University of Baltimore Law Review

Volume 1
Issue 1 *Winter 1971*

Article 5

1971

The Income Tax Consequences of a Holding of Unconstitutionality of Expatriation Statutes

THE INCOME TAX CONSEQUENCES OF A HOLDING OF UNCONSTITUTIONALITY OF EXPATRIATION STATUTES

The author discusses the impact of recent Supreme Court decisions and congressional statutes on the taxation of naturalized U.S. citizens not residing in the United States.

I. INTRODUCTION

As immigration has played such a prominent part in the development of the United States, the problems of naturalization, rights of citizenship, repatriation of former citizens, and expatriation, have been given considerable attention. However, it was not until the decision of *Schneider v. Rusk*[1] that attention was given to the tax consequences connected with these problems. As a result of this decision, a large group of persons believed to have been expatriated, found themselves to be citizens of the United States. The problem therefore is the tax effect of this action on these persons.

The Internal Revenue Service published in Revenue Ruling 70-506 its interpretation of the income tax consequences of the Schneider decision.[2] The Service's position is that, as section 352 of the Immigration and Nationality Act[3] was declared to be invalid by the Supreme Court, the law was void ab initio; therefore, people affected by the law are not now regaining their citizenship because they never lost it. Thus, persons who derived none of the benefits of United States citizenship, are nevertheless subject to the burdens of citizenship, *i.e.* taxation. Therefore, a question of policy arises as to the equity of taxing these persons during their period of "non-citizenship."

II. HISTORY OF THE *SCHNEIDER v. RUSK* DECISION

On May 18, 1964, the Supreme Court decided *Schneider v. Rusk.*[4] Mrs. Schneider, who was born in Germany, acquired derivative United States citizenship at the age of 16 through her mother, but later returned to Germany, married a German national, and resided there for

[1] Schneider v. Rusk, 377 U.S. 163 (1964).
[2] Rev. Rul. 70-506, 1970 INT. REV. BULL. NO. 401 at 7.
[3] Act of June 27, 1952, Pub. L. No. 82-414, 66 Stat. 269.
[4] 377 U.S. 163 (1964).

more than three years after her marriage. Her citizenship was declared terminated by the State Department under paragraph (1) of section 352 (*a*) of the Immigration and Nationality Act of 1952.[5] This Act provides that a naturalized citizen shall lose his citizenship by residing continuously for three years in the foreign state of which he was formerly a national or in which he was born. The Supreme Court held that the statute was so unjustifiably discriminatory against naturalized citizens, as opposed to native born citizens, that it violated the due process clause of the Fifth Amendment.[6]

In addition to *Schneider v. Rusk*, there have been several other decisions by the Supreme Court in recent years concerning expatriation.[7] Though the *Schneider* case arose under section 352 (*a*) of the Immigration and Nationality Act of 1952, all of the other cases arose under section 349 of the 1952 Act[8] or its predecessor, section 401 of the Nationality Act of 1940.[9]

From 1958 to 1966 the Court increasingly manifested doubt as to the constitutionality of statutes which expatriated citizens through the mere doing of acts which per se allegedly showed diluted allegiance to the United States. These decisions, in general, protected the citizen from involuntary expatriation, but nowhere denied the inherent right of voluntary expatriation.[10] Congress, however, has traditionally recognized an individual's right to renounce allegiance to any nation and has given legal significance to such renunciation.[11] Repudiating altogether the concept of statutory involuntary expatriation, *Afroyim v. Rusk* held that Congress had no power to take away an American's

---

[5] Act of June 27, 1952, Pub. L. No. 82-414, 66 Stat. 269.

[6] *See* Kurland, *Equal in Origin and Equal in Title to the Legislative and Executive Branches of the Government*, 78 HARV. L. REV. 143, 168 (1964).

[7] *See* Perez v. Brownell, 356 U.S. 44 (1958); Trop v. Dulles, 356 U.S. 86 (1958); Kennedy v. Mendoza-Martinez, 372 U.S. 144 (1963); Marks v. Esperdy, 377 U.S. 214 (1964).

[8] McCarran-Walter Act, ch. 3, §349, 66 Stat. 268.

[9] The Nationality Act of 1940, Pub. L. No. 76-853, 54 Stat. 1168-69.

[10] Dual or multiple nationality is a status applicable to many citizens of the United States as well as many citizens of other countries. Dual nationality results from the fact that there is no uniform rule of international law relating to the acquisition or loss of nationality. International law recognizes the right of each country to determine how its nationality may be acquired or lost. Each country has its own laws on the subject and its nationality is conferred upon individuals or divested on the basis of its own independent domestic policy. Individuals may be clothed with more than one nationality not by preference on their part but by reason of the operation of these different laws. It is extremely difficult to divest oneself of the nationality of many countries by reason of those countries' laws on loss of nationality. In such countries the voluntary acquisition of another nationality may not automatically result in the loss of the nationality of the country of origin. *See Dual or Multiple Nationality; Loss of Nationality*, 65 AM. J. INT'L. L. 187 (1971).

[11] *See* Gordon, *The Citizen and the State: Power of Congress to Expatriate American Citizens*, 53 GEO. L. J. 315 (1965); *See* Kramer, *The Restraints of Schneider v. Rusk Upon the Foreign Policy, Powers of the "Political Branches": How Meaningful Are They?* 38 TEMP. L. Q. 279 (1965); *See* Roche, *The Expatriation Cases: "Breathes There The Man, With Soul So Dead . . . ?"* 1963 SUP. CT. REV. 325; *See* Maxey, *Loss of Nationality: Individual Choice or Government Fiat?*, 26 ALBANAY L. REV. 151 (1962).

citizenship without his assent, and that he keeps it "unless he voluntarily relinquishes it."[12]

On April 5, 1971, the Supreme Court handed down its decision in the case of *Rogers v. Belle.*[13] The appellee challenged the constitutionality of section 301 (*b*) of the Immigration and Nationality Act of 1952, which provides that one who acquires United States citizenship by virtue of having been born abroad to at least one parent who is an American citizen and who has met certain residence requirements, shall lose his citizenship unless he resides in this country continuously for five years between the ages of 14 and 28.[14] The three-judge district court had held the section unconstitutional, citing *Afroyim v. Rusk*[15] and *Schneider v. Rusk.*[16] The Supreme Court held that Congress has the power to impose the condition subsequent of residence in this country on the appellee, who does not come within the fourteenth amendment's definition of citizens as those born or naturalized in the United States, and its imposition is not unreasonable, arbitrary, or unlawful.[17]

III. INCOME TAX ISSUE RAISED

The income tax issue raised by the *Schneider* decision is that the tax burden of a non-resident United States citizen in most cases is much greater than that of a non-resident alien.[18] A United States citizen is subject to taxation on all of his income from all sources and is allowed a credit for taxes paid to foreign countries on income from all sources within those countries.[20] A non-resident alien not engaged in a trade or business[21] in the United States is subject to taxation only on income from sources within this country.[22] Moreover, capital gains realized in this country by a non-resident alien are not taxable at all unless the alien spends more than a specified time in this country during any given year.[23] This freedom from tax applies even though the sale took place in the United States, so that the income was of a United States source, and it applies to the sale of United States real property as well as

---

12 Afroyim v. Rusk, 387 U.S. 253, 268 (1967).
13 Rogers v. Bellei, 91 S. Ct. 1060 z1971).
14 Act of June 27, 1952, Pub. L. No. 82-414, 66 Stat. 269.
15 387 U.S. 253 (1967).
16 377 U.S. 163 (1964).
17 Rogers v. Bellei, 91 S. Ct. 1060 (1971).
18 Schneider v. Rusk, 377 U.S. 163 (1964).
19 INT. REV..CODE OF 1954, §61.
20 I NT. REV. C ODE OF 1954,' §901.
21 Saunders, *"Trade or Business," Its Meaning Under the Internal Revenue Code,* 1960 S. CALIF. TAX INST. 693.
23 INT. REV. CODE OF 1954, §871 (a) (2). See Weyher & Kelley, 111, *Nonresident Alien Individuals and The Capital Gains Tax,* 1954 N. Y. U. TAX INST. 883.

personal property.[24] Further, it may be said generally that the principal effects of most tax treaties on a non-resident alien are to (1) reduce the tax rate on, or entirely exempt, certain dividend and interest income from United States sources; (2) exempt royalty income from patents, copyrights, artistic works, etc., paid by United States sources; (3) exempt a limited amount of compensation for personal services rendered in the United States; and (4) provide for a tax credit where income might otherwise be subjected to double taxation.[25] Consequently, the forcing of involuntary citizenship on persons who reasonably believed that they were not citizens would work extreme and unjust hardship taxwise.

IV. CITIZENSHIP ISSUES RAISED

Although the Supreme Court has clarified the law with respect to the power of Congress to impose involuntary expatriation,[26] the Court has not ruled that a citizen's renunciation must be manifested in any certain way. The cases have involved claims of citizenship, not claims of non-citizenship; hence the Court has not been called upon to determine what action is sufficient to constitute voluntary expatriation.[27]

In a statute enacted in 1868,[28] expatriation was acknowledged by Congress to be a natural and inherent right of every person. This statute is in full force and effect. In *Savorgnan v. United States,* the Supreme Court stated:

> Traditionally the United States has supported the right of expatriation as a natural and inherent right of all people. Denial, restriction, impairment or questioning of that right was declared by Congress, in 1868, to be inconsistent with the fundamental principles of this government. From the beginning, one of the most obvious and effective forms of expatriation has been that of naturalization under the laws of another nation. However, due to the common-law prohibition of expatriation without the

---

[24] Berens, *United States Taxation of the American Income of Foreigners,* 45 TAXES 830 (Dec. 1967).

[25] Schneider, *Aliens and the United States Income Tax*—1956, 34 TAXES 583 (Sept. 1956).

[26] *See* Schneider v. Rusk, 377 U.S. 163 (1964); Afroyim v. Rusk, 387 U.S. 253 (1967).

[27] The 5th U.S. Circuit Court of Appeals on April 13, 1971, upheld a deportation order against Thomas Glenn Jolley, ruling that he made himself an alien and must be regarded as such. Jolley had appeared before the U.S. Consul in Toronto and formally executed an oath of renunciation of U.S. citizenship. Jolley later returned to the United States and was arrested in Georgia, March 19, 1969, for violation of U.S. Selective Service Laws. In opposing deportation, Jolley argued that this renunciation was made under duress, with coercion being his desire to avoid breaking the Selective Service Laws. The majority opinion said Jolley's renunciation was the product of personal choice and consequently voluntary. Jolley v. Immigration and Naturalization Service, 441 F. 2d 1245 (5th Cir. 1971).

[28] Act of July 27, 1868, ch. 249, 15 Stat. 223.

> consent of the sovereign, our courts hesitated to recognize expatriation of our citizens, even by foreign naturalization, without the express consent of our Government. Congress finally gave its consent upon the specific terms stated in the Citizenship Act of 1907 and in its successor, the Nationality Act of 1940. Those Acts are to be read in the light of the declaration of policy favoring freedom of expatriation which stands unrepealed.[29]

Subsequently, Congress enacted the Immigration and Nationality Act of 1952, which provided that a U. S. citizen may lose his citizenship in a number of ways, including "by making a formal renunciation of nationality before a diplomatic or consular officer of the United States in a foreign state, in such form as may be prescribed by the Secretary of State."[30]

Against this background, two questions arise. The first is whether Congress intended that citizenship could be relinquished only in one of the ways prescribed in the statute, in particular, that citizenship could only be renounced in the manner provided in paragraph (6) of section 349 (*a*).[31] The second question is whether, even if Congress so intended, it could thus circumscribe the manner in which citizenship can be relinquished. There is no certain answer to either of these questions.

The position of the government that the taxpayer is a citizen rests upon the erroneous constitutional doctrine that an unconstitutional statute and all action taken under it are void. This constitutional doctrine was rejected many years ago by the Supreme Court in the case of *Chicot County Drainage Dist. v. Baxter State Bank.*[32] The Supreme Court held that the prior decree of the district was res judicata, saying:

> The courts below have proceeded on the theory that the Act of Congress, having been found to be unconstitutional was not a law; that it was inoperative, conferring no rights and imposing no duties and hence affording no basis for the challenged decree.[33] It is quite clear, however, that such broad statements as to the effect of a determination of unconstitutionality must be taken with qualifications. The actual existence of a statute prior to such a determination is an operative fact and may have consequences which cannot justly be ignored. The past cannot always be erased by a new judicial declaration. The effect of the subsequent ruling as to invalidity may have to

---

29 Savorgnan v. U.S., 338 U.S. 491, 497-98 (1950).

30 Act of June 27, 1952, Pub. L. No. 83-414, 66 Stat. 269.

31 *Id.*

32 Chicot County Drainage Dist. v. Baxter State Bank, 308 U.S. 371 (1940).

33 Norton v. Shelby County, 118 U.S. 425 (1886); Chicago, Indianapolis and Louisville Railway Co. v. Hackett, 228 U.S. 559 (1913).

> be considered in various aspects—with respect to particular relations, individual and corporate, and particular conduct, private and official. Questions of rights claimed to have become vested, of status, of prior determinations deemed to have finality and acted upon accordingly, of public policy in the light of the nature both of the statute and of its previous application, demand examination. These questions are among the most difficult of those which have engaged the attention of courts, state and federal, and it is manifest from numerous decisions that an all-inclusive statement of a principle of absolute retroactive invalidity cannot be justified . . . .[34]

In *J. A. Dougherty's Sons, Inc. v. Commissioner*[35] the taxpayer accrued and deducted from his gross income for 1935, 1936 and 1937, a tax imposed by a statute of Pennsylvania. The taxpayer had reported the taxes to the state, but had not paid them due to extensions of time for payment. Before payment was made the Pennsylvania statute imposing the taxes was held to be unconstitutional. The commissioner of Internal Revenue then disallowed the accrual by the taxpayer of the taxes for the years 1935, 1936, and 1937 on the grounds that there was never any liability for the taxes because the statute was unconstitutional. The court of appeals rejected the government's decision holding that the accruals were proper. It referred to the opinion in *Chicot County Drainage Dist. v. Baxter State Bank*, and said:

> Although it was formerly held that an unconstitutional statute is a nullity ab initio, more lately it has been recognized that the consequences of action taken or restricted in obedience to the requirements of a statute which subsequently is declared unconstitutional are to be appraised and adjusted in light of the compulsion exerted by the statute prior to its determined invalidity.[36]

Thus, the decision in the *Schneider* case did not retroactively wipe section 352 (*a*)[37] off the statute books, nor did it undo the actions taken by the State Department under it prior to that decision. Persons whose citizenship was terminated under section 352 (*a*) had to make adjustments in their affairs which were necessary or desirable because of their loss of citizenship.[39]

To treat the decision in the *Schneider* case as having the effect of establishing unbroken continuity of citizenship for all persons to whom section 352 (*a*)[40] had been applied is to ignore the facts. Considering

---

34 Chicot County Drainage Dist. v. Baxter State Bank, 308 U.S. 371, 374 (1940).
35 J. A. Dougherty's Sons v. Comm'r., 121 F. 2d 700 (3rd Cir. 1941).
36 Chicot County Drainage Dist. v. Baxter State Bank, 308 U.S. 371, 374 (1940).
37 Act of June 27, 1952, Pub. L. No. 82-414, 66 Stat. 269.
38 *Id.*
39 *See* §3 *infra.*
40 Act of June 27, 1952, Pub. L. No. 82-414, 66 Stat. 269.

such circumstances, the most that *Schneider* could do was to restore citizenship to those who wanted it. Moreover, to force such restoration upon all persons, completely disregards their wishes. If, because of a narrow view of the effect of an unconstitutional statute, restoration of citizenship is to be imposed upon an unwilling person, the result would be arbitrary and unjust.

V. ADMINISTRATIVE APPROACH

One solution to the taxpayers' predicament is for appropriate relief to be granted through legislation by Congress. However, only the possibilities of administrative relief will be discussed here. The Internal Revenue Service could have declared shortly after the opinion in the *Schneider* case was handed down, that no tax would be asserted against persons entitled to the protection of the *Schneider* decision who had not claimed citizenship or the benefits thereof. Such administrative relief would have depended on the Service's recognition that persons who have not taken advantage of the *Schneider* decision should not be taxed as citizens. Such a policy would be in keeping with the view of the Supreme Court expressed in *Chicot County Drainage Dist. v. Baxter State Bank.*[41] The argument which may be raised, however, is that persons entitled to citizenship under the decision in *Schneider* may claim citizenship in the future, and that unless they are taxed immediately for years subsequent to that decision, they could possibly avoid income taxes which they rightfully owe. This would not be the case unless a person is taxed for all years subsequent to the *Schneider* decision, whether or not he has claimed citizenship under that decision. If the more reasonable position is taken that only those who have claimed citizenship under the protection of the decision should be taxed as citizens, then it could be said that if any such person should claim citizenship in the future and takes advantage of his rights flowing from *Schneider,* he should be taxed for all years subsequent to that decision.

The case of *Rexach v. United States* supports this position.[42] In that case a native born Puerto Rican, who was a United States citizen, left Puerto Rico in 1944 and became a resident of the Dominican Republic, remaining there until 1961. In July, 1958, he executed a written renunciation of American citizenship before a United States consular official in the statutory form, and a certificate of loss of nationality was approved by the State Department. On July 26, 1958, the taxpayer was

[41] Chicot County Drainage Dist. v. Baxter State Bank, 308 U.S. 371 (1940). *See* Labor Board v. Rockaway News Co., 345 U.S. 71 (1953).

[42] Rexach v. U.S., 390 F. 2d 631 (1st Cir. 1969).

declared to be a citizen of the Dominican Republic. In 1961, the taxpayer applied for an American passport, claiming that his renunciation in 1958 was not voluntary, that he had been coerced into making it by economic pressure and physical threats. The court agreed with the Internal Revenue Service, holding the taxpayer liable as a citizen for tax purposes during the interim period. Based upon the taxpayer's reasoning, this would appear to be a correct result. The taxpayer claimed that his renunciation was invalid because it was involuntary; that he never lost his citizenship; and that he was a citizen for the entire period. Thus, he could not claim citizenship for the entire period of time for purposes of benefits, such as the right to a United States passport, and then deny citizenship to escape its burdens, such as taxes.

In like manner, whenever a person claims citizenship under the *Schneider* decision, no matter how much time has elapsed after that decision, he is in effect claiming that he has been a citizen from the moment of that decision and if he has been a citizen, he must then pay taxes as a citizen for all of the years subsequent to that decision. Furthermore, there would be no bar to the assessment and collection of taxes for all of those years in that such a person would not have filed returns as a citizen for the years subsequent to the *Schneider* decision.[43] Through this method, the revenue of the United States government would be fairly protected. However, this result is not entirely equitable, since, for those persons who affirm their United States citizenship, they are liable for the imposition of income tax during all of the intervening years of "noncitizenship." It may be recalled that one of the cries of the founders of this country was "no taxation without representation." Not only did these persons not have respresentation, but it is probable that some or all of them were denied access to this country during this period. The question is then raised as to the equity of taxing these persons during the period of time in which the United States government denied to them the benefits of citizenship.

Further consideration may be given to the case where although the individual has technically complied with the nationality requirements of another country, it is obvious on its face that this was done through tax motivations. This problem may be more difficult if the person resided in certain foreign countries which have no requirement beyond a certain period of residence to create citizenship in that country.[44] Here, the person would have to make no formal declaration of allegiance or sign other papers to constitute himself a citizen of that

[43] INT. REV. CODE OF 1954, §6501 (c)(3).

[44] Irish Nationality and Citizenship Act of 1956, Acts of the Oireachtas 439, 447, par. 14, 15 (Ire). *See* Law of Return No. 5710 (1950), 8 Laws of the State of Israel 114, *as amended*, 8 Laws of the State of Israel 144 (1954).

country. In this type of situation, a person may have had access and/or received the benefits of United States citizenship without its burdens as well as receiving the benefits of another country's citizenship.

In these cases of dual or multiple nationality, the holding of the International Court of Justice in the *Notebohm* case should be closely scrutinized.[45] Here, the court discussed those factors which it considered to constitute real and effective nationality. Among these the court mentioned:

> The habitual residence of the individual concerned is an important factor, but there are other factors such as the center of his interest, his family ties, his participation in public life, attachment shown by him for the given country and inculcated in his children, etc.[46]

Where the individual concerned claims that he has had little real or substantive contact with one particular country, this may negate his assertion that he had the intent to become a citizen of that country. On the other hand, where the person can show these factors, the argument that he retained United States citizenship and did not acquire the citizenship of the foreign country would appear to be very weak.

Of the many possibilities available to the government to provide relief to those persons who were affected by the *Schneider* decision, the Internal Revenue Service chose to publish a Revenue Ruling in 1970, holding as follows:

> As a result of *Schneider v. Rusk* any Certificate of Loss of Nationality of the United States issued by reason of section 352(*a*) of the Immigration and Nationality Act of 1952 is considered null and void and the individual affected thereby is a citizen of the United States and taxable under section 1 or section 1201 (*b*) of the Code on income received from sources within and with the United States . . . . Accordingly, *A* is a citizen of the United States and is taxable under section 1 or section 1201 (*b*) of the Code on income from sources both within and without the United States . . . . Pursuant to the authority granted by section 7805 (*b*) of the Code, this Revenue Ruling will not be applied for taxable years beginning prior to January 1, 1971, unless, under the applicable facts, the taxpayer is a citizen of the United States without regard to the *Schneider* decision. For taxable years beginning prior to January 1, 1971, an individual to whom the *Schneider* decision applies and to whom this Revenue Ruling is not applied is subject to tax as a nonresident alien.
>
> Furthermore, the mere fact that an individual affected by the *Schneider* decision and this Revenue Ruling takes affirmative steps before January 1, 1971 to establish noncitizen status,

[45] Nottebohm Case, [1955] I. C. J. 4.
[46] *Id.*

will not be considered evidence of a tax avoidance motive for purposes of section 877 of the Code.[47]

VI. CONCLUSION

The *Schneider* decision handed down in 1964 was a far-reaching decision; it affected thousands of persons around the world, and the tax consequences for persons affected were unclear. The most obvious way in which these consequences could have been clarified would have been through a published and publicized announcement in 1964, not in 1970, of the Internal Revenue Service's position. Such an announcement was called for and would have been in conformity with the Service's policy of notification to taxpayers of tax liability. For this reason, the Internal Revenue Service, by failing in 1964 to publish a clarifying Revenue Ruling as to the tax effect of *Schneider v. Rusk*, failed in its obligation to furnish needed guidance to taxpayers in order that they might not be misled to their detriment. The Revenue Ruling which the Internal Revenue Service published in 1970 is unclear as to whether only those individuals affected by the *Schneider* decision are to be affected by the Ruling. No mention is made of those citizens affected by the *Afroyim v. Rusk* decision. The Revenue Ruling should have made it clear that it would cover all persons expatriated by operation of any statute now held to be, or administratively deemed to be, unconstitutional. Further, the Revenue Ruling makes it mandatory under section 7805 (*b*) for all individuals involved to be taxed as nonresident aliens; although the Revenue Ruling holds that individuals under *Schneider* are citizens, the application of section 7805 (*b*) makes it mandatory that they be taxed as nonresident aliens prior to 1971. Section 7805 (*b*) is not here being applied as the relief provision it is intended to be. Such taxpayers should be allowed the choice to be taxed either as citizens or as non-resident aliens prior to 1971. In voluntarily electing to regain citizenship retroactively (the *Schneider* decision, after all, was intended as a protection, not a burden), they would also be liable for United States taxes as citizens, retroactively. Such would be the individual's election and the only fair method available under the circumstances.

---

[47] Rev. Rul. 70-506, 1970 INT. REV. BULL. NO. 40, at 7.