difficult to legitimize such a huge giveaway to Americans abroad, especially those earning income in low-tax jurisdictions where that foreign-source income was not subject to a comparable rate of tax.¹⁸² RBT advocates, however, believe the current FEIE does not go far enough in excusing nonresident citizens from U.S. taxation. "Conversely," they argue, "if worldwide taxation does not stand up to scrutiny, then it should be eliminated [entirely], not ameliorated by the FEIE and FHE."¹⁸³ This Part outlines the primary arguments for and against the exclusion: (A) the competition rationale, (B) equity concerns, and (C) administration and compliance costs.

178. See, e.g., Bugnion, *supra* note 173, at 865; Oei, *supra* note 152, at 698 ("Thus, high compliance burdens placed on these populations may not actually generate much revenue for the United States.").

179. Bugnion, *supra* note 173, at 865.

180. See generally GAO, NONFILING, *supra* note 104.

181. See, e.g., Shaviro, *supra* note 22, at 88; Peroni, *supra* note 127, at 1008–10; Kirsch, *Revisiting*, *supra* note 48, at 213 n.431.

182. Schneider, *supra* note 11, at 44.

183. *Id.*

A. Competitiveness of U.S. Multinationals

The FEIE was first introduced in 1926 in response to lobbying by U.S. multinational corporations that wanted to send their American citizen employees abroad.¹⁸⁴ Sending U.S. workers abroad was expensive, they argued, for essentially the same reasons described above in Section II.C. And for those American employers to remain competitive with foreign peer companies, they reasoned, the American employees they paid should not be subject to U.S. tax.¹⁸⁵ The FEIE, so the multinationals said, would promote U.S. exports, strengthening the American domestic manufacturing industry, because Americans workers abroad would promote foreign sales of American-made goods.¹⁸⁶ In effect, therefore, the FEIE was justified as an “indirect subsidy to [American] employers transferring [American] employees abroad because the corporation could pay the employee a significantly lower (untaxed) salary outside the United States instead of a higher (taxed) salary within the United States.”¹⁸⁷ Those employees, they reasoned, “expand[ed] their U.S. employers’ (and, accordingly, *America’s*) interests throughout the world.”¹⁸⁸

Keeping U.S. multinationals and their American employees abroad competitive remained the primary rationale for the FEIE through most of the twentieth century.¹⁸⁹ There are, however, a few important reasons to doubt the competition argument’s strength.

First, even though the FEIE has been around for nearly a century, no empirical data exists to show that section 911 actually drives U.S. exports and thus promotes U.S. multinationals’ interests.¹⁹⁰ The 2014 Government Accountability Office (GAO) study on the FEIE, tellingly titled *Economic Benefits of Income Exclusion for U.S. Citizens*

184. Kirsch, *Taxing Citizens*, *supra* note 10, at 457–58.

185. See, e.g., *id.*; Sobel, *supra* note 36, at 119.

186. Kirsch, *Taxing Citizens*, *supra* note 10, at 464, 516–17.

187. *Id.* at 513–14.

188. *Id.* at 458.

189. See, e.g., Sobel, *supra* note 36, at 123–41; Kirsch, *Taxing Citizens*, *supra* note 10, at 464.

190. GAO, *ECONOMIC BENEFITS*, *supra* note 43, at 1; Sobel, *supra* note 36, at 146–55 (reviewing the existing empirical studies performed before 1985 and concluding that “no study with appropriate methodology has linked the special tax treatment of expatriates to their overseas presence”).

Working Abroad Are Uncertain, concluded that “there is little evidence the tax expenditure affects exports.”¹⁹¹ Similar competitiveness arguments have been made in favor of other international tax expenditures, like the deferral subsidy for U.S. multinationals’ foreign-source income (i.e. the U.S. does not impose tax until that money is paid by a foreign subsidiary to a U.S. company) and FTC cross-crediting.¹⁹² However, like for the FEIE, there is “a paucity of empirical support” for claims that international tax expenditures support U.S. multinationals’ competitive position or even that a competitiveness problem exists in the first place.¹⁹³

Second, even if the competition rationale did justify the FEIE subsidy for U.S. multinationals in the mid-twentieth century, the argument is substantially undercut by changes in the global economy¹⁹⁴ and economists’ modern understanding of international trade imbalances.¹⁹⁵ The historical justification for the FEIE “envision[ed] a world of clearly delineated economic functions and corporate structures, with U.S. companies employing U.S. workers in the United States to manufacture tangible goods, which U.S. citizen-salesmen abroad sell in foreign markets.”¹⁹⁶ But that model is out of date, in part because of fundamental changes to American companies’ supply chains. “American-made” goods often crisscross international borders multiple times before being delivered to market,¹⁹⁷ meaning that “the links between U.S. resident companies, U.S.-produced goods and the advancement of U.S. national welfare are not so tight as they arguably might have been decades ago.”¹⁹⁸ Moreover, even if the FEIE did clearly “promote[] exports and encourage[] a favorable balance of payments,”¹⁹⁹ most economists do not believe

191. GAO, ECONOMIC BENEFITS, *supra* note 43, at 24.

192. Fleming & Peroni, *supra* note 25, at 532–43.

193. *Id.* at 543, 535–37.

194. See Kirsch, *Taxing Citizens*, *supra* note 10, at 517–20; GAO, ECONOMIC BENEFITS, *supra* note 43, at 13–17; Shaviro, *supra* note 22, at 104.

195. See, e.g., Adam Hayes, *Trade Deficit: Advantages and Disadvantages*, INVESTOPEDIA (March 8, 2020), <https://www.investopedia.com/articles/investing/051515/pros-cons-trade-deficit.asp> [<https://perma.cc/QW69-4QLA>].

196. Kirsch, *Taxing Citizens*, *supra* note 10, at 517.

197. Tim Heffernan, *What Does “Buying American” Even Mean?* N.Y. TIMES: WIRECUTTER (July 3, 2019), <https://www.nytimes.com/wirecutter/blog/what-does-buying-american-mean/> [<https://perma.cc/T32C-X8YL>].

198. Shaviro, *supra* note 22, at 104.

199. Sobel, *supra* note 36, at 114.

trade deficits are actually a problem for the American economy.²⁰⁰ On the contrary, “a larger trade deficit can be the result of a stronger economy, as consumers spend and import more while higher interest rates make foreign investors more eager to place their money in the United States.”²⁰¹ Still, some tax scholars believe the competition rationale should still bear on U.S. international tax policy.²⁰² “U.S. citizens and residents are competing in a global economic marketplace, and our government’s highest priorities should include the need to advance (and certainly not impede) the ability of American individuals, and the businesses that employ them, to be successful in the competition to sustain and create strong jobs in the United States.”²⁰³

Nevertheless, even if other international tax expenditures might be justified by enhancing domestic job creation—which, again, it is unclear they actually do²⁰⁴—that rationale is rather weak for section 911: *employers* appear to capture at least part of the exemption’s benefits because they “are able to pay lower total compensation to the U.S. worker than if the exclusion were not available,”²⁰⁵ offsetting the costs of tax equalization policies many employers use when sending workers abroad.²⁰⁶ That means any company, anywhere in the world, that hires an American citizen benefits from the subsidy. In fact, according to 2011 returns analyzed by the GAO, over half of all filers claiming the section 911 exclusion worked for a foreign entity.²⁰⁷ The FEIE does not, therefore, give U.S. multinationals an advantage, since the exclusion is available on the same terms to the U.S. employees of, for example, Canadian, Indonesian, and South African companies, too, and those foreign entities capture a substantial portion of the benefit.

200. See, e.g., James McBride & Andrew Chatzky, *The U.S. Trade Deficit: How Much Does It Matter?* COUNCIL ON FOREIGN RELS., March 8, 2019, <https://www.cfr.org/backgrounders/us-trade-deficit-how-much-does-it-matter> [<https://perma.cc/GR5T-L2V2>].

201. *Id.*

202. See, e.g., *ABA Task Force Report*, *supra* note 26, at 657.

203. *Id.*

204. Fleming & Peroni, *supra* note 25, at 532–43.

205. GUSTAFSON ET AL., *supra* note 36, at 167.

206. GAO, ECONOMIC BENEFITS, *supra* note 43, at 26–27. Companies’ tax equalization policies are designed to ensure employees working abroad do not take home higher or lower after-tax wages than they would have if they were on domestic assignment.

207. GAO, ECONOMIC BENEFITS, *supra* note 43, at 17.

B. Equity Concerns

Analyzing whether the FEIE treats taxpayers fairly depends on the point of comparison—domestic U.S. taxpayers, or other Americans abroad?—and whether the citizens abroad should be subject to U.S. taxation in the first place.²⁰⁸ Assuming for the moment that CBT is normatively justified and that the appropriate comparison is usually resident versus nonresident U.S. citizens, the FEIE might be a reasonable mechanism for helping Americans abroad offset extra living and tax costs paid by their employers, which increase their income and may even bump them into a higher tax bracket without making them any better off *after* those costs.²⁰⁹ The FEIE's structure also gives it some vertical equity advantages.²¹⁰ First, the exclusion is capped, so it does not provide unlimited benefits to high income earners.²¹¹ Second, it only applies to *earned*, not investment, income, and there are good reasons to believe labor income should be treated more favorably than investment income, since shifting the tax burden from capital to labor tends to increase wealth gaps and compromise vertical equity.²¹² Third, the FEIE now requires taxpayers' earned income above the cap to be taxed at the same rates that would apply but for the exclusion.²¹³ This "stacking rule" was added in 2006, apparently as a revenue-raising measure.²¹⁴ As a result, a single taxpayer residing abroad with \$120,000 of foreign-source earned income in 2021 could exclude the first \$108,700 of her income,²¹⁵ but her remaining \$11,300 would be taxed at 24%, the applicable rate bracket for income between \$86,375 and \$164,925, rather than at 10% and 12%, the applicable rate brackets for income below \$40,525.²¹⁶ This took away the previous double benefit the FEIE gave to *high* income earners: they paid no tax on the excluded income and then paid tax on remaining amounts at the low rates that would apply if that excluded income had never

208. See *supra* Part II.

209. GAO, ECONOMIC BENEFITS, *supra* note 43, at 26; cf. *supra* note 44.

210. See GAO, ECONOMIC BENEFITS, *supra* note 43, at 35.

211. See *id.*

212. Cf. Avi-Yonah, *Globalization*, *supra* note 87, at 1624–25.

213. § 911(f).

214. See Kirsch, *Taxing Citizens*, *supra* note 10, at 463.

215. See *supra* note 37.

216. See Rev. Proc. 2020-45, at 6.

existed, even though their ability to pay tax on that income was arguably the same.

On the other hand, there are good reasons to believe the FEIE violates equity principles. “[U]nless those working abroad are deemed to be sufficiently different from their *domestic* counterparts,” the FEIE weakens horizontal equity by exempting nonresident American workers’ first \$100,000 of income, regardless of the level of source taxation, but denying the same benefit to domestic workers.²¹⁷ As a result, Americans working abroad in low-tax or low-cost jurisdictions get an “unwarranted benefit.”²¹⁸ Moreover, even when employers do pay American workers abroad more to compensate for higher living or tax costs, it is unclear why those workers should *not* treat the extra income as taxable.²¹⁹ As discussed above in Section II.C, domestic firms often adjust pay for the cost of living in different U.S. cities, but the U.S. tax system provides no deduction or exclusion for that extra income. There is no apparent reason to treat American workers living abroad any differently. The FEIE thus decreases horizontal equity.

And the FEIE violates vertical equity principles “to the extent that individuals who benefit from the exclusion tend to have higher incomes than those living in the United States, unless the ultimate tax benefit falls *entirely* on employers.”²²⁰ And it does not appear to, given that not all employers offer tax equalization packages and employers’ hiring and location assignment decisions often depend primarily on non-tax factors like employee qualifications.²²¹ Even between citizens abroad, in pure dollar terms the exclusion confers a greater benefit on a worker making at or above the cap (like a multinational corporate executive earning \$300,000 per year who can exclude the first \$100,00 from

217. See GAO, ECONOMIC BENEFITS, *supra* note 43, at 68 (emphasis added); see also Peroni, *supra* note 127. This is the case even though some of the exclusion’s benefit may be captured by employers. See text accompanying *supra* note 206.

218. See JCT, COMPETITIVENESS, *supra* note 110, at 44.

219. See *Old Colony Trust Co. v. Comm’r*, 279 U.S. 716 (1929) (holding that costs incurred by an employee but paid by the employer on the employee’s behalf must be treated as income to the employee).

220. GAO, ECONOMIC BENEFITS, *supra* note 43, at 34–35 (emphasis added).

221. *Id.* at 26–29.

U.S. taxable income) than it does to lower-income workers abroad (like an aid organization worker earning \$35,000).

These horizontal and vertical equity concerns may also raise further downstream problems of social cohesion.²²² If resident U.S. taxpayers believe the FEIE means nonresidents are “getting away with something,” they may be less likely to voluntarily comply with U.S. tax laws themselves.²²³ Further, such a belief “might generate broader domestic social problems by reinforcing concerns that wealthy citizens receive more favorable treatment than the rest of society.”²²⁴

C. Administrative Complexity

Although the FEIE may be less complicated to administer and comply with than the FTC,²²⁵ it is still relatively complex. Without professional tax advice, some section 911 filers may struggle to determine, for example, whether they are eligible for the exclusion, how to determine the housing cost amount, and whether they are eligible for an extra cost of living adjustment under the regulations.²²⁶ Such advice can be expensive, and given that the FEIE completely wipes out U.S. taxes owed for some filers, it makes little economic sense to require taxpayers with no residual tax liability to pay hundreds or thousands of dollars for tax preparation services for a net gain to Treasury of \$0.²²⁷ And in addition to the compliance burdens on citizens abroad, section 911 is difficult to enforce for the same reasons discussed above in Section II.E.1. Although the IRS does collect data on tax filers who claim the FEIE, there simply is no reliable data on the incomes and residence countries of *all* U.S. citizens abroad, even though we have strong reasons to suspect a high rate of noncompliance.²²⁸

In sum, the FEIE has been justifiably criticized by both proponents of CBT and those who believe the U.S. should adopt an RBT

222. Cf. Kirsch, *Social Cohesion*, *supra* note 51, at 257 (developing the “social cohesion” thesis in the RBT context).

223. Cf. *id.* at 257.

224. Cf. *id.*

225. *Id.* at 223 (“[T]he exclusion may merely operate as an administratively simpler proxy for the foreign tax credit.”).

226. See Mason, *Citizenship*, *supra* note 11, at 218.

227. See Bugnion, *supra* note 173, at 865.

228. See generally GAO, ECONOMIC BENEFITS, *supra* note 43.

regime. It does not clearly promote the competitiveness of U.S. multi-nationals abroad, it compromises horizontal and vertical equity without accounting for nonresident citizens' genuine connections to the U.S. national community, and it may not raise enough revenue to justify the administrative and compliance burdens it imposes.

* * *

The final two Parts of this Article introduce two proposed changes to the U.S.'s current citizenship taxation regime. The first proposal, which would effectively transition the U.S. toward a residence-based taxation regime with a five-year residency lookback period, is significantly more ambitious but, I believe, best reconciles the fundamental fairness concerns about perpetual tax jurisdiction on long-term nonresidents while taking reasonable steps to avoid tax-motivated expatriations. The second proposal, however, bows to the reality that there may not be sufficient political will to move the U.S. away from citizenship taxation and instead focuses on reducing the administrative burdens on Americans abroad by uncapping the foreign earned income exclusion for those residing in high- and peer-tax countries. In presenting both proposals, one key concern is to avoid creating systems that could easily be manipulated by "tax exiles" who move abroad at least in part to avoid U.S. taxation.²²⁹

IV. PROPOSAL 1: RESIDENCE-BASED TAXATION WITH EXTENDED RESIDENCY RULES

The discussion above in Section II.B highlighted the difficult problems of line-drawing in defining who precisely belongs to the country's ability-to-pay community. To review, bright-line rules based on citizenship (got a passport or green card?) or residency (spend a certain number of days in-country?) are easy to administer but can lead to unfair results. Citizenship might be overbroad, as for the American citizen who moves to Italy for marriage and intends to spend the rest of her life there,

229. Cf. Gutmann, *supra* note 52, at 27 (using the term "tax exiles" to describe French nationals who move abroad to avoid French taxation); Cécile Crouzel, *Sarkozy: les exilés fiscaux paieront des impôts pour rester français*, FIGARO (March 13, 2012), <https://www.lefigaro.fr/presidentielle-2012/2012/03/13/01039-20120313ARTFIG00002-sarkozy-les-exiles-fiscaux-paieront-des-impots-pour-rester-francais.php> [<https://perma.cc/F3M5-SAV2>] (same).

or for the “accidental” or “unknowing American” who was born in the U.S. but moved away in the first year of her life, never obtains a U.S. passport, and grows up to spend the rest of her life outside the country. On the other hand, “residency” defined only by the number of days spent in-country can be easy to game, especially for the wealthy: buy a home in a European tax haven and spend six months and three days a year there, but the rest of the year in Connecticut, and pay no tax under a strict RBT regime.

Although we lack the data to draw robust empirical conclusions about Americans abroad, the reality for most citizens is somewhere in the middle. Many likely move abroad for a few years and maintain strong connections to the U.S. And in fact, some countries that, at least in principle, only exercise taxing jurisdiction on the basis of residency have departed from a pure residency approach by continuing to tax individuals living abroad on the basis of their “extended” domestic residency or domicile.²³⁰ Such extended residency or domicile tests consider factors like the property an individual owns in the country, the location of her primary business and economic ties, her close family members’ residency, and where she intends to settle permanently.²³¹ Citizenship itself can be one factor the tax authority considers in determining whether the individual is subject to the country’s taxing jurisdiction.²³² However, as discussed above, accurately testing for those connections can be administratively complex.

I ultimately believe that the U.S.’s pure CBT regime reaches too many unfair results, especially after the implementation of FATCA, to justify subjecting all Americans everywhere to full worldwide income

230. See, e.g., Allison Christians, *UPDATE: China does NOT follow US lead, taxing its global diaspora. (If they did, it would be a terrible idea)*, TAX, SOCIETY & CULTURE BLOG (Jan. 8, 2015), <http://taxpol.blogspot.com/2015/01/china-to-follow-us-lead-taxing-its.html> [<https://perma.cc/QQ8P-VTWC>] (listing countries that use extended tax residency rules for citizens; Gutmann, *supra* note 52, at 27–29 (describing the ways various European countries continue to tax citizens and former residents who are no longer current-year residents)).

231. Shaviro, *supra* note 22, at 76–77; Mason, *Citizenship*, *supra* note 11, at 206; Zelinsky, *supra* note 2, at 1323–43 (collecting cases from Australia, the United Kingdom and Canada, all of which use extended residency or domicile rules to reach results similar to or the same as a strict CBT regime would have).

232. Mason, *Citizenship*, *supra* note 11, at 206.

taxation. However, I also believe many Americans abroad continue to maintain the kinds of material connections to the country that would justify continuing to include them in our ability-to-pay community. But rather than asking the IRS to regularly make fact-sensitive and subjective determinations about an American expatriate's ongoing connections to the country, I propose that the U.S. formally end CBT and implement an RBT regime with a three-tier extended residency period.²³³

A. Mechanics

Under the proposal, a U.S. citizen who establishes a "tax home" in another country and meets specific foreign residency requirements would be deemed an ongoing U.S. tax resident for the first five tax years in which she lives abroad, beginning in the year after her departure.²³⁴ During Years 1 and 2, citizens would be subject to the full statutory tax rates. However, in Years 3–5, eligible taxpayers could claim a 50% reduction in their calculated U.S. income tax liability if they continued to meet the foreign tax home and residency requirements. Beginning in Year 6, eligible taxpayers would no longer be subject to U.S. income tax but would instead accrue a low but ongoing annual fixed dollar "return tax" which would be payable in the tax year she (re)establishes permanent residency in the U.S.²³⁵ If the taxpayer never again established permanent U.S. residency, this tax would never be paid.

Nothing in the proposal would alter the current foreign tax credit system in Years 1 and 2, so Americans abroad could continue to reduce their U.S. income tax liability dollar-for-dollar by showing they paid taxes to their country of residence. The FTC would be reduced to 50% in Years 3–5, since only half of the nonresident citizen's foreign-source income would be subject to U.S. tax. In addition, the new proposed

233. I have loosely modeled this proposal on peer- or higher-tax RBT countries' extended residency rules. *See generally, e.g.,* Gutmann *supra* note 52, at 28–31.

234. *Cf.* § 911(d)(1) (defining which taxpayers are eligible for the FEIE). The proposal would evaluate citizens abroad following the same tests currently used to define which U.S. taxpayers are eligible to claim the FEIE under section 911. *See id.*

235. The annual return fee might reasonably be \$500 or \$1,000, with annual inflation adjustments. The amount would also accrue interest at the lowest Applicable Federal Rate.

regime could also borrow elements of the modified FEIE I propose in Part V below.²³⁶

B. Normative Considerations

This proposal attempts to more closely—albeit only roughly—correlate expatriate citizens’ U.S. income tax liability to their degree of connection to the American ability-to-pay community. Reducing rates by 50% and then a low annual flat tax would begin to approximate long-term expatriate Americans’ decreasing connections to the U.S. and, therefore, its taxing community. The flat annual tax beginning in Year 6 would essentially excuse long-term American expatriates from our ability-to-pay taxing community but recognize the ongoing value of the right of all citizens to return to the U.S. and (re)establish residency without obtaining a visa.

This proposal would apply relatively straightforward rules—Is the citizen a foreign tax resident? For how long?—rather than a complex and cumbersome (though more accurate) facts-and-circumstances test. Of course, like a pure CBT or pure RBT regime, that means the proposed extended residency system is probably over- and under-inclusive and would not perfectly test for a nonresident citizen’s subjective, personal and property connections to the U.S. As a result, the extended residency rules might still induce some wealthy citizens to move abroad long-term to avoid U.S. tax. Congress could, however, counteract this “tax exile” effect by imposing an exit tax on citizens’ worldwide appreciated but untaxed assets at the end of the extended residency period, much like the exit tax currently imposed by section 877A on U.S. citizens who renounce.²³⁷ And though they may be imperfect, bright-line rules serve taxpayer interests of predictability and notice, which, if the IRS could mount an effective education campaign, might actually increase nonresident citizen compliance rates.

236. Note that if repealing CBT were politically infeasible, Congress could reach effectively the same result by retaining CBT in name but with an increasing foreign-source income exemption amount available each year the citizen continued to maintain a foreign tax home and meet the foreign residency rates.

237. See § 877A; see also Internal Revenue Service, *Expatriation Tax*, <https://www.irs.gov/individuals/international-taxpayers/expatriation-tax> [<https://perma.cc/P67Y-HZMS>] (last updated July 22, 2021) (explaining expatriation rules).

Further, I recognize that readers may dispute my numbers: Why two and then five years? Why 50%? And don't citizens abroad continue to pay a flat "return tax" each time they renew their passports? First, I only propose these numbers as a starting point for discussion and further study, and I believe additional research could certainly reveal a fairer and more accurate alternative tier and rate structure. Second, while American citizens everywhere must pay a passport renewal *fee*, that amount is not a tax—it is paid in direct exchange for renewal services and does not approximate the value of being able to re-enter the U.S. without obtaining a visa. More importantly, the "return tax" is normatively justified not as consideration for reentry, but rather as an ongoing signal that the taxpayer continues to belong to the American community, albeit in a way that does not justify full ability-to-pay taxation. I have proposed that the tax accrue beginning in Year 6 and only become payable in full in the tax year the citizen (re)establishes U.S. residency not because that citizen needs to "buy" her way back into the community when she returns, but rather because collecting the tax from citizens abroad each year would be so administratively costly as to eat away any net revenue gain.

V. PROPOSAL 2: MODIFIED FEIE WITH COUNTRY-SPECIFIC EXEMPTIONS

Whatever the merits of an RBT regime with extended residency rules, outside the niche academic tax community, there does not seem to be much political will to end U.S. citizenship taxation. Since we do not live in the best of all possible worlds, I propose Congress at least act to reduce the substantial but largely unjustified compliance burden imposed on U.S. citizens working abroad in high- or peer-tax jurisdictions, whose income tax burdens are often eliminated by the FTC in the first place.

I therefore propose Congress (1) greatly reduce the general FEIE exclusion cap in section 911 but continue to make it available to all U.S. citizens working abroad, and (2) simultaneously authorize Treasury to create and maintain a "nice list" of high- and peer-tax countries. Congress should (3) grant U.S. citizens who are tax residents of those "nice list" countries a new, uncapped foreign earned income exclusion and (4) authorize Treasury to develop simplified filing requirements for those who qualify.²³⁸

238. A few scholars have mentioned this or similar ideas in passing, but I have yet to find such a proposal developed fully in the literature. *See*

A. The Mechanics

The first piece of the puzzle—a reduced FEIE exclusion cap of, say, \$50,000—would primarily benefit relatively lower-income workers like American teachers, humanitarian workers, and clergy who reside in low-tax jurisdictions where the FTC would provide little to no relief. Some of these citizens probably should continue to belong to the American ability-to-pay community because they maintain the kinds of ongoing connections to the country that would justify their inclusion. Of course, nonresident citizens with income above the cap would still be able to exclude the first \$50,000 of income, avoiding a cliff effect but providing a benefit to high-income earners and thus still reducing vertical equity.

However, two arguments appear to justify the low-cap exclusion. First, those whose incomes fall below this lower cap probably moved abroad for non-tax reasons—they are not the kind of “exiles” that would raise concerns about tax-motivated expatriations. Second, the likely net revenue gain for Treasury is probably low. Enforcing U.S. tax laws abroad, as this Article has repeatedly emphasized, is complicated and expensive, and because these individuals probably would not owe very much income tax in the first place, it seems a reasonable compromise to excuse them from full U.S. tax liability.

The second, third, and fourth pieces would grant citizens with income above the FEIE cap and whose tax home is in a country included in the “nice list” of countries that impose high or comparable income tax rates an uncapped foreign earned income exclusion and simplified filing requirements. This would recognize that American citizens in many high- and peer-tax countries, like the United Kingdom, Canada

Blum & Singer, *supra* note 140, at 727 (“If desired, Congress could authorize the Treasury to provide a list of countries that impose significant tax on the income of detached workers and restrict use of the unlimited exclusion to workers in those countries.”); Kirsch, *Social Cohesion*, *supra* note 51, at 243 (mentioning an RBT proposal that would include a “‘white list’ of countries where a citizen could reside without being subject to U.S. worldwide taxation”); *see also* Peroni, *supra* note 127, at 985 (“[A]n exemption system could include the rule used in some foreign countries’ tax systems that income is exempt from residence country tax only if it incurs tax (or some specified minimum rate of tax) in the source country.”).

and Japan,²³⁹ typically see their entire U.S. tax liability wiped out by the foreign tax credit. The list would need to be developed and regularly updated by Treasury to account for changes in other countries' tax systems that might require inclusion on or removal from the list.

The uncapped exclusion for "nice list"-country residents would still only apply to *earned* income, but qualifying taxpayers' filing requirements could be greatly reduced because they do not appear to raise tax evasion concerns. I propose that rather than the complex Form 2555 citizens abroad must currently use to claim the section 911 exclusion, qualifying taxpayers instead (a) submit a simplified affidavit certifying that all of their current-year income is from labor abroad, rather than foreign-source capital income or U.S.-source income of any kind, and (b) attach their foreign tax return or equivalent as evidence.²⁴⁰ Taxpayers with U.S.-source income or foreign-source capital income, on the other hand, would still need to "show their work" by filing complete U.S. income tax returns claiming the FTC for any foreign taxes paid, a result pure RBT proponents would object to.

B. Normative Considerations

This modified FEIE proposal has two key advantages. First, it makes tax collection more efficient by scaling down administrative and compliance burdens without sacrificing revenue. Taxpayers living in high- and peer-tax countries who only have earned income will no longer be required to spend hundreds or thousands of dollars on specialized U.S. tax advice to ultimately discover they have \$0 in U.S. tax liability thanks

239. GOV.UK, *Income Tax rates and Personal Allowances*, <https://www.gov.uk/income-tax-rates> [<https://perma.cc/XL5A-GBZE>] (last visited Aug. 11, 2020); GOV'T OF CAN., *Canadian Income Tax Rates for Individuals—Current and Previous Years*, <https://www.canada.ca/en/revenue-agency/services/tax/individuals/frequently-asked-questions-individuals/canadian-income-tax-rates-individuals-current-previous-years.html> [<https://perma.cc/47TM-ZT5H>] (last visited Aug. 11, 2020); KPMG, *Japan—Income Tax*, <https://home.kpmg/xx/en/home/insights/2011/12/japan-income-tax.html> [<https://perma.cc/LRZ6-3V6D>] (last visited Aug. 11, 2020).

240. Given international variation in tax deadlines, Treasury might also need to issue regulations modifying filing deadlines for nonresident citizens in some qualifying countries.

to the operation of the FTC. Qualifying taxpayers would be able to complete the affidavit and append their foreign tax return without ever talking to an accountant or lawyer. And since the FTC almost always zeroes out these individuals' U.S. tax liability, Treasury should not see a net loss in revenue.

Second, the proposal strengthens horizontal and vertical equity between U.S. domestic and nonresident citizen taxpayers. An expatriate's foreign-source income from a low-tax jurisdiction will remain subject to residual U.S. income tax above the lower \$50,000 exclusion cap. Since the FTC is a compromise between ability-to-pay taxation and the unfair and inefficient results of overlapping tax jurisdictions, this is arguably the right result for nonresident citizens who continue to belong to the American taxing community.

Still, the proposal is far from perfect. To begin, the proposal will not satisfy CBT's harshest critics because it does not challenge the U.S.'s taxing jurisdiction over its citizens' worldwide income. In fact, the \$50,000 cap substantially *raises* the tax burden on many middle- and higher-income workers in low-tax jurisdictions and fails to reduce their current compliance burden. That said, however, a number of these nonresident citizens in low-tax countries may plausibly continue to belong to the American ability-to-pay community, and since they likely owe residual U.S. income tax under the proposal, it may be worth U.S. tax authorities' while to administer the tax despite the costs.

The proposal also does not reduce the compliance burdens on nonresident citizens with capital income no matter where they live: they must still "show their work" by filing full U.S. income tax returns and claiming the FTC. For nonresident citizens whose passive income is subject to a high rate of tax by the source country, they may still ultimately have \$0 in U.S. tax liability but still need expensive professional tax advice. However, without requiring those with capital income to file a full U.S. tax return, the IRS may struggle to catch tax evaders.

The most significant shortcoming of the modified FEIE proposal, however, is that it fails to directly address the admittedly unfair problem of accidental and unknowing Americans, especially if they live in a low-tax jurisdiction. This group of nonresident citizens does not appear to have the strong ties to the U.S. that would justify full membership in the American ability-to-pay community, but under the current CBT regime, they continue to be subject to U.S. tax liability. Moreover, since FATCA was enacted in 2006, these estranged citizens are increasingly likely to be caught out during absolutely ordinary, unsuspecting interactions with a bank in the non-U.S. country where

they live, work and have the strongest connections.²⁴¹ However, many accidental Americans are probably permanently out of compliance with U.S. tax laws, and resolving the problem can probably only be accomplished via a separate statute that, for example, permanently exempts all nonresident U.S. passport holders who left the country before age 18 and have not returned.

Although this second proposal has some important weaknesses, it is a second-best patch for the most obvious inefficiencies of the current CBT regime through the “nice list” uncapped exemption coupled with a rebalancing of the equities under the current FEIE.²⁴²

CONCLUSION

The scholarly debate over the United States’ exercise of citizenship taxation is, if niche, a fierce one. After weighing the fairness, efficiency and administrability arguments for and against citizenship-based taxation, I have presented two proposals that I believe could bring compliance relief to deserving citizens abroad, more closely correlate citizens’ level of connectedness to the U.S. with the level of tax they must pay and do so without reducing revenue.

Under the first proposal—which I believe to be more normatively sound if less likely to gain purchase in Congress—American expatriates would be subject to U.S. tax on their earned income for only a relatively short period after establishing residency abroad: at full U.S. income tax rates for the first two years, then at a reduced rate for an additional three years, and finally at a low, fixed “return tax” amount each subsequent year until they reestablish domestic residency. While an imperfect solution to a vexing problem, this shift toward residency-based taxation would more accurately correlate expatriate citizens’ U.S. income tax liability to connections to the American taxing community while minimizing the risk of tax-motivated relocation that has caused so much controversy in places like France and Germany.

The second proposal is, if less ambitious, perhaps more practical: Congress should reduce the current standard foreign earned income exclusion but grant an uncapped exclusion with minimal filing requirements to U.S. citizens working abroad in high- and peer-tax countries. This would lift the compliance burdens for American expatriates

241. See generally Christians, *Global Perspective*, *supra* note 3.

242. Cf. Cabezas, *supra* note 17, at 115–16.

working in countries where they are likely to see their U.S. tax liability completely eliminated by the foreign tax credit while also reducing what may be an unfair tax giveaway to Americans living in low-tax jurisdictions. While the proposals may not represent Pangloss's best of all possible worlds, I also believe these are compromise solutions that are both reasonably practicable and reasonably fair.

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