SUMMARY AND RECOMMENDATIONS

Emigration taxes

On the basis of a study of emigration taxes currently and previously applied in a number of countries, the author has made the following categorization of emigration taxes:

- **general exit taxes**: upon a taxpayer’s emigration, income tax is levied on accrued-but-not-yet realized gains on all taxable property;
- **limited exit taxes**: upon a taxpayer’s emigration, income tax is levied on accrued-but-not-yet realized gains on certain taxable property;
- **unlimited extended income tax liabilities**: emigrated individuals remain subject to income tax as if they had remained resident taxpayers in the emigration country;
- **limited extended income tax liabilities**: income tax is levied on certain income items from sources in the country in which the taxpayer was formerly resident, in a way that is more onerous than for other non-resident taxpayers;
- **clawback of tax deductions**: previously enjoyed tax deductions are clawed back from the emigrating taxpayer, or a previously permitted tax deferral is revoked when the taxpayer emigrates.

The main difference between (1) general and limited exit taxes and (2) unlimited and limited extended income tax liabilities is that the former are levied at the moment of emigration on accrued-but-not-yet-realized capital gains, whereas the latter are levied on income arising after the emigration. The clawback of tax deductions relates to receipts from pensions and life insurance contracts, which have been financed by tax-deductible premiums, and to deferred income tax claims on accrued rights on future pension receipts.

**Comparison of emigration taxes**

The analysis of the exit taxes imposed by Canada, Germany and the Netherlands reveals, *inter alia*, that the income tax treatment under a general or limited exit tax is comparable to the income tax treatment (for example, regarding the determination of taxable income and the applicable tax rate) of such gains upon realization by
resident taxpayers. However, emigrants are taxed when their taxable gain has accrued but is not yet realized, and their tax liability is therefore accelerated. The effective income tax burden of resident taxpayers therefore has a lower cash value than the income tax burden of emigrants.

It is the goal of an exit tax to accelerate the levy of income tax, because countries levying this type of emigration tax – e.g. Canada, Germany and the Netherlands – are not willing to give up their latent income tax claim on gains accrued-but-not-yet-realized at the moment a taxpayer emigrates.

Denmark and the Netherlands have introduced a measure to avoid international double taxation in the form of a credit against their exit taxes for the foreign income tax which is subsequently levied by the immigration country at the moment of realization.

The main common denominators of the German and US limited extended income tax liabilities are that in both countries the regime applies for a period of ten years after the emigration, and that for the purpose of the limited extended income tax liability the definition of "domestic income" is broader than the definition that applies for purpose of the taxation of other non-resident taxpayers.

The uncertainty about the effects of these tax regimes is best illustrated by the fact that both countries find it necessary to provide that the emigration tax under the limited extended income tax liability should not be less than the tax for other non-resident taxpayers. Germany has limited the tax to the tax for resident taxpayers as well (and this may even be less than the tax due by non-resident taxpayers). On the other hand, the United States permits a step-up for former immigrants, as well as a foreign tax credit.

International double taxation

The tax treatment of immigrants is vital in determining the ultimate effect of an emigration tax on the overall international tax burden for individuals moving from one country and immigrating to another.

1. For example, if the non-resident is subject to a final withholding tax at a rate that is higher than the graduated rates applying to resident taxpayers.

If an immigrant has all emigration country on an account of a certain taxable property and the cost as the tax base of the taxable gain is derived from the international double tax is because the emigration income of the emigrant.

With respect to extended international double taxation, the immigration country imposes an exit tax, the taxpayer was resident in the emigration country.

In the case of an unlimited national double taxation is because the emigration respect to this income, usually in the third country itself a country which imposes income.

2. However, no international is subject to income tax.

3. Consider, for example, the Netherlands and who is also in the income tax due in Finland on the interest.

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If an immigrant has already been subject to an exit tax in the emigration country on an accrued-but-not-yet-realized gain on (certain) taxable property and the immigration country uses the historic cost as the tax base of the taxable property of the immigrant when a taxable gain is derived from the alienation of the property, there will be international double taxation on the portion of the gain accrued while the taxpayer was resident in the emigration country.

If, in contrast, the immigration country allows a step-up in the tax base of an immigrant’s taxable property to the economic value at the moment of immigration and the emigration country does not impose an exit tax, the portion of the gain accrued while the taxpayer was resident in the emigration country, remains untaxed.²

With respect to extended income tax liabilities it is likely that international double taxation will result if both the emigration and the immigration country impose an income tax on the worldwide income of the emigrant.

In the case of an unlimited extended income tax liability, international double taxation is most likely for income from third countries because the emigration and the immigration country will, with respect to this income, usually only be prepared to credit the tax paid in the third country itself and not the income tax paid in the other country which imposes income tax on the taxpayer’s worldwide income.³

² However, no international tax principle exists which requires that all gains be subject to income tax.
³ Consider, for example, the case of a taxpayer who is a resident taxpayer in the Netherlands and who is also treated as a resident taxpayer by Finland. When this taxpayer receives interest from Belgium, the Netherlands will not allow a credit for the income tax due in Finland on the interest received from Belgium. Neither will Finland allow a credit for the tax levied by the Netherlands on the Belgian-source interest.
Whether there will be international double taxation in the case of a limited extended income tax liability depends on the definition of taxable income and the tax treatment thereof.\(^4\)

Three solutions for avoiding international double taxation have been discussed in this study:

- the immigration country may allow a step-up in the tax base of the taxable property of the immigrant to the economic value of the property at the moment of the immigration (\textit{mutatis mutandis} the same approach may be used if an extended income tax liability includes capital gains);
- the immigration country may, upon the realization of the portion of the gain which accrued while the immigrant was resident in the emigration country, allow a credit of the exit tax levied in the emigration country against the income tax due in the immigration country (\textit{mutatis mutandis} the same approach may be used if an extended income tax liability applies to income received after the emigration); and
- the emigration country may allow a credit of the income tax due in the immigration country, upon the realization of the portion of the gain which accrued while the taxpayer was resident in the emigration country, against the exit tax paid or due (in the case of a preserving assessment) in the emigration country (\textit{mutatis mutandis} the same approach may be used if an extended income tax liability applies to income received after the emigration).

Whether a clawback of tax deductions or tax deferral causes international double taxation depends upon the systems applied by the emigration and immigration countries to the taxation of pensions and receipts from life insurance contracts.

A unilateral clawback of tax deductions or revocation of a previous tax deferral is understandable from the revenue perspective of an emigration country, but it is in flagrant contradiction of the traditional (at least since 1963) tax treaty practice under which receipts from life insurance contracts in the country of residence are not taxed in the country of residence.\(^4\) New countries have amended to protect the income from life insurance contracts. It is suggested that countries which have exit taxes, as well as countries that do not levy income tax, will consider the implementation of this solution.

Policy considerations

There is no principle in international taxation to tax a certain gain or income twice which the taxpayer was resident in.

There are two main approaches which have not yet realized during the period:

1. a country has the right to tax a taxpayer who was resident in the emigration country;
2. the country where a taxpayer was resident has the right to tax gains which accrued while the taxpayer was resident in the emigration country.

The first approach (i.e., taxation solely by the country of residence) is currently applied by virtually all countries. Countries that do not levy income tax or have exit taxes, as well as countries with income tax, will consider the implementation of this solution.

International tax guidance (James P. Dray, Secretary of the Committee of the OECD) on attribution of the right to tax income from life insurance contracts. It is suggested

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4. For example, where a country normally only imposes a low flat-rate withholding tax on interest on non-residents, it may progressively tax interest received by former residents subject to a limited extended income tax liability. The former resident may very well also be taxed progressively in his new country of residence, so that international double taxation results.
from life insurance contracts and private pensions are taxable only in the country of residence. Instead, if desired, the attribution rules in tax treaties regarding the right to tax such income should be amended to protect the income tax claims of source states, preferably along lines to be developed by the OECD.

Policy considerations

There is no principle in international tax law whereby the right to tax a certain gain or income is to be shared by the countries in which the taxpayer was resident during the period the gain accrued. There are two main approaches to the taxation of gains accrued but not yet realized during the period a taxpayer is resident in a country:

1. a country has the right to tax gains that accrued during the period a taxpayer was resident;
2. the country where a taxpayer is resident at the moment of realization is exclusively entitled to levy tax on the entire gain.

The first approach (i.e. each country is entitled to tax accrued gains during the taxpayer’s period of residence) can be implemented in practice. The approach is based on the relation between residence and the accrual of gains during that period. Since this approach is applied in practice to “emigrating” permanent establishments, implementation of this solution should be possible – and is defensible – with respect to emigrants as well.

The second approach (i.e. levy of income tax on the entire gain solely by the country of residence at the moment the gain is realized) is currently applied by virtually all of the countries that do not – yet – have exit taxes, as well as by some countries that have exit taxes. Countries that do not levy income tax on capital gains remain attractive destinations for residents of countries which do subject such gains to income tax and which do not impose any kind of emigration tax.

International tax guidelines for dealing with gains that were accrued but not yet realized while the taxpayer was resident in a country should be decided upon (for example, by the Fiscal Committee of the OECD). Also decisions should be made on the attribution of the right to tax private pensions and income from life insurance contracts. It is suggested that the decision-making process
should include statistical research to determine whether the negative revenue effects of emigration are compensated by the positive effects of immigration.

A balance must be found between the revenue interests of the emigration and the immigration country. Emphasis should be put on an individual’s right to freedom of movement. One possible approach might be to apply emigration taxes only in cases of tax avoidance; in this context the scope of paragraph 26 of the Commentary to Article 1 of the 1992 OECD Model Convention should be clarified, in order to indicate that counteracting measures against the improper use of tax treaties should not be applied to countries (immigration countries) in which taxation is comparable to that of the other country (emigration countries).

**Tax treaties**

It is encouraging to see that many countries have included provisions in their tax treaties dealing with aspects of emigration taxes (in any case, dealing with the first four types of emigration tax). The three above-mentioned solutions for avoiding international double taxation have all been applied in practice.

Nevertheless, many tax treaties concluded by countries levying emigration taxes do not yet contain such provisions. On the one hand, this makes emigrating taxpayers vulnerable to international double taxation, since exit taxes are levied at the point in time (immediately prior to the actual emigration) when a tax treaty is not yet applicable. On the other hand, the lack of provisions dealing with emigration in tax treaties limits the effective application of extended income tax liabilities.

Countries introducing an unlimited extended income tax liability have to exclude taxpayers subject to the application of this tax regime from the application of the tie-breaker rule of the residence article (similar to Article 4 of the successive OECD Models). Otherwise, items of income which under the tax treaties are allocated to the residence (i.e. immigration) country, cannot be taxed by the emigration country.

The introduction of such taxes may be ineffective regarding the concerns of the immigration country has concerning the revenue effects of emigration. Nevertheless, emphasis should be put on an individual’s right to freedom of movement. One possible approach might be to apply emigration taxes only in cases of tax avoidance; in this context the scope of paragraph 26 of the Commentary to Article 1 of the 1992 OECD Model Convention should be clarified, in order to indicate that counteracting measures against the improper use of tax treaties should not be applied to countries (immigration countries) in which taxation is comparable to that of the other country (emigration countries).

**EC law**

The EC Treaty only prescribes one of the freedom of movement provisions under the European Court of Justice rules on the avoidance of international double taxation. Nevertheless, if such a tax is levied, the methods chosen have to be compatible with EC law and the interests of migration policies.

It is suggested that an unlimited extended income tax liability has to be imposed only if the accrued income is realized in another country. This would require some type of clearing mechanism that ensures that income is taxed in the country of residence (i.e. immigration) and the country of emigration at the same time.

Countries introducing an unlimited extended income tax liability have to exclude taxpayers subject to the application of this tax regime from the application of the tie-breaker rule of the residence article (similar to Article 4 of the successive OECD Models). Otherwise, items of income which under the tax treaties are allocated to the residence (i.e. immigration) country, cannot be taxed by the emigration country.
The introduction of a limited extended income tax liability may be ineffective regarding emigrants to countries with which the emigration country has concluded tax treaties: items of income for which the right to tax under tax treaties is allocated to the residence (i.e. immigration) country, cannot be taxed by the emigration country.

EC law

The EC Treaty only protects migrating individuals who are exercising one of the freedoms guaranteed by the EC Treaty. The European Court of Justice has not yet expressly dealt with emigration taxes. Nevertheless, it may be expected that, if EC law is applicable, the methods chosen by some Member States will be held to be in conflict with EC law because of a violation of the proportionality requirement: i.e. Member States may protect their income tax claims but they must choose methods that are proportional to their interest and the interests of migrant individuals.

It is suggested that an EC Directive or Regulation requiring uniform taxation of capital gains on (certain) taxable property throughout the entire European Union should be introduced. By means of some type of clearing house system or compensation agreement, each of the Member States in which a taxpayer was resident during the accrual of the capital gain should receive its share when the gain is ultimately realized.