NO MIGRATION WITHOUT TAXATION: STATE EXIT TAXES

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The movement of people and the movement of money are often discrete. As such, governments can address the effects of each separately. Because residence provides a general jurisdictional basis for state personal income taxation, however, money often moves with people. States must disentangle the two to prevent tax base erosion and improve distributional equity, particularly with many high-net-worth individuals migrating to states with more favorable tax regimes. A state exit tax may be the answer.

This Article begins by examining exit tax theory and advancing novel applications of theories that support subnational exit taxation, both domestically and internationally. With a robust theoretical and technical foundation, this Article turns to state and local exit tax design. This discussion examines constitutional constraints to address specific tax base migration challenges—focusing on the justifications, distributional impact, and optimal exit tax design features to address each situation.

If a state has a solid theoretical foundation and incorporates proper design principles, as this Article provides, an exit tax can effectively mitigate tax base migration while aligning with prevailing policy goals and avoiding constitutional infirmities.

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I. Introduction

The movement of people and the movement of money are often discrete. As such, governments can address the effects of each separately. Because residence provides a general jurisdictional basis for state personal income taxation, however, money often moves with people. States must disentangle the two to prevent tax base erosion and to improve distributional equity. A carefully crafted state exit tax may be the answer.

People are increasingly moving to states with less burdensome tax regimes.[1] Because of technological advances, remote work proliferation, and divergent subnational taxation philosophies, interstate migration is advancing after decades of stagnation.[2] Taxpayers best equipped to migrate prove to be high-net-worth individuals and profitable closely held businesses.[3]

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[1] *See* Jared Walczak, *Americans Moved to Low-Tax States in 2021*, Tax Found. (Jan. 4, 2022), https://taxfoundation.org/state-population-change-2021 [https://perma.cc/884L-L9PQ]; *State-to-State Migration Flows*, U.S. Census Bureau, https://www.census.gov/data/tables/time-series/demo/geographic-mobility/state-to-state-migration.html [https://perma.cc/E28M-93AL]; Cristobal Young, Charles Varner, Ithai Z. Lurie & Richard Prisinzano, *Millionaire Migration and Taxation of the Elite: Evidence from Administrative Data*, 81 Am. Soc. Rev. 421, 431–33 (2016); E.J. McMahon, *Tracking the Increased Outflow of NY Taxpayers in 2019-20*, Empire Ctr. (May 25, 2022), https://www.empirecenter.org/publications/new-york-taxpayer-migration-surged-in-2019-20-irs-data-show/ [https://perma.cc/7HTA-QNEC].

[2] *See State-to-State Migration Flows, supra* note 1; McMahon, *supra* note 1; Enrico Moretti & Daniel J. Wilson, *The Effect of State Taxes on the Geographical Location of Top Earners: Evidence from Star Scientists*, 107 Am. Econ. Rev. 1858, 1863 (2017) (recognizing that "[w]hile there are many other factors that determine where innovative individuals and innovative companies decide to locate, there are enough firms and workers on the margin that relative taxes matter"); David R. Agrawal & Kenneth Tester, The Effect of Taxes on Where Superstars Work 29 (2021) (unpublished manuscript) (finding that "location of employment is likely to be tax-sensitive for many other high-income occupations," which is "increasingly important if the pandemic has a lasting effect on remote work"); Peter Haslag & Daniel Weagley, From L.A. to Boise: How Migration Has Changed During the COVID-19 Pandemic (2021) (unpublished manuscript); Editorial, *The Great Pandemic Migration*, Wall St. J. (Dec. 28, 2021), https://www.wsj.com/articles/covid-states-migration-lockdowns-census-11640733268 [https://perma.cc/DZ3H-YMF8]; Selim Algar, *Startling Exodus to Florida Accelerating Despite NY Reopening After COVID Restrictions*, N.Y. Post (May 24, 2022), https://nypost.com/2022/05/24/flight-to-florida-is-still-accelerating-despite-ny-covid-19-reopening-push/ [https://perma.cc/P38K-Z2ZC] (analyzing driver's license data); Richard Florida & Adam Ozimek, *How Remote Work Is Reshaping America's Urban Geography*, Wall St. J. (Mar. 6, 2021), https://www.wsj.com/articles/how-remote-work-is-reshaping-americas-urban-geography-11614960100 [https://perma.cc/8VD5-K9D7].

[3] Enrico Moretti & Daniel J. Wilson, *Taxing Billionaires: Estate Taxes and the Geographical Location of the Ultra-Wealthy* 1–2 (Nat'l Bureau of Econ. Rsch., Working Paper No. 26387, 2020) (finding ultra-wealthy individuals' "geographic location highly sensitive to state estate taxes"); Cristobal Young & Charles Varner, *Millionaire Migration and State Taxation of Top Incomes: Evidence From a Natural Experiment*, 64 Nat'l Tax J. 255, 265 (2011) (finding "an observable increase in migration associated with the introduction of the new millionaire tax bracket"); Young et al., *supra* note 1, at 431 (finding "[m]illionaires are more sensitive to income tax rates than is the general population"); Thomas P. DiNapoli, Moving In or Moving Out? New York State Personal Income Taxpayer Migration Trends, Office of the N.Y. State Comptroller 15 (2022), https://www.osc.state.ny.us/files/reports/pdf/taxpayer-migration.pdf [https://perma.cc/CMY7-MQE3] (finding the greatest number of taxpayer departures from New York State were married filers earning between $100,000 and $500,000 per year); McMahon, *supra* note 1 (finding that the income of

Money is moving with people, and the result is a serious tax base outflow for many states.

Making matters worse, in many cases the initial or "departure" jurisdiction provided the benefits that allowed the departing taxpayers to generate their income. Typically, the taxpayers' income—whether derived from property or stock appreciation, deferred compensation, or retained corporate earnings—accrued while the taxpayer was a resident of the departure jurisdiction.[4] Under the benefit theory of taxation advanced herein, the departure jurisdiction has a compelling justification to impose tax on the income that accrued while the taxpayer resided in, and benefited from, that jurisdiction.[5] Absent a realization event, the departure jurisdiction may lose the ability to tax the accrued income when the taxpayer leaves the jurisdiction—unless the jurisdiction adopts an exit tax.[6]

Exit taxes have existed for decades at the national level.[7] Many nations have implemented exit taxes with varying levels of success, although the United States federal-level exit tax is the most prominent.[8] The United States exit tax regime is narrower than other nations' exit tax regimes because the United States implements a unique citizenship-based personal income tax regime. The United States imposes income tax on its citizens regardless of their nation of residence.[9] So, the United States exit tax applies when indi-

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taxpayers leaving New York State increased by nineteen percent in 2020 compared to 2019, the largest percentage increase since 2011).

[4] At the outset, it is imperative to recognize that source provides a predominant jurisdictional basis for income taxation. *See infra* note 33 and accompanying text. In many cases, especially with respect to the situations discussed herein, the source state and residence state are the same—either because the taxpayer resides and generates the specific income in the same state, or because the income has no distinct source and is thus assigned to the taxpayer's state of residence.

[5] As discussed immediately above, a taxpayer's income is often sourced to the residence/departure jurisdiction as well, so the departure jurisdiction would have provided the benefits that allowed the taxpayer to generate that specific income.

[6] *See* Alice G. Abreu, *Taxing Exits*, 29 U.C. Davis L. Rev. 1087, 1098 (1996).

[7] *See infra* Part III.

[8] *See* Abreu, *supra* note 6; Henry Ordower, *The Expatriation Tax, Deferrals, Mark to Market, the Macomber Conundrum and Doubtful Constitutionality*, 15 Pitt. Tax Rev. 1, 1–4 (2017); William L. Dentino & Christine Manolakas, *The Exit Tax: A Move in the Right Direction*, 3 Wm. & Mary Bus. L. Rev. 341, 343–44 (2012); William Thomas Worster, *The Constitutionality of the Taxation Consequences for Renouncing U.S. Citizenship*, 9 Fla. Tax Rev. 921, 923 (2010); Eva Farkas-DiNardo, *Is the Nation of Immigrants Punishing Its Emigrants: A Critical Review of the Expatriation Rules Revised by the Jobs Creation Act of 2004*, 7 Fla. Tax Rev. 1, 7 (2005); Richard A. Westin, *Expatriation and Return: An Examination of Tax Driven Expatriation by United States Citizens, and Reform Proposals*, 20 Va. Tax Rev. 75, 78 (2000); C. Eugene Steuerle, *Alternatives to the Expatriate Tax*, 57 Tax Notes 567, 567 (1995).

[9] I.R.C. § 1; Treas. Reg. § 1.1-1; *see also* Ruth Mason, *Citizenship Taxation*, 89 S. Cal. L. Rev. 169 (2016); Michael S. Kirsch, *Citizens Abroad and Social Cohesion at Home: Refocusing a Cross-Border Tax Policy Debate*, 36 Va. Tax Rev. 205, 205 (2017); Edward A. Zelinsky, *Citizenship and Worldwide Taxation: Citizenship as an Administrable Proxy for Domicile*, 96 Iowa L. Rev. 1289, 1289 (2011); Young Ran (Christine) Kim, *Considering 'Citizenship Taxation': In Defense of FATCA*, 20 Fla. Tax Rev. 335, 356 (2017); Cynthia Blum & Paula N. Singer, *A Coherent Policy for U.S. Residence-Based Taxation of Individuals*, 41 Vand. J. Transnat'l L. 705, 706 (2008).

viduals renounce their United States citizenship and will thus depart the nation's taxing jurisdiction.[10] Since 1996, the number of expatriating individuals who were subject to the United States exit tax, discussed further in Part III, ranges between less than 100 to 7,000 annually.[11] The current iteration of the United States exit tax was estimated to generate only $411 million over ten years.[12] Even with its narrower application, the United States exit tax has heightened importance because of sensitivities and signaling related to citizenship renunciation.[13]

The migration dynamics are quite different at the subnational level, which partially explains why state and local jurisdictions have not yet embraced exit taxes. Most obviously, migration within the United States does not implicate thorny citizenship issues. As such, state and local exit taxes would not serve a patriotic deterrence function.[14] States may also be concerned about signaling hostility toward high-net-worth individuals and businesses, which would be counterproductive to attracting and retaining those taxpayers.[15] Because interstate migration is much easier than renouncing national citizenship, taxpayers are more likely to respond to unfavorable state tax policy by leaving the state. State policymakers must also consider the complex constitutional limitations on state taxation. Exit taxes implicate the

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[10] I.R.C. § 877A. The United States exit tax also applies when a "long-term resident" of the United States ceases to be a lawful permanent resident of the United States. I.R.C. § 877A(g)(2)(B).

[11] I.R.C. § 6039G(d) requires the Secretary of the Treasury to publish the names of expatriating individuals who are subject to either I.R.C. § 877 or I.R.C. § 877A. For 1996, the first year in which expatriating individuals' names were published, ninety names were listed. Individuals Who Have Chosen to Expatriate, 62 Fed. Reg. 4570 (Jan. 30, 1997). For 2020, 6,707 names were listed. Individuals Who Have Chosen to Expatriate, 85 Fed. Reg. 27507 (May 8, 2020); Individuals Who Have Chosen to Expatriate, 85 Fed. Reg. 47843 (Aug. 6, 2020); Individuals Who Have Chosen to Expatriate, 85 Fed. Reg. 68625 (Oct. 29, 2020); Individuals Who Have Chosen to Expatriate, 86 Fed. Reg. 8251 (Feb. 4, 2021). For a summary of the number of expatriating individuals each year, see Andrew Mitchel, *2020 Sets New Record For Published Expatriates*, Int'l Tax Blog (Feb. 3, 2021), https://intltax.typepad.com/intltax_blog/2021/02/2020-sets-new-record-for-published-expatriates.html [https://perma.cc/9HZ4-SK2Z].

[12] Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110-245, 122 Stat. 1624; Staff of Joint Comm. On Tax'n, 110th Cong., Technical Explanation of H.R. 6081, The "Heroes Earnings Assistance and Relief Tax Act of 2008" 45–46 (2008).

[13] The theories supporting the United States federal-level exit tax are discussed in further detail in Part II.

[14] *See infra* Part II.

[15] *See, e.g.*, Keshia Clukey, *No Wealth Tax, New York Governor Says: 'Have Right Balance Now'*, Bloomberg (Nov. 4, 2021), https://news.bloombergtax.com/daily-tax-report-state/no-wealth-tax-new-york-governor-vows-have-right-balance-now [https://perma.cc/2Y4C-NVVT]; Catarina Saraiva & Shruti Date Singh, *Chicago, Connecticut Attempt to Woo Texans Leery of New Laws*, Bloomberg (Sept. 10, 2021), https://news.bloombergtax.com/daily-tax-report/chicago-connecticut-attempt-to-woo-texans-leery-of-new-laws [https://perma.cc/SM7H-8X2S]; Amy Hodges, *Mississippi Governor Renews Call for Ending Individual Income Tax*, Tax Notes (Nov. 16, 2021) (Mississippi's governor proclaiming that "eliminating the individual income tax would help Mississippi remain competitive with Florida, Tennessee, and Texas"), https://www.taxnotes.com/tax-notes-today-state/budgets/mississippi-governor-renews-call-ending-individual-income-tax/2021/11/16/7clwh [https://perma.cc/SXQ6-NY4H].

fundamental right to travel under the Privileges and Immunities Clause, a constraint with which most state tax policymakers have little experience.[16] But perhaps the most likely reason why states have not embraced exit taxes is that, from a tax perspective, migration was approximately net neutral.[17] If a state exit tax would not generate substantial revenue above the status quo, there is simply no point.[18]

State and local migration dynamics, however, are shifting quickly and dramatically. The distributional shift towards high-net-worth individuals and businesses migrating out of certain states and cities is creating significant tax base erosion for these jurisdictions.[19] There are now winners and losers among subnational jurisdictions.[20] The motivations underlying this migration shift are multifaceted and have been amplified by several elements of the Tax Cuts and Jobs Act of 2017 ("TCJA").[21]

The primary catalyst, however, is a policy shift in many jurisdictions focused on imposing higher taxes on those with greater ability to pay. This redistributive policy shift goes beyond simply increasing a state's individual

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[16] *See infra* Section IV.A.

[17] *See* Young et al., *supra* note 1, at 439 (finding that from 1999–2011, "migration flows represent a very small share of top income-earners, the observed patterns of migration have little impact on the millionaire population tax base"). If a state had roughly the same inflow and outflow of individuals—especially if those individuals had similar economic characteristics—the state would not experience a meaningful net increase or decrease in tax revenue due to migration.

[18] Raising revenue may not be as important for a national level exit tax because of different prevailing theories underlying the tax regime. *See* Abreu, *supra* note 6, at 1109. At the subnational level, however, the complexity of administering an exit tax, and the theories supporting it, are justified only if the tax will generate substantial revenue. A properly designed state and local exit tax has the potential to generate significant revenue, as discussed in Part IV.

[19] *See* Moretti & Wilson, *supra* note 3, at 1–3 (estimating that "tax induced mobility" resulted in "$80.7 billion less in Forbes 400 wealth exposed to state estate taxes"); Lance Lambert & Lucinda Shen, *Why Would Elon Musk Move to Texas? The Answer Could Be in the Billions*, FORTUNE (Dec. 4, 2021), https://www.yahoo.com/video/why-elon-musk-move-texas-000000570.html [https://perma.cc/EA8B-JBM4] (estimating that California could lose $18 billion in income tax revenue solely by Elon Musk's move from California to Texas); Chris Edwards, *Tax Reform and Interstate Migration*, 84 TAX & BUDGET BULL. 1 (2018) (estimating that $33 billion in aggregate income migrated from the twenty-five highest tax states to the twenty-five lowest tax states in 2016 alone); McMahon, *supra* note 1.

[20] Young et al., *supra* note 1, at 429 ("[M]igration into Florida is more likely from states that have *higher* tax rates. The greater Florida's tax rate advantage over another state, the more likely millionaires from that state will migrate to Florida."); Austin J. Drukker, Internal Migration and the Effective Price of State and Local Taxes, 48 (2021) (unpublished manuscript) (on file with author) (finding migration from high-tax states to low-tax states by the top one percent of income distribution in response to the TCJA's state and local deduction cap effective 2018); Walczak, *supra* note 1; DiNapoli, *supra* note 3; Lee Miller & Wei Lu, *Migration's Biggest Loser Is Connecticut as Florida Profits*, BLOOMBERG (May 24, 2019), https://www.bloomberglaw.com/product/tax/bloombergtaxnews/daily-tax-report-state [https://perma.cc/53HC-JVTK].

[21] *See* Drukker, *supra* note 20, at 48–49; Moretti & Wilson, *supra* note 2, at 1863; Joshua D. Ruah, *Taxes and Net Migration in California*, 1–3 (Feb. 17, 2022) (unpublished manuscript) (finding that net outflows of taxable income from California in the TCJA's first year reached $3.8 billion, with taxpayers who would experience a larger state tax increase because of the TCJA more likely to leave the state).

income tax rate or converting from a flat rate to a progressive rate.[22] Rather, states and localities are proposing and enacting entirely new tax regimes or surtaxes expressly targeted at certain classes of taxpayers. These regimes include "millionaire" surtaxes, "wealth" taxes, and gross receipts and payroll taxes on large businesses.[23] States and localities have communicated this policy shift emphatically and it appears many targets of the increased taxation movement are responding with migration to lower-tax jurisdictions—manifesting the longstanding concern of tax base migration "as a key threat to redistributive social and fiscal policies."[24] State and local jurisdictions can mitigate this serious fiscal threat, however, with a well-designed exit tax.

For an exit tax to find success, particularly given the pejorative nature of the term itself, it requires unassailable theoretical support. Existing exit tax literature provides several theoretical justifications for national level exit taxes, including tax neutrality, progressivity, deterrence, and symbolism.[25] These theories support subnational exit taxes—in some cases more so than national level exit taxes. The benefit theory, however, provides the requisite support for subnational exit taxes to overcome policy and constitutional hurdles. Although existing literature considers the benefit theory in the context of general jurisdiction to tax and not exit taxation, this Article strives to demonstrate how the benefit theory justifies, and arguably requires, a subnational exit taxation regime. In addition, the theory advanced herein applies not only to interstate migration within the United States, but also to intrastate migration and migration within any other fiscally decentralized nation.

This Article proceeds in three main Parts. Part II begins by examining exit tax theory and advancing novel applications of theories that support subnational exit taxation, both domestically and internationally. Part III ex-

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[22] States are proposing these changes as well. *See, e.g.*, Evan Fallor, *Illinois Republicans File Resolution Against Graduated Income Tax*, Tax Notes (Mar. 8, 2021), https://www.taxnotes.com/tax-notes-today-state/individual-income-taxation/illinois-republicans-file-resolution-against-graduated-income-tax/2021/03/08/3k5h3?highlight=evan%20fallor [https://perma.cc/JL59-CCL6].

[23] *See, e.g.*, David Voreacos, *Millionaire-Tax Plan in Massachusetts Challenged by Groups*, Bloomberg (Jan. 28, 2022), https://www.bloomberg.com/news/articles/2022-01-27/millionaire-tax-plan-in-massachusetts-challenged-by-tech-backers#xj4y7vzkg [https://perma.cc/26FV-YF3D]; Brian D. Galle, David Gamage, Emmanuel Saez & Darien Shanske, *The California Tax on Extreme Wealth (ACA 8 & AB 310): Revenue, Economic, and Constitutional Analysis* 1 (Ind. Legal Stud. Rsch. Paper No. 461, 2021) https://ssrn.com/abstract=3924524 [https://perma.cc/59KS-LPRK]; Eric Coffill, *The Path Forward – Are Tax Increases Coming In California in 2022?*, Tax Notes (Dec. 20, 2021), https://www.taxnotes.com/tax-notes-state/tax-policy/path-forward/2021/12/20 [https://perma.cc/8DHC-RDGX]; Andrew Appleby, *Targeted Taxes: Localities Take Aim at Large Employers to Solve Homelessness and Transportation Challenges*, 98 Or. L. Rev. 477, 491–94 (2020).

[24] Young et al., *supra* note 1, at 439; *see also* Moretti & Wilson, *supra* note 2, at 1858–60; Walczak, *supra* note 1; Annie Lowrey, *If You Soak the Rich, Will They Leave?*, The Atlantic (Oct. 27, 2020), https://www.theatlantic.com/ideas/archive/2020/10/if-you-soak-rich-will-they-leave/616863/ [https://perma.cc/2RES-C3EP].

[25] *See infra* Part II.

plores existing national level exit taxes to identify useful features that may be incorporated into subnational exit taxes.

With a robust theoretical and technical foundation, Part IV turns to state and local exit tax design. This discussion navigates constitutional constraints to address specific tax base migration challenges. This Part analyzes each specific challenge, focusing on the justifications, distributional impact, and optimal exit tax design features to address each situation. In conclusion, Part IV provides potential state and local exit tax options tailored to a jurisdiction's specific areas of concern, existing tax regime, and policy preferences.

II. Exit Tax Theory

Exit taxes have existed for decades, and for good reason. If a taxing jurisdiction provides benefits to a taxpayer that allow the taxpayer to generate income, that jurisdiction should have the ability to impose tax on the resulting income.[26] Most tax regimes adopt a realization requirement whereby the jurisdiction imposes tax only upon a triggering event.[27] Most commonly, if a taxpayer holds an asset that increases in value, the taxing jurisdiction imposes tax on the gain only upon sale or other disposition of the asset.[28] There are several tax policy justifications that support a realization requirement, most notably liquidity concerns.[29] Absent taxpayer mobility, the realization requirement is essentially a timing issue.[30] Theoretically, the taxing jurisdiction will eventually tax the income.

The problem arises with taxpayer mobility. If a taxing jurisdiction has a strict realization requirement, all the income that accrued within that jurisdiction could migrate to another jurisdiction along with the taxpayer before the realization event occurs.[31] The taxing jurisdiction that provided the benefits that facilitated the income would lose the ability to tax it.[32] The resulting tax revenue would inure to a different taxing jurisdiction that did not deserve it, or more commonly, would be eliminated through simple tax planning strategies.

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[26] This principle is true whether the jurisdiction provides the benefits that allow a taxpayer to generate income specifically sourced to that jurisdiction, or if there is no ascertainable source, based on the taxpayer's residence in that jurisdiction.

[27] *See* Eisner v. Macomber, 252 U.S. 189, 207 (1920); Comm'r v. Glenshaw Glass Co., 348 U.S. 426, 430–31 (1955) ("The Court was there endeavoring to determine whether the distribution of a corporate stock dividend constituted a realized gain to the shareholder, or changed 'only the form, not the essence,' of his capital investment.") (quoting *Eisner*, 252 U.S. at 210); Abreu, *supra* note 6, at 1097–99; Ordower, *supra* note 8, at 3, 37–49.

[28] *See, e.g.*, I.R.C. § 1001.

[29] *See* Abreu, *supra* note 6, at 1099 n.4; Ordower, *supra* note 8, at 47–48.

[30] *See* Andrew D. Appleby, *Ball Busters: How the IRS Should Tax Record-Setting Baseballs and Other Found Property under the Treasure Trove Regulation*, 33 Vt. L. Rev. 43, 70 (2008).

[31] *See* Abreu, *supra* note 6, at 1101; László Kovács, *European Commission Policy on Exit Taxation*, Studi Tributari Europei, Jan. 1, 2009, at 4.

[32] Again, depending on the specific situation, this benefit may be based on source or residence, with source providing the prevailing jurisdiction for taxation.

Existing exit tax literature provides several theoretical justifications for national level exit taxes, although the benefit theory has been minimized. As discussed below, these alternative theories do support subnational exit taxes—in some cases more so than national level exit taxes. The benefit theory, however, provides the requisite support for subnational exit taxes to overcome policy and constitutional hurdles.

The benefit theory has provided a jurisdictional basis for income taxation for decades.[33] The United States Supreme Court explained:

> That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized. Domicil itself affords a basis for such taxation. Enjoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws are inseparable from responsibility for sharing the costs of government. . . . The tax, which is apportioned to the ability of the taxpayer to pay it, is founded upon the protection afforded by the state to the recipient of the income in his person, in his right to receive the income and in his enjoyment of it when received. These are rights and privileges which attach to domicil within the state.[34]

Indeed, the benefit theory was the prevailing theory supporting individual taxation for hundreds of years.[35] The benefit theory's fundamental premise is that individuals generate their income and wealth because the government provides economic, physical, and legal infrastructure; protection of property; and other facets of an "orderly, civilized society."[36] Without the benefits the government confers, the individual would not be able to generate their income or wealth, and the greater an individual's income or wealth, the more they benefit from the government's services.[37]

As such, it is well established that a state has the power and justification to impose tax on the income of current residents—insofar as that income was not derived from another state.[38] The benefit theory, however, also extends to taxing certain income of prior residents. The state has the power

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[33] *See, e.g.*, Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444–45 (1940); New York *ex rel.* Cohn v. Graves, 300 U.S. 308, 312–13 (1937); Jerome R. Hellerstein, Walter Hellerstein & Andrew D. Appleby, State Taxation ¶¶ 6.04[1], 20.04[1] (3d ed. 2022 rev.).

[34] *Graves*, 300 U.S. at 312–13.

[35] *See* David Elkins, *A Scalar Conception of Tax Residence for Individuals*, 41 Va. Tax Rev. 149, 157–59 (2021) [hereinafter Elkins, *Scalar Conception*]; David Elkins, *Taxation and the Terms of Justice*, 41 U. Tol. L. Rev. 73, 73–75 (2009) [hereinafter Elkins, *Taxation and the Terms of Justice*] (discussing the benefit theory of taxation as interpreted by Thomas Hobbes, Adam Smith, and John Stuart Mill).

[36] J.C. Penney Co., 311 U.S. at 444; Elkins, *Scalar Conception, supra* note 35, at 157–59.

[37] *See* Elkins, *Scalar Conception, supra* note 35 at 157–59; Steuerle, *supra* note 8.

[38] If income is sourced to a specific state, the source state rather than the residence state has the prevailing justification to impose tax on the income. *See* Hellerstein et al., *supra* note 33, ¶ 6.04.

and justification to tax gains that accrued while the taxpayer was a resident of the state whether they remain a resident of the state when the realization event occurs or not. Although there may be administrative and timing challenges, discussed in Section IV.C, those challenges do not diminish the state's right to tax the gain.

A state exit tax is necessary to effectuate the benefit theory because interstate migration is so easy and common. At the federal level, there may be a few thousand individuals departing the tax jurisdiction annually, regardless of an exit tax.[39] Because so few individuals depart, the overall federal tax burden roughly coincides with the benefits received from the federal government. Within the United States, however, millions of individuals change their state of residence each year.[40] In addition, depending on how a state statute defines residency and the state's ability to enforce that statute, individuals may change their state of residence but still spend significant time in the departure state each year. An individual could foreseeably spend nearly half of each year residing in, and benefiting from, the departure state without being considered a resident for tax purposes.[41] Because of the dynamics of interstate migration, there is a serious disconnect between many taxpayers' tax burdens and benefits received from the state—absent an exit tax to align the two.

Perhaps more important, however, is the distributional impact of interstate migration. If high-net-worth individuals avoid paying tax on the gain that accrued during their residence in the jurisdiction, the tax burden is left to be shouldered by those who have received immensely less benefit and who do not have the same ability to pay.[42] Without an exit tax, the tax burden may be inversely correlated with the benefit received. This incongruous result is intensified if greater percentages of those migrating out of the state are high-net-worth individuals, which often proves to be the case.[43] Thus, a

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[39] *See* Elkins, *Scalar Conception*, *supra* note 11 and accompanying text.

[40] *See State-to-State Migration Flows*, *supra* note 1.

[41] *See, e.g.*, Eric Parker, *Major League Baseball Player Settles Tax Case With New York State*, TAX NOTES (Feb. 11, 2008), https://www.taxnotes.com/tax-notes-today-state/compliance/major-league-baseball-player-settles-tax-case-new-york-state/2008/02/07/3rbq [https://perma.cc/NH7H-5FVB]; Andrea Muse, *Tax Issues May Cloud Trump's Move to Sunshine State*, TAX NOTES (Nov. 4, 2019), https://www.taxnotes.com/tax-notes-today-state/individual-income-taxation/tax-issues-may-cloud-trumps-move-sunshine-state/2019/11/04/2b372 [https://perma.cc/6BUH-D8C5].

[42] *See generally* Gladriel Shobe, *Subsidizing Economic Segregation Through the State and Local Tax Deduction*, 11 U.C. IRVINE L. REV. 539, 540–61 (2020) (detailing the mechanics of economic segregation).

[43] *See* Moretti & Wilson, *supra* note 3, at 1–3; Edwards, *supra* note 19, at 11–14 (illustrating that "within each particular age category, the migration rate is much greater for high earners than it is for middle-income earners"); DINAPOLI, *supra* note 3, at 10 (finding the greatest number of taxpayer departures from New York State were married filers earning between $100,000 and $500,000 per year); McMahon, *supra* note 1; Mason, *supra* note 9, at 223 (describing "marginal migrants" for whom tax factors into migration decisions and who are valuable to the taxing jurisdiction because of their "skills, wealth, and income"); Paul R. Organ, Citizenship and Taxes: Evaluating the Effects of the U.S. Tax System On Individuals' Citizenship Decisions, 6–70 (Aug. 23, 2022) (unpublished manuscript) (analyzing the income,

state exit tax can effectuate distributive equity by aligning the tax burden with the benefit received.

Other theories supporting national level exit taxes include tax neutrality, progressivity, deterrence, and symbolism.[44] Although the benefit theory provides the strongest support for subnational exit taxes, these theories provide secondary support.

An overarching tax policy goal is to avoid distorting behavior—to make neutral the tax consequences of a particular decision.[45] In the exit tax context, a taxpayer's migration should produce neither a tax benefit nor a tax detriment. Designing an exit tax regime that eliminates an existing tax benefit without creating a countervailing tax detriment is difficult. A fundamental impediment is the current estate tax regime in the United States that often treats a taxpayer's death as a non-recognition event and thus allows all the taxpayer's accrued gain to escape taxation completely.[46] If an exit tax deems migration to be a realization event on the basis that the taxpayer will eventually have an actual realization event, the argument fails if the taxpayer can escape realization through the estate tax regime. Achieving meaningful neutrality, especially at the United States federal level, may be impossible.[47]

A state exit tax may not be entirely tax neutral, but it moves the overall tax regime toward neutrality. A state's existing personal income tax regime without an exit tax creates a strong incentive to migrate out of the state before realizing income or gain, as discussed in Section IV.B. Imposing a tax on the gain that accrued while the taxpayer resided in the state removes that tax incentive to migrating out of the state, thus making the migration decision more tax neutral. With an exit tax that deems an exit to constitute a realization event, the detriment to migration is essentially just one of timing.[48] The taxpayer can stay in the state and pay tax when there is a true realization event or leave the state and pay tax now. As discussed above, however, this assertion relies on an unavoidable realization event if the taxpayer remains in the state. If the state conforms to the current broken federal estate tax regime, the taxpayer may be able to avoid realization and thus obtain a tax benefit from staying within the state and avoiding the exit tax. The solution, however, is not to eschew an effective exit tax because of an ineffective estate tax. Rather, the state should consider enacting its own via-

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wealth, and age of individuals renouncing U.S. citizenship and falling within federal exit tax regime).

[44] *See* Abreu, *supra* note 6, at 1108–09.

[45] *Id.* at 1111; *see also* Mason, *supra* note 9, at 223–27.

[46] *See* Abreu, *supra* note 6, at 1119 n.118.

[47] *See id.* at 1119–20.

[48] The timing detriment is allayed by the potential benefit of further capital appreciation not being subject to income tax in the departure state. For example, if an individual has an asset that appreciates $1 million in value each year and they leave the state at the end of Year 5, they would pay exit tax on the $5 million of gain in Year 5 even though they did not sell the asset. If the individual migrates to a state with no personal income tax and sells the asset at the end of Year 8, the additional $3 million will not be taxed. Thus, the individual accrued a net tax benefit compared to staying in the departure state despite the timing detriment.

ble estate or inheritance tax if the federal tax is not reformed.[49] Regardless, if a state exit tax incorporates a tracking and reporting alternative to immediate realization, essentially a continuation tax, the result is as close to tax neutral as possible. The taxpayer's only burden would be filing a tax return in the departure state annually until there is an actual realization event.[50]

Progressivity is an important justification underlying national level exit taxes.[51] The progressivity theory is tied to fairness—a more progressive tax regime improves the distribution of the tax burden.[52] An exit tax naturally effectuates progressivity because it primarily impacts individuals with substantial wealth from capital appreciation. These individuals tend to be wealthier generally and they enjoy the benefit of deferred taxation until a realization event, the timing of which they control.[53] An exit tax mitigates the inequity between individuals with income from capital appreciation as opposed to income from labor, the latter of whom generally cannot choose when to realize and thus pay tax on their income.[54]

A state exit tax can effectuate progressivity even further, especially if the tax has an exemption or application threshold so the tax applies only to residents with substantial income or wealth.[55] If an individual can migrate out of a state and avoid paying income tax on the gain that accrued while in the state, it is unfair to the individual who does not—or does not have the financial means to—migrate out of the state.[56] In addition, most states have progressive personal income tax rate structures and most states do not have

[49] *See* Moretti & Wilson, *supra* note 3, at 4 (estimating "that state revenues in Florida and Texas would increase by $7.67 billion and $7.06 billion, respectively, if the states adopted an estate tax"). As an alternative to a separate estate tax, a state could simply deem the taxpayer's death to constitute a taxable realization event for purposes of the state's existing personal income tax.

[50] Although the taxpayer would face only an administrative filing burden, that burden could be significant if the taxpayer has many assets to track and has resided in many states that require an annual filing.

[51] *See* Abreu, *supra* note 6, at 1131; Michael J. Graetz, *To Praise the Estate Tax, Not to Bury It*, 93 YALE L.J. 259, 270 (1983) (discussing progressivity in the federal estate tax context).

[52] *See* Abreu, *supra* note 6, at 1131–32.

[53] *Id.* at 1132.

[54] *Id.* at 1132–33.

[55] *Id.* at 1133.

[56] For a detailed discussion of the distributional aspects of interstate mobility, see David Schleicher, *Stuck! The Law and Economics of Residential Stagnation*, 127 YALE L.J. 78, 78 (2017) (asserting that "[i]nterstate mobility rates are particularly low and stagnant among disadvantaged groups," and "policies that unnaturally inhibit interstate moves worsen national economic problems."); Naomi Schoenbaum, *Stuck or Rooted? The Costs of Mobility and the Value of Place*, 127 YALE L.J.F. 458 (2017); Sheila R. Foster, *The Limits of Mobility and the Persistence of Urban Inequality*, 127 YALE L.J.F. 480 (2017); Michelle Wilde Anderson, *Losing the War of Attrition: Mobility, Chronic Decline, and Infrastructure*, 127 YALE L.J.F. 522 (2017); David Schleicher, *Surreply: How and Why We Should Become Un-Stuck!*, 127 YALE L.J.F. 571 (2017).

preferential capital gains rates.[57] Thus, the exit tax can be even more progressive at the subnational level than at the United States national level.

Deterrence and symbolism are closely related justifications. At the United States national level, both are powerful because the exit tax is triggered when an individual renounces their citizenship—an act of much greater consequence and symbolism than changing residence.[58] Still, state and local governments generally want to deter high-net-worth individuals and businesses from leaving the jurisdiction.[59] This deterrence goal, however, must be balanced against the goal of attracting new residents to the state.[60] If a state implements an exit tax to deter current residents from leaving, it may signal to potential new residents that the state does not provide a tax environment in which they can thrive. In addition, incoming residents will know that once they become residents of the state, they will be locked into the state's exit tax regime if they ever decide to leave, creating a disincentive for migration into the state.

A competing, although less compelling, argument is that an exit tax actually signals that the jurisdiction provides such significant benefits to residents that the benefits justify an exit tax. For example, California could assert that Silicon Valley provides unparalleled benefits—access to an educated workforce, research institutions, and venture capital—that make it possible for startup companies to attain far greater success than anywhere else.[61] This argument further reinforces the role of the benefit theory in subnational exit taxation.

III. National Exit Taxation

To mitigate tax base migration, many nations have implemented national level exit taxes.[62] The United States federal level exit tax applies when

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[57] *See 50 State Overview: Individual Income Chart*, Bloomberg Law (last visited Oct. 29, 2022), https://www.bloomberglaw.com/product/tax/bbna/chart/2/10099/02bb9642baa05a8ab93c3caeebd181b9 [https://perma.cc/LX7W-RY3A]. If a state exit tax regime were to use the state's existing personal income tax rate structure, the gains would be taxed at the same rates as ordinary income. By contrast, the federal exit tax incorporates preferential long-term capital gains rates, which may be half that of ordinary income tax rates.

[58] Although residence and domicile are the predominant concepts at the subnational level, a state could potentially create a citizenship-based tax regime instead. Such a regime would face constitutional hurdles, and citizenship-based taxation has been heavily criticized at the national level. *See supra* note 9; Reuven S. Avi-Yonah, *The Case Against Taxing Citizens*, 58 Tax Notes Int'l 389, 389–90 (2010).

[59] *See* Clukey, *supra* note 15.

[60] *See* Saraiva & Singh, *supra* note 15. Any state legislation that deters interstate movement must also avoid violating constitutional constraints, as discussed in Section IV.A.

[61] *See, e.g.*, Don Lee, *Silicon Valley's Tech Monopoly Is Over. Is the Future in Austin, Texas?*, L.A. Times (Feb. 9, 2022), https://www.latimes.com/politics/story/2022-02-09/silicon-valleys-tech-monopoly-is-over [https://perma.cc/V8JW-6NWW].

[62] *See, e.g.*, Dentino & Manolakas, *supra* note 8; Worster, *supra* note 8; Kovács, *supra* note 31; Bruno Gouthière, *France: Exit Tax for Wealthy Individuals*, 38 Int'l Tax J. 9 (2012); Leif Muten, *Exit Taxes in Sweden*, 2009 Eur. Tax Stud. 233 (2009); Camilla Jotun Borge-Andersen & Joachim Bjerke, *Norway's Exit Tax and Cross-Border Mergers Challenged*, 22

a United States citizen renounces their citizenship.[63] In such a case, the United States would lose the jurisdiction to tax the individual if the individual renounced their citizenship and became a resident of a different nation. Absent the exit tax, a technology company founder with billions worth of stock, for example, could renounce their citizenship and change their residence to the Cayman Islands. If they then sold their stock, the United States would lose the ability to tax the gain, and the individual may pay no tax depending on their new residence nation. To prevent this tax base migration, the United States exit tax considers the citizenship renouncement a realization event.[64] Thus, the individual must pay tax to the United States based on their overall accrued wealth up to the point of renouncing their citizenship.[65] The current United States exit tax regime became effective in 2008 and replaced a widely criticized continuation tax regime that did not impose an immediate deemed realization but instead tracked the expatriate's property transactions for ten years after their expatriation.[66]

Mechanically, the current United States exit tax marks-to-market, as of the day before the expatriation, most of the individual's worldwide assets and treats the fair market value as the deemed amount realized.[67] Any resulting gain that exceeds an inflation-adjusted exclusion amount—$744,000 for 2021—is subject to United States income tax.[68] To further assuage liquidity concerns, the United States exit tax exempts individuals with income and wealth below a certain threshold, and also allows individuals to pay the tax in installments over several years. The exit tax applies to individuals that either (1) have average annual net income tax liability for the five years ending before the expatriation date that exceeds an inflation-adjusted amount—$172,000 for 2021; or (2) have a net worth greater than $2 million.[69] The individual may also defer paying the tax as to each specific prop-

INT'L TAX REV. 45 (2011); Alexander M. Gelardi, *A Comparison of the New U.S. Expatriation Tax and the Canadian Departure Tax*, 7 J. LEGAL TAX RSCH. 76 (2009).

[63] I.R.C. § 877A. The United States exit tax also applies when a "long-term resident" of the United States ceases to be a lawful permanent resident of the United States. I.R.C. § 877A(g)(2)(B). A "long-term resident" is a non-United States citizen who is a lawful permanent resident of the United States in at least eight taxable years during the period of fifteen taxable years ending with the taxable year during which the exit occurs. I.R.C. § 877A(g)(5), (e)(2).

[64] I.R.C. § 877A(a), (g).

[65] *See* I.R.C. § 877A(a).

[66] I.R.C. § 877; *see* Westin, *supra* note 8, at 150–60. The number of individuals expatriating, and thus becoming subject to the United States exit tax, increased dramatically after the current exit tax regime became effective. *See* Mitchel, *supra* note 11. It is unclear the extent to which the new exit tax regime influenced these expatriations, and other factors such as the 2010 enactment of the Foreign Account Tax Compliance Act (FATCA) likely contributed to increased expatriation. *See* Organ, *supra* note 43, at 6–12 (analyzing the impact of compliance burden on expatriation).

[67] *See* I.R.C. § 877A(a). The exit tax excludes certain property such as deferred income and certain tax deferred accounts. I.R.C. § 877A(c).

[68] I.R.C. § 877A(a)(1), (3).

[69] I.R.C. §§ 877A(g)(1), 877(e)(2).

erty until they actually sell the property.[70] To make the irrevocable deferral election, the covered expatriate must provide "adequate security" and agree to pay statutory interest on the deferred tax amount.[71] If an individual defers payment of the exit tax, they must file annual reports until all the deferred tax amounts are satisfied.[72] The current iteration of the exit tax is far superior to the former iteration. There are still enforcement difficulties and tax planning opportunities, however, that may result in tax avoidance or reduction.[73]

Although states have not yet enacted interstate exit taxes, most states indirectly adopt the federal level exit tax discussed immediately above. The vast majority of states with a personal income tax incorporate the federal exit tax through the state's general conformity to the Internal Revenue Code and by using federal gross or taxable income as a starting point for the state tax computation.[74] Thus, in the relatively rare case that an individual is subject to the federal exit tax, they will generally also be subject to a de facto state exit tax because the income that is reflected on the federal return will also be reflected on the state return.

Canada and several European nations have enacted exit taxes as well. Canada imposes a "departure tax" on individuals who cease to be Canadian residents, the act of which Canada deems to constitute a realization event.[75] Yet, unlike most other countries, Canada's exit tax does not incorporate an income or wealth threshold.[76] Canada does allow former residents to defer the departure tax by posting adequate security.[77]

Many European exit taxes have either been invalidated or narrowed by European Union constraints. But with many European nations facing increased tax migration threats, there may be movement toward reinvigorated exit taxes or some other mechanism to prevent tax base erosion.[78] European exit taxes differ slightly from the United States exit tax because these na-

[70] I.R.C. § 877A(b). The deferral period also ends upon death or if the security required to make the deferral election fails to meet statutory requirements. *Id.*

[71] *Id.* § 877A(b)(4), (7). Adequate security includes bonds and letters of credit, subject to certain requirements. *Id.* §§ 877A(b)(4), 6325.

[72] I.R.S. Notice 2009-85, 2009-2 C.B. 598. There are several other scenarios that necessitate annual reporting as well. *Id.*

[73] *See, e.g.*, Dentino & Manolakas, *supra* note 8, at 414–17; Scott Andrew Bowman, *Should I Stay or Should I Go - Tax Considerations in the U.S. Expatriation*, 86 Fla. Bar J. 48, 52–53 (2012); Gary Forster & J. Brian Page, *Expatriation from the United States: The Exit Tax*, 94 Fla. Bar J. 60, 62–63 (2020).

[74] *See* Hellerstein et al., *supra* note 33, ¶ 20.02; *50 State Overview-Individual Income Chart*, Bloomberg Law (2022), https://www.bloomberglaw.com/product/tax/bbna/chart/2/10099/c2a2cc27401ece7dc5ab631ab9b4644f [https://perma.cc/6BJ9-6D83].

[75] *See* Income Tax Act, R.S.C. 1985, c 1, § 128.1(4)(b); Gelardi, *supra* note 62, at 78–81.

[76] *See* Income Tax Act, R.S.C. 1985, c 1, § 128.1(9). Canada imposes a reporting obligation only on individuals who own applicable assets with a value exceeding CAD $25,000. *See id.*

[77] *See id.* § 220(4.5).

[78] Indeed, European nations are also grappling with similar migration issues. *See* Stephen Gardner, *Fears Grow Over Income Tax Loss as Europe Chases Remote Workers*, Bloomberg (Aug. 3, 2021), https://news.bloombergtax.com/daily-tax-report-international/fears-grow-over-income-tax-loss-as-europe-chases-remote-workers [https://perma.cc/9FLC-SMVE].

tions do not impose a broad citizenship-based taxation regime. European exit taxes do, however, resemble the United States exit tax as applied to long-term residents who cease to be lawful United States residents. The European exit taxes generally provide thresholds on how long the individual resided or was domiciled in the nation before the exit tax applies.

In addition, the European Union imposes constraints on exit taxes, at least as to emigration to another member state.[79] Many of these underlying limiting principles are similar to those implicated by the United States Constitution, as discussed below. The European Union's fundamental freedom of establishment principle is the key constraint driving the structure of member states' exit taxes.[80]

The economic purpose of the European Union is to create a united economy that improves efficiency and promotes growth.[81] The European Union's Court of Justice (ECJ) determines whether a member state's law violates the Treaty on the Functioning of the European Union's (TFEU) fundamental freedoms.[82] The fundamental freedoms help ensure that a member state refrains from tax discrimination by discouraging free movement.[83] As a general matter, the European Union does not create a universal income tax system for the member states. Rather, the European Union mandates that member states do not create tax policies that favor domestic actors by applying higher discriminatory rates to cross-border actors.[84] Therefore, the ECJ must assess the laws of a member state to determine if cross-border tax discrimination exists.[85]

In 1999, France enacted the first iteration of its exit tax to deter the flight of wealthy individuals.[86] The ECJ, however, found that the French exit

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[79] *See* Kovács, *supra* note 31, at 6–8; Dominique Troy, *The End of the Exit Tax*, 16 J. INT'L TAX 51 (2005).

[80] *See* Case C-9/02, Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie, 2004 E.C.R. I-2409 (invalidating the previous French exit tax because it violated the fundamental right of establishment); *cf.* Case C-513/03, Heirs of M.E.A. van Hilten-van der Heijden v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen, 2006 E.C.R. I-1957 (upholding the Dutch estate tax's extended-residence rule that applied to Dutch citizens because, unlike the French exit tax, the Dutch tax did not accelerate taxation).

[81] *See* Ruth Mason & Michael S. Knoll, *What Is Tax Discrimination?*, 121 YALE L.J. 1014, 1023–24 (2012).

[82] *Id.* at 1026–30.

[83] *Id.* at 1097.

[84] *See id.* at 1029 (citing Case C-336/96, Gilly v. Directeur des Services Fiscaux du Bas-Rihn, 1998 E.C.R. I-2793, ¶¶ 49, 53 ("[H]olding that a cross-border disadvantage due to differences in national tax rates was not discriminatory.")); Case C-294/97, Eurowings Luftverkehrs AG v. Finanzamt Dortmund-Unna, 1999 E.C.R. I-7447 ("[R]ejecting as a justification for discriminatory source taxation against nonresidents the fact that such nonresidents may be subject to no or lesser taxation in their residence state.").

[85] *See* Ruth Mason & Michael S. Knoll, *A Brief Sur-Reply to Professors Graetz and Warren*, 123 YALE L.J.F. 1, 5–6 (2013); Ruth Mason, *Flunking the ECJ's Tax Discrimination Test*, 46 COLUM. J. TRANSNAT'L L. 72, 77 (2007).

[86] *See* Gouthière, *supra* note 62, at 9.

tax violated European Union law.[87] The French exit tax violated the "principle of freedom of establishment" by enforcing an immediate tax on the unrealized gains of taxpayers when they migrated out of France.[88] France then created a second iteration of its exit tax to conform to European Union requirements, which has undergone many alterations over the past decade.[89] The tax applies only to individuals who were domiciled in France for at least six of the ten years prior to changing their domicile.[90] In addition, the individual's assets must reach a certain threshold before the exit tax applies. The individual must have either stock or shares equal to or greater than €800,000, or their shares must represent at least fifty percent of the corporation's profits.[91]

The French exit tax generally treats the change of domicile as a realization event and imposes income tax and social levies on unrealized and unrecognized capital gains.[92] Yet, unlike the first exit tax iteration, if the taxpayer moves to another European Union member state or a nation that has signed a cooperative agreement with France, the individual benefits from an automatic stay of payment of tax.[93] The automatic stay requires the taxpayer to file annual reports, and France allows discretionary stays for those migrating to noncooperative nations.[94] The most recent iteration of the exit tax allows taxpayers to avoid the French exit tax entirely if they hold the applicable assets for at least two or five years after changing residence, depending on the value of the taxpayer's assets.[95] The previous regime imposed a fifteen-year look-forward period, although that regime was relaxed effective 2019.[96]

If taxpayers sell their shares before the statutory period expires, they are liable for income tax and social levies on the gain that accrued between the time of purchase and time of residence change.[97] They must pay tax at

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[87] Case C-9/02, Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie, 2004 E.C.R. I-2409; *see also* Troy, *supra* note 79, at 51–52.

[88] *Hughes de Lasteyrie du Saillant*, 2004 E.C.R. I-2409; *see also* Troy, *supra* note 79, at 51–52.

[89] *See* Gouthière, *supra* note 62, at 9; *Do I Have to Pay an Exit Tax?*, République Française, https://www.impots.gouv.fr/international-particulier/questions/i-am-leaving-france-do-i-have-pay-exit-tax [https://perma.cc/R2GW-Y89Q]; *France to Replace 'Exit Tax' on Capital Gains, Target Fiscal Cheats*, Reuters (Sept. 15, 2018), https://www.reuters.com/article/us-france-budget-entrepreneurs/france-to-replace-exit-tax-on-capital-gains-target-fiscal-cheats-idUSKCN1LV09X [https://perma.cc/X2VT-JVEN].

[90] *Do I Have to Pay an Exit Tax?*, *supra* note 89.

[91] *Id.*

[92] *Id.*

[93] *See id.*

[94] *Id.*

[95] The two-year look-forward period applies if the taxpayer's applicable assets are worth less than €2,570,000; the look-forward period is five years if the taxpayer's assets equal or exceed that amount. *Id.*

[96] *Id.*; *France to Replace 'Exit Tax' on Capital Gains, Target Fiscal Cheats*, *supra* note 89.

[97] Gouthière, *supra* note 62, at 10. If the ultimate sales price is less than the fair market value at the time of residence change, the lower value is used for the gain calculation. *Id.*

the rate that was in effect when they transferred domicile.[98] In the event a taxpayer migrates back to France without ultimately selling their applicable assets, the exit tax will be canceled and any prior payment refunded.[99]

States can certainly draw from the successes and failures of national level exit taxes. Most fundamentally, a regime that imposes a realization event at the time of residency change is much more effective and practical to enforce than a continuation tax regime that tracks former residents for a stated number of years. The regime should provide a mechanism, however, that allows for deferred payment of the exit tax. As discussed in Section IV.C, an option to defer payment serves many purposes and may be required to avoid constitutional infirmity. Exit taxes satisfy the European Union's freedom of establishment, which is similar in many ways to the United States Constitution's right to travel, when there is an immediate declaration of tax due, but there is no accelerated payment.[100]

IV. State and Local Exit Taxation

Although many states are facing a serious tax base erosion threat due to interstate migration, an exit tax may mitigate this threat while achieving distributional equity and avoiding constitutional infirmities. This Part examines constitutional constraints to address specific tax base migration challenges and concludes with potential state exit tax alternatives.

There are five specific situations in which state and local governments are most likely to forgo tax revenue that is properly attributed to their jurisdiction unless they adopt an exit tax. These areas of concern include (1) personal and intangible property appreciation; (2) real property non-recognition provisions; (3) deferred compensation and stock options; (4) corporate retained earnings and carried interest; and (5) business deductions and recapture. Although two areas of concern are corporate and business focused, relevant to this Article are the business owners' personal income tax obligations. All five challenges implicate state personal income tax, for which an individual's residence generally provides a jurisdictional basis for taxation.[101]

States do not generally face the concerns discussed throughout this Article with their corporate income tax regimes because a corporation's state of headquarters or incorporation is much less relevant than an individual's state of residence in a personal income tax regime. States use formulary apportionment to determine the amount of a corporation's business income that is properly attributed to the state, which is typically determined by the corpora-

[98] *Id.*
[99] *Id.*
[100] *See* Kovács, *supra* note 31, at 5–6.
[101] In many cases in which the source of income can be ascertained, the source and residence states are the same.

tion's percentage of sales into the state.[102] States do, however, allocate a corporation's non-business income to the corporation's principal place of business.[103] In theory, a corporation could move its headquarters to a different state in anticipation of a transaction that would generate substantial non-business income.[104] In practice, such a scenario is unlikely because of the practical considerations of moving a corporation's headquarters and because there is much greater parity with corporate income tax rates than with individual income tax rates, so there is little for the corporation to gain.[105]

This Part discusses in detail each situation outlined above, analyzing the policy considerations, distributional impact, and optimal design for an exit tax to address each. But first, this Part considers the relevant constitutional constraints on state and local exit taxes.

A. Constitutional Considerations

Despite compelling justifications for state and local exit taxes, they face several potential constitutional hurdles. State and local exit taxes may implicate several clauses of the United States Constitution and the respective state constitution. Taxing authorities may also face federal preemption, as a recently proposed federal bill would preclude all state and local exit taxes.[106] As a practical matter, however, it can be difficult to invalidate a state tax statute on constitutional grounds. State and local tax disputes must generally be litigated in the respective state court system pursuant to the federal Tax Injunction Act.[107] State court judges may be less comfortable analyzing federal constitutional issues, and most states' tax trial courts are administrative bodies, many of which do not have jurisdiction to decide constitutional questions.[108]

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[102] *See* HELLERSTEIN ET AL., *supra* note 33, ¶¶ 8.05, 9.02, 9.18.

[103] *Id.* ¶¶ 8.04, 9.02, 9.07.

[104] There are also situations where the corporate taxpayer could sever nexus with the departure state, generally in the context of being acquired or selling substantial assets, and receive income related to that transaction after the taxpayer no longer has nexus with the departure state. Questions also arise with the sale of S-Corporations, which are discussed briefly in Section IV.B. These situations are exceedingly rare compared to the millions of individuals that migrate across state lines each year, and many state corporate income tax regimes already incorporate mechanisms to address these situations.

[105] *See 50 State Overview-Corporate Income Chart*, BLOOMBERG LAW (2022), https://www.bloomberglaw.com/product/tax/bbna/chart/2/10088/4f47d69ddf20890d8d41dcfdecf97601 [https://perma.cc/4HPD-PPLT].

[106] Exit Tax Prevention Act of 2021, H.R. 2165, 117th Cong. (2021). The proposed bill provided that "[a] State, or taxing jurisdiction in a State, may not impose an obligation for the collection of an income tax, wealth tax, or any similar tax on a resident who has relocated permanent residence to another State or a taxing jurisdiction of another State." *Id.* § 2.

[107] 28 U.S.C. § 1341.

[108] *See* W. Scott Wright, Jonathan A. Feldman & Andrew D. Appleby, *Courting Independence: The Rise of Effective State Tax Courts and Tribunals*, 63 TAX ANALYSTS: STATE TAX NOTES 475, 478 (2012).

Fundamentally, the states have the general constitutional power to tax their residents' personal income regardless of its source, and nonresidents' personal income to the extent it is derived from sources within the state.[109] Depending on its design, a state exit tax should be able to satisfy these baseline principles, either by imposing tax on a resident before they formally become a nonresident, or by imposing tax only on income that is sourced to the departure state, or both. But there are additional constitutional restrictions beyond this general principle, most notably the fundamental right to travel and nondiscrimination, that must inform state and local exit tax design. Exit tax regimes that impose a mandatory tax upon migration are most susceptible to constitutional challenge, while regimes that impose only continued reporting obligations are least susceptible.

1. Privileges and Immunities Clause

The primary constitutional concern with state exit taxes is the fundamental right to travel, which arises under the Privileges and Immunities Clauses of Article IV and the Fourteenth Amendment.[110] The Privileges and Immunities Clause does not expressly provide a right to travel.[111] For over a century, however, the United States Supreme Court has interpreted its language to provide a fundamental right to travel that prohibits a state from impeding individuals' interstate mobility.[112] The Privileges and Immunities Clause is also the only constitutional restraint that is directed explicitly to equal treatment of residents and nonresidents.[113]

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[109] *See* New York *ex rel.* Cohn v. Graves, 300 U.S. 308, 312–13 (1937); HELLERSTEIN ET AL., *supra* note 33, ¶¶ 20.03, 20.04[1], 20.05[1]. Although a state may impose taxes on all of a resident's income, if that income is properly sourced to another state, the state of residence will provide a credit for taxes paid to the source state to satisfy internal consistency.

[110] U.S. CONST. art. IV, § 2; *id.* amend. XIV, § 1. Although courts have generally relied on the Privileges and Immunities Clause of Article IV, the United States Supreme Court recently relied on the Privileges or Immunities Clause of the Fourteenth Amendment in a right to travel case. *See* Saenz v. Roe, 526 U.S. 489 (1999). Thus, this Article uses the term Privileges and Immunities Clause to refer to both constitutional sources collectively.

[111] "The citizens of each state shall be entitled to all privileges and immunities of citizens in the several states." U.S. CONST. art. IV, § 2.

[112] *See, e.g.,* Crandall v. Nevada, 73 U.S. (6 Wall.) 35, 49 (1868); Paul v. Virginia, 75 U.S. (8 Wall.) 168, 180 (1869); Ward v. Maryland, 79 U.S. (12 Wall.) 418, 430 (1871); Edwards v. California, 314 U.S. 160, 173–74 (1941); Shapiro v. Thompson, 394 U.S. 618, 629–31 (1969); Dunn v. Blumstein, 405 U.S. 330, 338–39 (1972); Mem'l Hosp. v. Maricopa Cnty., 415 U.S. 250, 254–55 (1974); Zobel v. Williams, 457 U.S. 55, 59 n.5 (1982); Sup. Ct. of N.H. v. Piper, 470 U.S. 274, 279–80 (1985); *Saenz*, 526 U.S. at 489; *see also* Corfield v. Coryell, 6 F. Cas. 546, 551–52 (Washington, Circuit Justice, C.C.E.D. Pa. 1823). In some of the aforementioned cases, the Court derived the fundamental right to travel from the Equal Protection Clause. *See* Walter Hellerstein, *Federal Constitutional Restraints on Property Tax Assessment Limitations: An Analysis of Florida's 'Portability' Proposals*, 44 TAX NOTES STATE 789, 799 (2007) ("[T]he precise constitutional source of that right is unclear, because the Court has relied on several provisions of the Constitution in delineating it, and the scope of the right itself is less than certain.").

[113] HELLERSTEIN ET AL., *supra* note 33, ¶ 20.06.

Although there is no serious dispute that the Privileges and Immunities Clause provides a fundamental right to interstate travel, the Court's doctrinal right to travel analysis has been described as "a fragmented, complex, and confusing mass of interlocking, overlapping theories."[114] Right-to-travel disputes generally fall within one of two categories: where a state treats its own residents more favorably than nonresidents who are temporarily within the state (e.g., commuters), and where a state treats established residents more favorably than new residents.[115] The Court has generally struck down state laws that discriminate in both situations.[116]

No court in the United States, however, has addressed the constitutionality of a conventional exit tax.[117] Because right to travel cases implicate a fundamental right, they generally require a compelling state interest.[118] There is precedent, however, that suggests only a rational basis is required in certain tax contexts.[119] So, despite general right-to-travel precedent, there is considerable uncertainty as to both the analytical framework and result of a constitutional challenge to various types of exit taxes.

If a state were to impose a conventional exit tax that required all individuals to recognize and pay tax on all their unrealized income and gain when the individuals leave the state, the individuals would face a substantial burden. In many cases, the taxpayer may not have the liquidity to pay the exit tax and would be forced to remain a resident of the state. Regardless of the analytical framework or standard of review, this exit tax variation would likely be held unconstitutional. The result is much less clear, however, if the exit tax regime were to incorporate income or wealth applicability thresholds, limit taxable assets to those that are publicly traded, or provide payment assistance of some kind.[120] If an exit tax regime were to incorporate a continuation tax approach, either instead of a realization-based approach or as an optional alternative, the tax would likely be upheld because it does not

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[114] Bryan H. Wildenthal, *State Parochialism, the Right to Travel, and the Privileges and Immunities Clause of Article IV*, 41 Stan. L. Rev. 1557, 1557 (1989).

[115] *Id.*

[116] *See id.*; *supra* note 112; Hellerstein et al., *supra* note 33, ¶ 20.06[4].

[117] As discussed in Part II, the European Court of Justice has addressed whether various exit tax and continuation tax regimes violate the fundamental right of establishment. *See supra* note 80 and accompanying text.

[118] *See* Wildenthal, *supra* note 114, at 1558; Worster, *supra* note 8, at 944–51; Steve R. Johnson, *Living by the Initiative and Dying by the Initiative*, 54 State Tax Notes 809, 810 (2009); Hellerstein, *supra* note 112, at 799–801.

[119] *See, e.g.*, Nordlinger v. Hahn, 505 U.S. 1, 13–14 (1992); Rowitz v. McClain, 138 N.E.3d 1241, 1254 (Ohio Ct. App. 2019) ("But even when the right to travel is implicated, the application of a strict scrutiny analysis is not automatic."); Martin v. Bd. of Cnty. Comm'rs of Laramie Cnty., 503 P.3d 68, 77 (Wyo. 2022) (applying rational basis review of a residence duration requirement for property tax exemption); Sylvester v. Comm'r of Revenue, 837 N.E.2d 662, 666–67 (Mass. 2005) (applying rational basis review of a residence duration requirement for property tax exemption); *see also* Henry Ordower, *Avoiding Federal and State Constitutional Limitations in Taxation*, 97 Tax Notes State 1447, 1450 (2020); Hellerstein, *supra* note 112, at 799–801.

[120] See *infra* Section IV.C for a discussion of these potential exit tax design features.

impose any burden on the migrating taxpayer other than an annual reporting obligation. This constitutional analysis would be consistent with the European Court of Justice's decisions, which held that exit taxes violate the European Union's right of establishment if they require accelerated payment but not if there is only an immediate declaration of tax due.[121]

Not limited to the right to travel, the Privileges and Immunities Clause also provides the strongest general protection against states discriminating against nonresident individuals.[122] The Court has expressly recognized that the Privileges and Immunities Clause prohibits a state from imposing on a nonresident individual "any higher taxes or excises than are imposed by the state upon its own [residents]."[123]

The Privileges and Immunities Clause does not, however, provide a blanket prohibition on nonresident discrimination. A discriminatory law will be upheld if "(i) there is a substantial reason for the difference in treatment; and (ii) the discrimination practiced against nonresidents bears a substantial relationship to the State's objective."[124] Courts have phrased this *Toomer* test as justifying discrimination when it was "linked to some evil or problem caused by the nonresident and . . . the revenue derived from the tax . . . [bore] a substantial relationship to the cost of amelioration of the evil or the solution of the problem."[125]

In the exit tax context, "[t]he evil, of course, is difficulty in enforcement, and nonresidents do appear to constitute a 'peculiar source' of that difficulty."[126] The question, though, is whether imposing an immediate tax on nonresidents that is not immediately imposed on residents bears a substantial relationship to the cost of solving the state's enforcement difficulties. Unlike the unlawful regime in *Austin v. New Hampshire*, the tax would be imposed equally on residents and nonresidents—an exit tax impacts only the timing of tax payment.[127] In the tax realm, however, timing is crucial and can provide a sufficient basis to invalidate a tax law.[128] The Oregon Tax Court struck down a tax provision that imposed immediate realization only on nonresidents, seeing no reason why in today's modern society the state could not

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[121] *See supra* note 80 and accompanying text.

[122] HELLERSTEIN ET AL., *supra* note 33, ¶ 20.06. Importantly, though, the Privileges and Immunities Clause protects only fundamental rights. *Id.* ¶ 20.06[1][c]; Baldwin v. Mont. Fish & Game Comm'n, 436 U.S. 371, 383 (1978).

[123] Ward v. Maryland, 79 U.S. (12 Wall.) 418, 430 (1871). Although the language of the clause uses the term "citizens" of different states, the United States Supreme Court has effectively extended the protection to "residents." HELLERSTEIN ET AL., *supra* note 33, ¶ 20.06[1][a].

[124] Sup. Ct. of N. H. v. Piper, 470 U.S. 274, 284 (1985) (citing Toomer v. Witsell, 334 U.S. 385, 396 (1948)).

[125] Salorio v. Glaser, 461 A.2d 1100, 1104 (N.J. 1983) (invalidating a tax on nonresident commuters), *cert. denied*, 464 U.S. 993 (1983).

[126] James Charles Smith & Walter Hellerstein, *State Taxation of Federally Deferred Income: The Interstate Dimension*, 44 TAX L. REV. 349, 395 (1989).

[127] *See* Austin v. New Hampshire, 420 U.S. 656, 665–66 (1975).

[128] *See* Fisher v. Dep't of Revenue, 16 Or. Tax 323, 330 (2001).

implement an effective reporting and tracking system instead.[129] In the limited context of real property like-kind exchange non-recognition, the burdens imposed on nonresidents may not be within proximity of the state's enforcement costs. If an exit tax applied much more broadly, however, a state may be able to successfully justify a realization based exit tax. Regardless, it appears a continuation-type tax that imposes only a reporting obligation would easily pass muster.

Although the Privileges and Immunities Clause provides substantial protection for nonresident individuals, particularly when implicating the fundamental right to travel, there is no existing precedent analyzing exit taxes specifically. Thus, there is uncertainty as to how courts would view various iterations of a state and local exit tax under the Privileges and Immunities Clause.

2. Commerce Clause

Although the Privileges and Immunities Clause is the strongest constitutional restraint on state and local exit taxes, the Commerce Clause also constrains a state's ability to impose an exit tax. In the personal income tax context generally, state courts have been divided as to the Commerce Clause's application.[130] Where a tax implicates an interstate capital flow, however, the United States Supreme Court and state courts have found the Commerce Clause applicable.[131] Indeed, any personal income tax regime that exposes taxpayers who cross state lines to greater tax burdens than those who do not would seem to implicate the Commerce Clause, particularly after *Comptroller of the Treasury v. Wynne*.[132]

The United States Supreme Court established the analytical framework for addressing dormant Commerce Clause challenges to state and local taxes in *Complete Auto Transit v. Brady*.[133] The four-prong *Complete Auto* test provides that the tax must: (1) be applied to an activity that has a substantial nexus with the jurisdiction; (2) be fairly apportioned to activities carried on by the taxpayer in the jurisdiction; (3) not discriminate against interstate

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[129] *Id.* at 331.

[130] *See* Hellerstein et al., *supra* note 33, ¶ 20.03 (opining that "[t]he holdings of the New York and Minnesota courts are open to serious question"). *Compare* Tamagni v. Tax Appeals Tribunal, 695 N.E.2d 1125, 1133 (N.Y. 1998) (holding that personal income "tax does not fall on any interstate activity, but rather on a purely local occurrence—the taxpayer's status as a resident of New York State"), *cert. denied*, 525 U.S. 931 (1998), *and* Luther v. Comm'r of Revenue, 588 N.W.2d 502, 511 (Minn. 1999) (holding that a residency definition did not involve interstate commerce), *cert. denied*, 528 U.S. 821 (1999), *with* Wilson v. Dep't of Revenue, 727 P.2d 614, 618–19 (Or. 1986) (holding that personal real estate transactions constituted interstate commerce).

[131] *See, e.g.*, Comptroller of the Treasury v. Wynne, 575 U.S. 542 (2015); *Wilson*, 727 P.2d at 615.

[132] Hellerstein et al., *supra* note 33, ¶ 20.03.

[133] Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

commerce; and (4) be fairly related to services provided by the jurisdiction.[134]

The substantial nexus prong has been the subject of considerable controversy in the past. The United States Supreme Court's decision in *South Dakota v. Wayfair, Inc.* reduces the likelihood of substantial nexus challenges.[135] In the context of state and local exit taxes, the individual is a resident of the state when the exit tax regime is triggered, so there does not appear to be a nexus concern.[136] And assuming the exit tax is imposed only on the income or gain that accrued while the individual was a resident of the departure state, the regime should satisfy the "fair apportionment" and "fairly-related" prongs.[137] Indeed, the theoretical basis for state and local exit taxation mirrors the standard under the "fairly-related" prong. The Court looks to whether "the *measure* of the tax [is] reasonably related to the extent of the contact, since it is the activities or presence of the taxpayer in the state that may properly be made to bear a 'just share of state tax burden.'"[138]

The anti-discrimination prong is most relevant to state and local exit taxes. Exit taxes implicate the anti-discrimination prong because they apply only to taxpayers engaged in interstate activities—i.e., individuals moving from one state to another—and not to taxpayers engaged solely in intrastate activities. If a state tax law has a discriminatory impact on interstate commerce, the United States Supreme Court will generally invalidate the law without balancing the competing state interests.[139]

The Oregon Supreme Court analyzed a tax non-recognition provision based on I.R.C. § 1031, discussed in Section IV.B.2. The Oregon provision allowed non-recognition only if the replacement property was located within the state, and recognized gain immediately if the replacement property was located outside the state.[140] The court upheld the tax provision, finding no discriminatory purpose because the statute's purpose was not to keep money and business in the state. The court likewise found no discriminatory effect

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[134] *Id.*

[135] *See* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2092–93 (2018).

[136] If an exit tax imposes tax on income or property that was generated because of the benefits provided by the state, due process should be satisfied even if the taxpayer is no longer resident in the state. *See supra* note 33 and accompanying text.

[137] An exit tax that is imposed only on the income or gain that accrued while the individual was a resident of the departure state should also satisfy the external consistency requirement, which looks to whether "income attributed to the State is in fact 'out of all appropriate proportions to the business transacted in that State.'" Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 169–70 (1983) (quoting Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell, 283 U.S. 123, 134 (1931)).

[138] Commonwealth Edison Co. v. Montana, 453 U.S. 609, 626 (1981) (emphasis in original) (quoting W. Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938)). This framework incorporates the fundamental assumption that the "measure of a tax is reasonably related to the taxpayer's activities or presence in the state—*from which it derives some benefit* such as the substantial privilege of [doing business] . . . ." *Id.* at 628–29 (emphasis added).

[139] *See* Smith & Hellerstein, *supra* note 126, at 394.

[140] *See* Wilson v. Dep't of Revenue, 727 P.2d 614 (Or. 1986).

because the statute affected the time at which taxes were due, not the tax rate or tax liability.[141] Commentators found the court's analysis "dubious" because "timing of tax payments can and frequently does make an enormous difference in actual tax liabilities," and "a tax scheme that limits deferral to those who invest in in-state replacement property imposes a substantial penalty on out-of-state investment."[142] If the Oregon provision discriminated against interstate investment, however, a provision that allowed non-recognition for all replacement properties would discriminate in favor of interstate investment. If the replacement property was located in a state without a personal income tax, all the gain would likely go untaxed unlike the in-state replacement property, creating a windfall for interstate investors.[143] A carefully crafted exit tax can solve this problem, avoiding discrimination while achieving parity.[144]

Perhaps the most important Commerce Clause inquiry post-*Wynne* is whether a tax regime achieves internal consistency.[145] The internal consistency test assumes that every state has adopted an identical tax regime and looks to whether such a scenario would place interstate commerce at a disadvantage compared to intrastate commerce.[146] Importantly, even if a tax regime would otherwise be internally inconsistent, a state can cure the constitutional defect with a credit mechanism.[147] An exit tax should satisfy internal consistency if it includes in the tax base only the income and gain that accrued while the taxpayer was resident in the state and that was not properly sourced to another state. If every state adopted such a regime there would be no risk of double taxation. To ensure that the exit tax regime tailors its tax base in such a manner, the tax regime must implement a credit or exemption mechanism. As discussed further in Section IV.C, when determining the tax base, the regime should allow a credit for taxes paid on income properly sourced to other states, and should provide either a basis step-up or credit for exit taxes paid to prior states of residence.[148] These principles should ensure that the exit tax base consists only of income and gain that accrued while the taxpayer was a resident of the departure state, thus satisfying internal consistency.

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[141] *Id.* at 619–20. The court also noted that the non-recognition provision did not turn on whether the individual remained a resident of the state or not. *Id.* at 620–21.

[142] Smith & Hellerstein, *supra* note 126, at 394.

[143] *See id.* at 398.

[144] *See infra* Sections III.B.2 and III.C.

[145] *See* Hellerstein et al., *supra* note 33, ¶¶ 4.16[1][a][vii], 20.10[2][a][i].

[146] *See* Comptroller of the Treasury v. Wynne, 575 U.S. 542, 561–62 (2015); Hellerstein et al., *supra* note 33, ¶ 4.16.

[147] *See* Hellerstein et al., *supra* note 33, ¶¶ 4.16[1][a][vii], 20.10[2][a][i].

[148] For example, if a taxpayer had taxable assets with a fair market value of $1 million and paid exit tax in State A using that fair market value as the deemed sales price for the assets, the taxpayer's basis in those taxable assets should be $1 million if the taxpayer later leaves State B. With that basis step-up, State B would impose tax only on gain that accrued since the taxpayer changed their residence to State B.

Another relevant concern is that many states have internally inconsistent definitions of "resident."[149] Although New York state courts have upheld these internally inconsistent definitions, which resulted in double taxation in those cases because two states each claimed a residence-based jurisdiction to tax the individual's income, the courts' reasoning is far from convincing.[150] If states with internally inconsistent residency definitions adopt exit taxes, the result could be so egregious that even New York courts could be convinced of their constitutional defects. For example, if individuals were statutory residents of both New York and Connecticut, and each state imposed an exit tax, the individual could be subject to two exit taxes when they attempt to migrate to Florida. States must be cognizant of this issue when designing an exit tax, as discussed below.[151]

Taxpayers could also assert that an exit tax unduly burdens interstate commerce under the potentially reinvigorated balancing test announced in *Pike v. Bruce Church, Inc.*[152] Although the *Wayfair* Court suggested that the *Pike* balancing test may play a larger role in dormant Commerce Clause challenges moving forward, it has traditionally been eschewed in state and local tax jurisprudence and diminished generally.[153] In *Pike*, the Court established the following balancing framework to analyze Commerce Clause challenges:

> Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.[154]

As a threshold matter, it is unclear if an exit tax would regulate in an "even-handed manner." If the exit tax applied to all assets of all individuals migrating out of the state, it would seem to satisfy this baseline requirement.[155] Exit

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[149] HELLERSTEIN ET AL., *supra* note 33, ¶ 20.03[1].

[150] *See* Edelman v. N.Y. State Dep't of Tax'n & Fin., 80 N.Y.S.3d 241, 242 (N.Y. App. Div. 2018), *cert. denied*, 140 S. Ct. 134 (2019) (mem.); Chamberlain v. N.Y. State Dep't of Tax'n & Fin., 88 N.Y.S.3d 257, 258–59 (N.Y. App. Div. 2018), *cert. denied*, 140 S. Ct. 133 (2019) (mem.).

[151] *See infra* Section IV.C.

[152] *See* 397 U.S. 137, 142 (1970).

[153] *See, e.g.*, Walter Hellerstein & Andrew Appleby, *Substantive and Enforcement Jurisdiction in a Post-*Wayfair *World*, 90 STATE TAX NOTES 283, 292 (2018); Brannon P. Denning, *Reconstructing the Dormant Commerce Clause Doctrine*, 50 WM. & MARY L. REV. 417, 493–94 (2008).

[154] *Pike*, 397 U.S. at 142 (citation omitted).

[155] If an exit tax exempted individuals below a certain income or wealth threshold, it would still seem to regulate evenhandedly overall. But if the tax applied only to certain asset

taxes would also serve a clear and compelling local purpose: to protect the state from revenue loss that it will likely incur because the state cannot collect tax from the prior resident when they ultimately sell their assets.[156] In addition, a state could assert the legitimate purpose of effectuating distributive equity by aligning the tax burden with the benefit received. An exit tax serves the local purpose of preventing high-net-worth individuals from shifting the tax burden to those who have received immensely less benefit and who do not have the same ability to pay, and who remain residents in the departure state.

The resulting inquiry is then twofold: whether the burdens imposed on taxpayers outweigh the respective statute's purpose; and if not, whether the state's purpose could be accomplished just as well in a less burdensome manner. For this determination, it is helpful to break exit taxes into two categories—those that deem a realization event upon migration and impose tax immediately, and those that act as continuation taxes where the individual must file annual reports but not pay tax until they actually realize gain. With the realization tax alternative, the *Pike* balancing test would present a difficult decision for a court. Although the burden imposed on the taxpayer is simply one of timing, because the state would theoretically impose the tax at some point in the future absent an exit tax, imposing tax without a realization event creates substantial liquidity concerns. With the continuation tax alternative, however, asserting that an annual tax reporting obligation outweighs the state's purposes described above would be quite tenuous.

If a court were to find that the realization tax alternative imposed burdens that outweighed the local purpose, it would also likely find that there exists a less burdensome alternative. The fact that there are two viable exit tax options, assuming the second is close to as effective as the first, illustrates that there is a less burdensome manner in which the state could achieve its purpose. Regardless, based on longstanding judicial reluctance to apply the inherently nuanced *Pike* balancing framework in the tax context, especially in a state court, it may be difficult for a taxpayer to succeed on this basis.

3. Equal Protection Clause

Even if state exit taxes disparately affect prior residents compared to current residents, it is unlikely a court would invalidate a state exit tax on equal protection grounds. The Equal Protection Clause prohibits a taxing jurisdiction from making unreasonable tax classifications, which is a fairly

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classes, imposed higher tax rates on certain taxpayers or asset classes, or allowed a continuation tax reporting option only for certain taxpayers, the tax may not regulate evenhandedly.

[156] *See* Smith & Hellerstein, *supra* note 126, at 394.

lenient standard for taxing jurisdictions.[157] The United States Supreme Court will generally analyze whether "the State's classification is 'rationally related to the State's objective.'"[158] If the taxing jurisdiction presents a reasonable justification, the Supreme Court will generally sustain the tax even if it is discriminatory.[159] If a state can advance a rational basis for disparate tax treatment of nonresidents compared to residents, such as protecting the right to impose tax on income that accrued in the state, the tax should comport with the Equal Protection Clause.[160] In the exit tax context, however, the classification is actually current residents versus prior residents, not all nonresidents. This classification further weakens any equal protection argument because the prior residents had a direct connection with the departure state.

Although unlikely in the state exit tax context, state courts have been more likely than the Supreme Court to find that taxes violate the state or federal Equal Protection Clause.[161] A state court may be more comfortable analyzing its state constitution rather than the United States Constitution, which also allows the state court to deviate from Supreme Court Equal Protection Clause precedent.[162] And, although some state courts may assert that Uniformity Clause and Equal Protection Clause standards are essentially identical, it appears taxpayers may have more success with state uniformity clause challenges.[163] Ultimately, because of the greater protection afforded by the Privileges and Immunities Clause in the personal income tax context, "the Equal Protection Clause has virtually no independent function as a bulwark against unconstitutional discrimination against nonresidents."[164]

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[157] *See* HELLERSTEIN ET AL., *supra* note 33, ¶ 3.02. A state imposing a higher rate of tax based on a taxpayer's overall income or revenue would also likely satisfy the Equal Protection Clause. *See id.* ¶ 20.06[3].

[158] Harrah Indep. Sch. Dist. v. Martin, 440 U.S. 194, 198 (1979) (quoting Mass. Bd. of Ret. v. Murgia, 427 U.S. 307, 315 (1976)).

[159] *See, e.g.*, Allied Stores of Ohio, Inc. v. Bowers, 358 U.S. 522, 526–27 (1959). The Supreme Court has invalidated a residency-based economic regime by implicating the fundamental right to travel and applying a strict scrutiny standard under the Equal Protection Clause. *See* Zobel v. Williams, 457 U.S. 55, 65 (1982). As pointed out in Justice O'Connor's concurrence, however, it is unclear why the Court applied the Equal Protection Clause instead of the Privileges and Immunities Clause. *Id.* at 73–74 (O'Connor, J., concurring).

[160] *See* Smith & Hellerstein, *supra* note 126, at 394.

[161] HELLERSTEIN ET AL., *supra* note 33, ¶ 2.06[2]. "[S]ome state courts appear to be more sympathetic than the U.S. Supreme Court to equal protection challenges to state tax classifications." *Id.* ¶ 3.04[1].

[162] State courts are bound by Supreme Court precedent when applying the United States Constitution, but are not so bound when applying the state's constitution. *Id.* ¶ 3.04[1]; *see generally* Robert F. Williams, *Equality Guarantees in State Constitutional Law*, 63 TEX. L. REV. 1195, 1220 (1985).

[163] *See* HELLERSTEIN ET AL., *supra* note 33, ¶ 3.04[1][c]; Arangold Corp. v. Zehnder, 787 N.E.2d 786, 793 (Ill. 2003) (recognizing that "[t]he uniformity clause was intended to be a broader limitation on legislative power to classify for nonproperty tax purposes than the limitation of the equal protection clause"); *infra* Section IV.A.4.

[164] HELLERSTEIN ET AL., *supra* note 33, ¶ 20.06.

4. *State Uniformity Clauses*

In addition to the United States Constitution, most state constitutions include some type of tax uniformity clause, which requires that a tax apply uniformly across each taxpayer classification.[165] These uniformity clauses vary considerably across the states, and many apply only to property taxes.[166] Importantly, though, some courts have characterized net income taxes as a type of property tax.[167] If exit taxes proliferate, this characterization could take on additional importance as impacted taxpayers would likely assert uniformity clause challenges.

State courts tend to interpret uniformity clauses broadly, and although taxpayers may also raise state and federal Equal Protection Clause challenges, taxpayers are more likely to be successful with a state uniformity challenge to exit taxes.[168] The overarching uniformity and equal protection inquiries are whether the taxing jurisdiction properly determined each taxpayer class, and whether it applies the tax uniformly across that class.[169]

In the exit tax context, the taxpayer class would typically consist of individual residents of the state who are changing their residence to another state. Given the theoretical and practical justifications discussed throughout this Article, this taxpayer classification appears proper. The determinative inquiry, then, would be whether the tax applies uniformly across that class.

An exit tax that exempts certain taxpayers, provides an income or wealth application threshold, or imposes progressive rates could violate the state uniformity clause if it applied. All these features are likely to be incorporated into an exit tax, so whether the state uniformity clause applies is an important determination. The few states that have broad uniformity clauses may want to design their exit taxes differently to achieve uniformity or limit them to reporting instead of tax imposition. For most states, however, the uniformity clause is unlikely to interfere with an exit tax, particularly if the exit tax regime is incorporated into the state's existing personal income tax regime.

B. *Specific Areas of Concern*

The theoretical discussion above supports state and local exit taxes in the abstract. If a state is to design an effective and unassailable exit tax, the

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[165] *Id.* ¶ 2.01. For example, if a state had a uniformity clause that applied to personal income taxes, to ensure uniformity the tax would need to be imposed at a flat rate, not a progressive rate where some individuals would be subject to higher tax rates than other individuals.

[166] *Id.* ¶¶ 2.01, 2.06. Neither New York nor Connecticut has constitutional tax uniformity provisions. *Id.* ¶ 2.01.

[167] *See* Kunath v. Seattle, 444 P.3d 1235, 1243 (Wash. Ct. App. 2019) (citing Culliton v. Chase, 25 P.2d 81, 82 (Wash. 1933)).

[168] *See* Hellerstein et al., *supra* note 33, ¶ 3.04[1][c].

[169] *Id.* ¶ 2.06; Arangold Corp. v. Zehnder, 787 N.E.2d 786, 793 (Ill. 2003).

state must analyze the specific situations that are effectuating its tax base migration. There are five specific situations related to interstate migration, each of which may affect certain states more than others.

The first two situations are extremely common—an individual owns property that appreciates in value, and the individual migrates out of the departure state before realizing or recognizing the accumulated gain on that property. Because these situations are so common, and because the accrued gain may be in the hundreds of billions of dollars for certain states, these situations represent the greatest threat to a state's tax base. Some states have attempted to address the much narrower second situation, real property non-recognition, without much success. Some states have also attempted to address the third situation, deferred compensation and stock options, with targeted provisions. But the true potential of a state and local exit tax is to encompass the widespread situation involving personal and intangible property.

The fourth and fifth situations—corporate retained earnings and carried interest, and business deductions and recapture—are exacerbated greatly by the TCJA, which reduced the corporate tax rate drastically and allowed unprecedented, accelerated depreciation and immediate expensing.[170] As such, these situations became impactful relatively recently, with the TCJA's 2018 effective date.

At the outset, it is important to note that none of these situations is inherently wrong. Especially with the very common first situation, in which individuals migrate to another state and their unrealized wealth follows, there is generally no malicious intent. The tax base erosion is simply a side effect of interstate migration that is often driven, at least in part, by non-tax motivations. Although some of these situations may be driven by tax planning, an anti-abuse exit tax approach may be inappropriate at the state level even if it is appropriate at the federal level.[171] States can weigh the degree to which they design their exit taxes as an anti-abuse provision or something broader, however, as discussed below.

1. Personal and Intangible Property Appreciation

If an individual has personal or intangible property—such as stock or cryptocurrency—that appreciated while a resident of the departure state, that state stands to lose substantial tax revenue if the individual leaves the state before realizing the accrued gain. An exit tax that deems the residency change to be a realization event would allow the departure state to impose tax on the gain that accrued within that state.

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[170] *See* Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054 (2017).

[171] *See* Mason, *supra* note 9, at 234 (discussing the federal exit tax's "anti-abuse purpose").

The potential, and the difficulty, with this situation is that it is so prevalent. Essentially every individual who migrates from one state to another has some amount of appreciated personal or intangible property. Aside from real estate, all meaningful wealth is held as personal or intangible property, including securities, commodities, cryptoassets, artwork, and other collector assets such as vehicles.[172] Although some states have attempted to address the narrower situations discussed below, the true threat and value to states lie in this category. The migration of unrealized gain held in personal and intangible property is what makes an exit tax potentially worth the effort.

States are becoming increasingly cognizant of this issue generally. Several states have considered wealth taxes, which are aimed at the same target.[173] Although any wealth tax requires an exit tax component of some kind to prevent all the wealth from leaving the state's taxing jurisdiction before the tax becomes effective, an exit tax can stand on its own and accomplish many of the same goals without the considerable drawbacks.[174]

The stakes are high for states. States may have hundreds of billions of dollars that could migrate out of the state without being taxed.[175] Recently, many individuals with wealth tied to cryptocurrency have migrated from high-tax states to Puerto Rico, where they can eliminate both federal and state personal income tax.[176] The individuals who left states for Puerto Rico between 2012 and 2016 had paid $558 million in federal income taxes over the five years before they departed, which equates to tens of millions in state income taxes.[177] In addition, states generally do not impose preferential tax rates on long-term capital gains, but rather tax these gains at ordinary rates.[178] This approach provides a greater incentive for states to protect the tax base, but also for wealthy individuals to engage in simple tax planning to

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[172] Real property generally avoids the issues discussed in this Article because state tax regimes are able to source the income to the situs of the property and incorporate tax withholding provisions. *See generally* Kyle J. Sweeney, *The Nonresident Real Estate Withholding: An Exit Tax in Disguise*, 26 GEO. MASON L. REV. 549, 551–60 (2018). Narrower real property issues are discussed in Section IV.B.2.

[173] *See* Galle et al., *supra* note 23; Coffill, *supra* note 23; Henry Ordower, *New York's Proposed Mark-to-Market Tax Decouples from Federal Tax*, 99 TAX NOTES STATE 794, 798 (2021); Billy Hamilton, *Washington State Weighs a Wealth Tax*, 99 TAX NOTES STATE 815 (2021).

[174] *See, e.g.*, Ordower, *supra* note 173, at 799.

[175] *See, e.g.*, Kyle Pomerleau, *How Much Revenue Would a Wealth Tax Raise?*, 167 TAX NOTES FED. 481 (2020); Tom Maloney, Anders Melin & Ben Steverman, *Elon Musk's California Exit Holds Path to $2 Billion Tax Savings*, BLOOMBERG (Nov. 29, 2021), https://news.bloombergtax.com/daily-tax-report/elon-musks-california-exit-can-save-him-2-billion-in-taxes [https://perma.cc/5BTD-S3XE].

[176] *See, e.g.*, Francesca Maglione, *Zero Taxes, Golf and Mansions Create a Crypto Island Paradise*, BLOOMBERG (Dec. 11, 2021), https://news.bloombergtax.com/daily-tax-report/zero-taxes-golf-and-mansions-create-a-crypto-island-paradise [https://perma.cc/LL5C-MHEJ].

[177] *See* Donna Borak, *IRS Seizes Foothold on Puerto Rico Tax Haven Audits*, BLOOMBERG (June 3, 2021), https://news.bloombergtax.com/daily-tax-report-state/irs-seizes-foothold-on-puerto-rico-tax-haven-audits [https://perma.cc/Q7J3-6G56].

[178] *See 50 State Overview*, *supra* note 57.

avoid state personal income tax on their vast wealth.[179] In addition, an individual could change their state of residence to a state with no income tax, sell appreciated assets, and then change their residence back to the departure state.[180] There are also situations that may inadvertently result in states losing this tax base, including installment sale payments related to the sale of businesses, art, or other assets.[181]

Taxing jurisdictions at the federal and state levels are considering wealth taxes, and a push toward mark-to-market taxation is gaining significant traction.[182] There are still serious administrative and tax policy concerns—most notably liquidity—when imposing mark-to-market taxation on such widely held assets. If a state imposes a tax without a realization event, especially if the tax applies this broadly, it will likely force many taxpayers to sell a portion of their assets to pay the tax. Liquidity concerns can be mitigated, however, with various mechanisms such as application thresholds, deferral alternatives, and payment plans, as discussed below. A broad-based exit tax can mitigate massive tax base migration and allow states to tax gain to which they are entitled, while also furthering distributional equity.

2. *Real Property and Non-Recognition Provisions*

One of the clearest examples of a jurisdiction losing the right to tax income that accrued in the jurisdiction arises with non-recognition provisions, most notably real property like-kind exchanges under I.R.C. § 1031.[183] When a taxpayer sells or exchanges property located in the jurisdiction, there is unquestionably a realization event, and the jurisdiction may impose tax on the gain. If the state conforms to federal non-recognition treatment, however, which almost all states do, the state will not recognize the gain at that time.[184] If the acquired property is also located within the state, the result

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[179] *See, e.g.*, Laura Davison, *Musk's 2020 Texas Move May Yield Big Tax Savings on Tesla Sale*, BLOOMBERG (Apr. 29, 2022), https://news.bloombergtax.com/daily-tax-report-state/musks-2020-texas-move-may-yield-big-tax-savings-on-tesla-sale [https://perma.cc/Q3BU-6TWG] (estimating that Musk's change of residence from California to Texas could result in a $1.1 billion California tax savings on the sale of just a small portion of his stock).

[180] *See* Westin, *supra* note 8, at 180 (discussing tax planning strategies for migration and return at the U.S. federal level).

[181] *See, e.g.*, Amarr Co., Nos. 20046125 & 20046127 (Cal. Off. Tax App. Dec. 9, 2021) (consolidated appeals); HELLERSTEIN ET AL., *supra* note 33, ¶ 20.05[7][a].

[182] *See supra* note 173 and accompanying text; Pomerleau, *supra* note 175; Victor Thuronyi, *All of the Above: How to Tax the Wealthy*, 171 TAX NOTES FED. 343 (2021); Reuven S. Avi-Yonah, David Gamage, Darien Shanske & Kirk J. Stark, *Is New York's Mark-to-Market Act Unconstitutionally Retroactive?*, 99 TAX NOTES STATE 541 (2021); Zachary D. Liscow & Edward G. Fox, *The Psychology of Taxing Capital Income: Evidence from a Survey Experiment on the Realization Rule*, 213 J. PUB. ECON. 104714 (2022); Lawrence A. Zelenak, *1924, 2021: Taxes of the Ultrarich, and Mark-to-Market Reforms*, 172 TAX NOTES FED. 583 (2021).

[183] Effective 2018, I.R.C. § 1031 applies only to real property and no longer applies to personal property.

[184] *See IRC Conformity Chart*, BLOOMBERG (Sept. 5, 2022), https://www.bloomberglaw.com/product/tax/bbna/chart/2/10076/4ced58566900a986098d5daf40543a33 [https://perma.cc/

is simply deferral. But if the acquired property is located outside the state, especially if the individual is a nonresident, the departure state may lose its practical ability to impose tax on the gain that accrued on the initial property. Rather, the destination state may attempt to impose tax on the entire gain when the acquired property is eventually sold.[185]

The challenges with state conformity to federal non-recognition provisions are not new.[186] But because these situations are so inconsequential compared to the personal and intangible property non-realization discussed immediately above, many states likely did not see the value in creating a controversial tax provision to address non-recognition.[187] Of the states that have, the results have been mixed. In the context of real property non-recognition under I.R.C. § 1031, states have three options to prevent this tax base migration.[188] First, the state could decouple from I.R.C. § 1031 completely, which would be difficult politically and could have other adverse effects.[189]

Second, the state could provide non-recognition treatment only for intrastate exchanges. The Oregon Supreme Court upheld this approach,[190] although the court's reasoning was suspect. Oregon repealed that provision, and the Oregon Tax Court later invalidated a similar statute on constitutional

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N6V3-N9QS]; Louis S. Weller & Gregory A. Marques, *State Income Tax Conformity with Section 1031*, 34 J. REAL ESTATE TAX'N 4, 6 (2006). Pennsylvania is one of the few states that does not use federal income as a starting point for its personal income tax, which has resulted in recognizing gain for state purposes even when not recognized for federal purposes. *See generally* Pearlstein v. Commonwealth, No. 743 F.R. 2017, 2021 WL 5707121 (Pa. Commw. Ct. Dec. 2, 2021). Pennsylvania expressly conformed to I.R.C. § 1031 effective January 1, 2023. 72 PA. STAT. ANN. § 7303(a.5) (West 2022).

[185] *See* HELLERSTEIN ET AL., *supra* note 33, ¶ 7.09[2][a]; Dungan v. Ariz. Dep't of Revenue, No. 1951-06-1, 2007 WL 1806666 (Ariz. Bd. Tax App. May 1, 2007) (Arizona residents taxable on deferred gain from like-kind exchange of Washington property realized but not recognized prior to time taxpayers were Arizona residents).

[186] *See* HELLERSTEIN ET AL., *supra* note 33, ¶ 7.09.

[187] Nevertheless, "the revenue losses from failure to collect the tax on the deferred gain in the context of like-kind exchanges or involuntary conversions may be of some practical significance." Smith & Hellerstein, *supra* note 126, at 398; *see also infra* note 189 and accompanying text.

[188] In the narrower context of corporate non-recognition provisions, courts have been split regarding statutes that impose tax only on nonresident shareholders in the case of corporate non-recognition transactions. *See* HELLERSTEIN ET AL., *supra* note 33, ¶ 20.06[5]. At the federal level, I.R.C. § 367(a) addresses a similar situation in which a U.S. taxpayer may be able to shift gain offshore by contributing property to a foreign corporation. The Code disallows non-recognition treatment unless the taxpayer enters into a gain recognition agreement whereby the taxpayer agrees to pay tax, interest, and penalty on any gain if the contributed assets are sold within a five-year period. I.R.C. § 367(a); Treas. Reg. § 1.367(a)-8. A state exit tax could adopt a similar regime to address corporate non-recognition issues discussed in this Section and in Section IV.B.4.

[189] There are several purported economic benefits to real property non-recognition provisions. *See* Donald B. Susswein, Ryan P. McCormick & Kyle Brown, *The Tax Policy Case for Section 1031*, 172 TAX NOTES FED. 923 (2021); Suzanne Goldstein Baker & Stephen M. Breitstone, *The 1921 Like-Kind Exchange Policy Still Makes Economic Sense*, 172 TAX NOTES FED. 1601 (2021); David C. Ling & Milena Petrova, The Tax and Economic Impacts of Section 1031 Like-Kind Exchanges in Real Estate (Sept. 2020) (unpublished manuscript) (submitted to the Real Estate Research Consortium).

[190] Wilson v. Dep't of Revenue, 727 P.2d 614, 619–20 (Or. 1986).

grounds.[191] The latter statute granted non-recognition treatment only to residents, and not nonresidents, if the newly acquired property was located outside of Oregon. This treatment was found to discriminate against nonresidents in violation of the Privileges and Immunities Clause.[192] Georgia and Mississippi also adopted an intrastate limitation approach but have subsequently abandoned it.[193]

Third, the state could attempt to impose tax on the portion of the gain that accrued in the departure state whenever the acquired property is eventually sold.[194] Several states currently adopt this approach—and states have the jurisdictional basis upon which to impose tax on that portion of gain—but enforcing that jurisdiction is very difficult practically.[195] Of the states that currently adopt this general approach, including California, Massachusetts, Montana, and Oregon, only California and Oregon impose an annual reporting obligation.[196] If a state conditions non-recognition, for both residents and nonresidents, on an annual reporting obligation, the state would protect its interest in taxing the accrued gain and comport with constitutional constraints.[197] If a state were to adopt an exit tax with a deferral option or a continuation tax design overall, this approach would be incorporated automatically.[198]

3. Deferred Compensation and Employee Stock Options

If an individual earns deferred compensation in the departure state but does not actually receive the compensation until the individual resides in another state, the departure state may lose the ability to tax the income generated in that state.[199] Similarly, if an individual is awarded stock options

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[191] Fisher v. Dep't of Revenue, 16 Or. Tax 323, 337 (Or. T.C. 2001).

[192] *Id.* at 331–32 ("Nothing in the evidence shows that in these modern times, the state's purported difficulties in tracking and collecting from nonresidents are so great that the state must wholesale deny gain deferral to nonresidents who exchange for property outside Oregon while residents who exchange for property outside Oregon are allowed to elect the deferral and file what amounts to an information return.").

[193] HELLERSTEIN ET AL., *supra* note 33, ¶ 7.09[2][b][i].

[194] *Id.* ¶ 7.09[2][b][ii].

[195] If a state is actually able to track and assess a tax liability in this context, the state should be able to legally enforce the claim against the nonresident pursuant to the Full Faith and Credit Clause. U.S. CONST. art. IV, § 1. Thus, there is at least one fewer enforcement hurdle in the interstate context compared to the international context.

[196] CAL. REV. & TAX. CODE §§ 18032, 24953 (West 2022); OR. REV. STAT. ANN. § 317.327(3) (West 2022); *see also* HELLERSTEIN ET AL., *supra* note 33, ¶ 7.09[2][b][ii].

[197] Alternatively, a state could condition non-recognition on the taxpayer executing a waiver of the statute of limitations for the state to audit and assess any tax liabilities related to assets held when the taxpayer changes their residence. Such an approach would preserve the state's ability to impose tax when each asset is sold but would create practical audit and enforcement challenges for taxing authorities.

[198] Addressing real property non-recognition as part of a general exit tax may minimize political pressure from the real estate industry compared to a provision targeted expressly at real property.

[199] It is important to note that although the principles discussed in this Article also apply to tax-deferred retirement accounts such as IRAs and 401(k)s, Congress in 1996 enacted

while employed in the departure state but does not exercise the options and realize the gain until the individual resides in another state, the departure state may lose substantial tax revenue. As with the real property non-recognition provisions discussed immediately above, the departure state may attempt to track and tax the deferred compensation when the individual ultimately receives it or the gain on stock options when the individual ultimately exercises them. However, such efforts are onerous, and the destination state may also attempt to tax the same income. The departure state has two advantages in these contexts: the state generally has jurisdiction over the employer that is distributing the deferred compensation or allowing the exercise of stock options, and the state arguably has jurisdiction to tax the income based on source in addition to residence.

Some states have specific provisions addressing deferred compensation, although a broad exit tax may be able to more effectively encompass deferred compensation than a narrow provision. States' treatment of deferred compensation has varied considerably, stemming largely from the competing jurisdictional source and residence bases of taxation.[200]

The more pressing concern for states, though, is employee stock options. Individuals who hold stock options worth billions of dollars, generally in the technology industry, are increasingly moving from California to Texas.[201] Maybe most notably, Elon Musk changed his state of residence from California to Texas and subsequently exercised billions of dollars' worth of stock options.[202] California does have rules in place that would impose tax on this stock option gain because Musk was employed in California when these options were granted.[203] But options granted after Musk left the state, and any of Musk's other sales of stock, would no longer be within California's personal income tax jurisdiction on either a source or residence basis. Some estimate that Musk's move alone could cost California $18 billion in income tax revenue.[204]

The proper tax treatment of stock options is complicated because the income generally combines elements of both compensation and investment income.[205] States have a long and tortured history with attempting to tax

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legislation prohibiting a state from imposing "an income tax on any retirement income of an individual who is not a resident or domiciliary of such State (as determined under the laws of such state)." 4 U.S.C. § 114(a).

[200] *See* HELLERSTEIN ET AL., *supra* note 33, ¶ 20.07[3][a].

[201] *See, e.g.*, Lee, *supra* note 61; Brendan Case, *Hedge Funds, Tech Spur Texas Wealth Boom as California Fades*, BLOOMBERG (June 4, 2021), https://www.bloomberg.com/news/articles/2021-06-04/texas-rising-hedge-funds-big-tech-drive-lone-star-wealth-boom [https://perma.cc/JB5U-NQ5R].

[202] *See* Maloney et al., *supra* note 175.

[203] *See id.*; HELLERSTEIN ET AL., *supra* note 33, ¶ 20.05[7][b][i].

[204] Lambert & Shen, *supra* note 19.

[205] *See* HELLERSTEIN ET AL., *supra* note 33, ¶ 20.05[7][b][i].

stock options, with no end in sight.[206] A comprehensive exit tax may help streamline this fragmented area of taxation.

4. *Corporate Retained Earnings and Carried Interest*

The TCJA dramatically reduced the federal corporate income tax rate from thirty-five percent to twenty-one percent.[207] Almost immediately, certain businesses converted from passthrough entities to corporate entities, especially hedge funds and private equity funds.[208] Although there were many reasons driving this conversion, most importantly access to public capital, the tax rate reduction made the conversion financially viable. A popular tax planning strategy quickly emerged: a firm can convert from a partnership to a corporation and retain earnings until the shareholders migrate from a high-tax state to a state with no personal income tax. Once the individual shareholder is a resident of a state that imposes low or no personal income tax, the corporation can distribute the accumulated earnings via dividends or liquidate the corporation.

This retain-and-relocate strategy can be effective for closely-held businesses of all types.[209] It can also be effective for hedge fund and private equity fund managers, even if they retain a passthrough structure, because the fund managers' carried interest would go unrealized and untaxed until the fund or its assets are sold.[210] As discussed above, the tax rate considerations at the state level influence these tax planning strategies because most states do not have preferential rates for dividends or long-term capital gains.[211] Whether tax-motivated or not, there is an undeniable trend, and po-

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[206] *See id.*; Shail P. Shah & Campbell McLaren, *California's 'Long Range' Taxing Scheme: Taxation of Nonresident Equity-Based Compensation*, 103 Tax Notes State 351 (2022).

[207] I.R.C. § 11; Robert J. Shiller, *Once Cut, Corporate Income Taxes are Hard to Restore*, N.Y. Times (June 22, 2018), https://www.nytimes.com/2018/06/22/business/big-war-to-raise-the-corporate-income-tax.html [https://perma.cc/6645-6UXA].

[208] *See* Anders Melin & Jasmine Teng, *Private Equity Titans Get Even Richer With Corporate Conversions*, Bloomberg (July 5, 2019), https://www.bloomberg.com/news/articles/2019-07-05/private-equity-titans-get-even-richer-with-corporate-conversions [https://perma.cc/T46A-PTX4]; Emily L. Foster, *Carlyle's 'Full C Corp' Conversion Differs From Others*, 164 Tax Notes Fed. 920 (2019).

[209] Although not necessarily motivated by tax planning, this issue arises in the context of the sale of S-Corporations, installment sales of businesses, and I.R.C. § 338(h)(10) elections. *See, e.g.*, Amarr Co., Nos. 20046125 & 20046127 (Cal. Off. Tax App. Dec. 9, 2021) (consolidated appeals). Many state corporate income tax regimes already incorporate mechanisms to remedy these situations. *See, e.g.*, Caprio v. N.Y. State Dep't of Tax'n & Fin., 37 N.E.3d 707 (N.Y. 2015).

[210] If the fund did convert to a C-Corporation, or at least inserted a C-Corporation holding company atop the ownership structure, all the realized gain would be subject to state corporate income tax. That tax burden would generally be substantially less than if the gain flowed through directly to the fund managers' personal income tax returns because of potential apportionment benefits and state corporate income tax rates that are often half that of state personal income tax rates.

[211] *See* 50 State Overview, *supra* note 57.

tentially a critical mass, of financial firms leaving New York for Florida.[212] A meaningful portion of the state and local tax base is moving with them.

5. *Business Deductions and Recapture*

In addition to lowering the federal corporate net income tax rate dramatically, the TCJA provided immediate expensing benefits and substantial accelerated depreciation.[213] Although simply a timing issue at the federal level, there are serious revenue implications at the state level, to the extent the state conforms.[214] In the case of unincorporated businesses, the individual taxpayers could receive the benefit of full deductions immediately and then subsequently relocate. Unlike at the federal level, the departure state would not have the ability to tax the outsized income that is derived from the capital expenditures in future years. Any resultant income would be sourced to the state that generated the income or the individual's new state of residence, even though the departure state allowed the individual a substantial deduction when they were a resident. In addition, if the asset is sold, the departure state would also forgo any depreciation recapture.

The tax deficit related to this timing disjunction is nominal compared to the other situations described above, but it illustrates the compounding effect of states losing the ability to tax income that accrued within their taxing jurisdiction. The detriment is magnified because of the timing aspect: the state is not only giving a deduction against non-existent future income, but the state is granting the deduction immediately, so the state's revenue is further eroded by the time value of money.

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[212] *See, e.g.*, Jonathan Levin & Claire Ballentine, *Cathie Wood's ARK Departs NYC With Shift to Florida Office*, Bloomberg (Oct. 6, 2021), https://www.bloomberg.com/news/articles/2021-10-06/cathie-wood-s-ark-leaving-nyc-in-shift-to-florida-headquarters?leadSource=Uverify%20wall [https://perma.cc/KHS4-493H]; Sonali Basak & Hema Parmar, *Schonfeld Plans New Florida Hub as Hedge Funds Move South*, Bloomberg (Aug. 17, 2021), https://www.bloomberg.com/news/articles/2021-08-17/schonfeld-plans-new-florida-hub-as-hedge-funds-move-south?leadSource=Uverify%20wall [https://perma.cc/9XWM-SUVJ]; Oshrat Carmiel, *NYC Billionaire Catsimatidis Joins Florida Shift With New Condos*, Bloomberg (Oct. 22, 2021), https://www.bloomberg.com/news/articles/2021-10-22/nyc-billionaire-catsimatidis-joins-florida-shift-with-new-condos?leadSource=Uverify%20wall [https://perma.cc/4ABU-XTCA]; Natalie Wong & David Westin, *Billionaire Stephen Ross Sees Florida 'Gold Rush' as Firms Shift South*, Bloomberg (Dec. 14, 2021), https://www.bloomberg.com/news/articles/2021-12-14/billionaire-ross-sees-florida-gold-rush-as-firms-shift-south?leadSource=Uverify%20wall [https://perma.cc/YW6D-EJBD]; Sridhar Natarajan, *Goldman CEO Warns NYC Must 'Keep Itself Attractive' to Workers*, Bloomberg (Nov. 30, 2021), https://www.bloomberg.com/news/articles/2021-11-30/goldman-ceo-warns-nyc-must-keep-itself-attractive-to-workers?leadSource=Uverify%20wall [https://perma.cc/X8CS-K7J5]; Case, *supra* note 201; Edwards, *supra* note 19, at 12.

[213] I.R.C. §§ 168(k), 179.

[214] Many states do not conform to federal bonus depreciation and immediate expensing provisions entirely, although most incorporate some degree of accelerated cost recovery. *See* Hellerstein et al., *supra* note 33, ¶¶ 7.10, 18, 19.

C. Exit Tax Design

There are two overarching exit tax design options, although they are not mutually exclusive. First, an exit tax may deem a residency change to be a realization event and impose tax on any gain at the time of residency change. Second, an exit tax may instead require initial and continued reporting so the departure jurisdiction is able to impose tax whenever an actual realization event occurs—often called a continuation tax.

Each option has advantages and drawbacks, so a regime that incorporates both is preferred. A pure realization-based exit tax is very effective, but it raises serious liquidity concerns and may be unconstitutional because it imposes a tax burden sooner for prior residents than for current residents. A pure continuation tax may allow a state to track and monitor prior residents' income and gains, but it relies heavily on self-reporting of individuals who are no longer physically present in the state. The former United States federal level continuation tax failed because of these inherent design flaws.[215] The United States faced the substantial administrative burden of "tracking the transfer of real, tangible, and intangible property by sale, gift, or other disposition, reviewing U.S. tax returns, and conducting audits" for a ten-year period for each expatriate, with these activities generally taking place in a different jurisdiction.[216] At the subnational level, however, tracking and enforcement is easier because of state tax information sharing agreements and the Full Faith and Credit Clause.[217] Although a realization-based exit tax with a continuation tax deferral option, much like the current United States exit tax, is the preferred structure, it adds complexity in design.

Regardless of the operative design, an exit tax generally requires an initial report that includes the adjusted basis and fair market value of each relevant asset at the time of residency change so the state can determine the amount of gain or loss that accrued while the individual was a resident of the state or that is sourced to the state. If the tax incorporates a deferred payment or a continuation tax concept, the continued reporting must disclose whenever a relevant asset is sold or otherwise disposed of, and the individual must pay the resultant tax to the departure jurisdiction.

As a threshold matter, the state must determine if an individual is a resident and also when they change their residence. Determining an individual's state of residence is one of the most contentious issues in state and local taxation.[218] States have differing statutory residency definitions, which may

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[215] *See* Westin, *supra* note 8, at 150–60; Farkas-DiNardo, *supra* note 8, at 41.

[216] Farkas-DiNardo, *supra* note 8, at 41; Westin, *supra* note 8, at 152–53.

[217] *See supra* note 195 and accompanying text.

[218] *See* HELLERSTEIN ET AL., *supra* note 33, ¶ 20.03; Eric J. Coffill, *California Office of Tax Appeals Issues Major Residency Decision in 'Bracamonte'*, BLOOMBERG (June 28, 2021), https://news.bloombergtax.com/daily-tax-report-state/california-office-of-tax-appeals-issues-major-residency-decision-in-bracamonte [https://perma.cc/8LC9-WRHC].

result in an individual being considered a resident of multiple states.[219] This result is problematic and arguably unconstitutional, and it could be exacerbated in the exit tax context. If an individual were considered a resident of multiple states and each had an exit tax, the individual could be subject to multiple exit taxes if they changed their residence. The cumulative effect could jeopardize even the least intrusive exit taxes.

Determining when an individual changes their residence from the departure state, however, is often easier. The individual has two options: continuing to file annual tax returns as a resident of the departure state and thus remaining within the state's taxing jurisdiction, or filing a final tax return in the departure state indicating a change of residence, which would trigger the exit tax. States must also consider whether to impose a durational residency application threshold for the exit tax. Primarily for administrative ease, most national level exit taxes will exempt residents who resided in the country for a short period of time. The taxing jurisdiction has the power and justification to tax the income or gain that accrued while the individual was a resident of the jurisdiction regardless of duration, but the tax revenue is likely far outweighed by the administrative burden for both the taxing authority and the taxpayer if the residency period did not exceed at least one year. Although a durational threshold provides administrative benefits, like the other potential application thresholds discussed below, it creates opportunities for individuals to plan around the exit tax and may also raise distributional and discrimination concerns.

Determining the basis and fair market value of all relevant assets can be even more difficult than determining residency.[220] A crucial component of any exit tax is assessing the gain that accrued while the individual resided in the state, which requires valuing all the relevant assets when the individual changes their residence. For both fairness and accuracy, that valuation should occur as of the exact date the individual changes their state of residence. The individual may have discretion regarding the precise timing of their residency change, possibly with the benefit of hindsight, so they may be able to manipulate that date to their advantage to some degree. It may also be difficult or impossible administratively to value certain assets, particularly in the middle of the tax year.[221] In addition to setting the tax base, the asset valuation may determine if the exit tax even applies if the regime implements an income or wealth application threshold. Determining the fair

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[219] *See* Edelman v. N.Y. State Dep't of Tax'n & Fin., 80 N.Y.S.3d 241, 242 (N.Y. App. Div. 2018) (holding that two states, both on the basis of residence, could impose tax on an individual's intangible income without violating constitutional restraints).

[220] In the wealth tax context, scholars have proposed novel regimes and identified valuation techniques that could be implemented in a state exit tax regime as well. *See* Brian Galle, David Gamage & Darien Shanske, *Solving the Valuation Challenge: A Feasible Method for Taxing Extreme Wealth*, 72 DUKE L. REV. (forthcoming 2022); Jason S. Oh & Eric M. Zolt, *Wealth Tax Design: Lessons from Estate Tax Avoidance*, 74 TAX L. REV. 175 (2021).

[221] An exit tax regime could either as a mandatory or optional timing mechanism use the value at the beginning of the tax year, the end of the tax year, or an average of the two values.

market value of the taxpayer's assets is necessary not just for the departure state, but also for the taxpayer to determine the stepped-up basis in the assets in the destination state. As discussed below, if the destination state also imposes an exit tax it must provide either a stepped-up basis in the assets or a credit for taxes paid to the departure state.[222] The valuation difficulties and the possibility of valuation inconsistencies leading to multiple taxation increase if the individual changes their state of residence multiple times before selling an asset. The taxpayer would need to determine the basis and fair market value of the relevant assets—the definition of which could vary by state—each time they change their state of residence. The taxpayer could also return to the departure state at some point, and the deferred tax amount would either need to be eliminated or at the very least incorporate a basis adjustment.

Because valuation can be difficult and costly, particularly if a taxpayer engages an independent valuation expert, states could incorporate several features that reduce the valuation burden.[223] The state could limit the relevant assets to real property and publicly traded assets.[224] Limiting the exit tax's scope to these assets would make valuation much easier, especially with the inherent difficulty of valuing closely held businesses, but this option has distributional effects. It would effectively carve out much of the wealth held in personal property and both the business-related situations discussed in Section IV.B.

Another option, most applicable to a continuation tax regime, is to use a rough approximation to apportion gain to each state, which would eliminate the need for any valuation. The state could divide the number of years the individual resided in the state over the number of years the individual owned the asset to determine the percentage of gain that each state could tax. This approach, which mirrors the mechanics of the non-qualified use calculation for purposes of the federal principal residence exclusion, sacrifices accuracy

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[222] If the destination state had an exit tax regime and did not provide a stepped-up basis or credit for taxes paid to the departure state, the exit tax regime would likely violate the constitutional requirement of internal consistency. If the destination state did not have an exit tax regime, however, and simply conformed to the federal tax treatment, it is less clear whether the destination state would need to provide a stepped-up basis or credit. The constitutional argument would focus on external consistency rather than internal consistency and would be a difficult challenge under current precedent.

In a situation where a taxpayer has accrued loss in an asset, however, the disjunction between the two states' regimes could result in a windfall for the taxpayer, where they are able to realize losses in the departure state without a stepped-down basis in the destination state.

[223] A national database that tracks the value of a broad range of assets would significantly mitigate valuation challenges. *See* Henry Ordower, *Capital, an Elusive Tax Object and Impediment to Sustainable Taxation*, 23 FLA. TAX REV. 625, 654 (2020). Such a database could be used in conjunction with a centralized exit tax regime, as discussed below. *See infra* notes 244–245 and accompanying text.

[224] *See* Westin, *supra* note 8, at 182; *supra* Part III (discussing the current French exit tax's limited asset scope).

for simplicity.[225] It would also need to be optional or have all states agree to use the formula to avoid the significant risk of multiple taxation.

Multiple taxation is indeed a viable concern in the exit tax context. Although a state cannot alter a neighboring state's overall tax regime, it can design its own tax regime in an internally consistent manner so that its regime comports with tax policy and constitutional requirements. There are two ways in which an exit tax regime can sufficiently prevent both the departure state and destination state from imposing tax on the same gain. First, the state can allow a stepped-up basis to account for the gain taxed (or to be taxed) by the individual's previous state of residence. The difficulty with this approach is that it depends on the problematic valuation process discussed above. If states disagree about the assets' valuation, the individual could be subject to multiple taxation. States could enter into a multilateral agreement that the amount declared or determined to be fair market value by the departure state becomes the basis for the destination state.[226] In many cases, there would also be an incentive for an individual to overstate or understate the value of their assets, depending on the tax rate differences between the departure and destination states.

The second option to satisfy internal consistency is a credit mechanism. The destination state could impose tax on the entire gain when an individual sells a relevant asset but allow a tax credit for any taxes the individual pays to the departure state related to that asset. The credit mechanism has several benefits for the state. First, the destination state does not need to determine the asset's value. Second, if the departure state did not impose tax on the gain, the destination state would receive a windfall because it would tax all the gain including that which accrued while the individual was a resident of another state. Although the individual would not face double taxation, the destination state does not have justification to tax that portion of the gain.[227] States already incorporate tax credits for taxes paid to other states, so it would be feasible to extend that existing mechanism to exit taxes.[228]

Any mark-to-market tax regime also needs to address losses, which raise additional complexities. Assume for example that every state had an identical exit tax that imposed tax when the individual changed their residence; the individual paid tax to the departure state on the unrealized gain of a particular intangible asset; the taxpayer received a stepped-up basis in that asset; and the taxpayer later sold the asset for a loss while a resident of the

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[225] *See* I.R.C § 121(b)(5).

[226] *See* Kovács, *supra* note 31, at 8.

[227] *See, e.g.*, Smith & Hellerstein, *supra* note 126, at 373 ("The state of new residency cannot make any similar claim of protection afforded to the taxpayer merely because income that was earlier received was first recognized for federal tax purposes while the taxpayer was a resident.").

[228] States generally limit their credits for taxes paid to other states to taxes that are paid on income "derived from sources in other states." Hellerstein et al., *supra* note 33, ¶ 20.10[2]. In the exit tax context, the credit would in many cases be allowed for taxes paid on a prior residence basis rather than a source basis.

destination state. In this case, the taxpayer would have paid tax on the gain that accrued while in the departure state and would also have the benefit of the loss that accrued while in the destination state, which the taxpayer could use to offset other income or gain in the destination state. The result in this straightforward scenario aligns with the benefit and jurisdictional principles discussed in Part II.[229]

If a taxpayer has some relevant assets with built-in gain and some with built-in loss, the taxpayer should be able to offset gains with losses within the basket of relevant exit assets.[230] If a taxpayer's built-in losses exceed their gains, the taxpayer may be able to use the deemed realization provision to harvest those losses and offset ordinary income in the departure state, providing the taxpayer an unintended benefit. The taxpayer may be able to effectively unlock losses in a high-tax jurisdiction without selling the underlying asset. If a state adopts a deferral option, losses present additional complexities. The regime should require that the deferral option apply to all the taxpayer's relevant assets. If the taxpayer can choose immediate realization for certain assets and deferral for others, the taxpayer could unlock losses immediately and defer gain indefinitely. The state should also use the lower of the fair market value at the time of residence change or the ultimate amount realized when the taxpayer sells the asset and pays the deferred tax liability. Otherwise, the state would impose greater tax on those who migrate compared to those who do not.[231]

There are several other design elements a state must consider if it allows a deferred payment option. The first consideration is whether to impose tax at the rate that was in effect when the individual changed their residence, or at the rate that is in effect when the individual sells the relevant asset. Rates can move in either direction over time, so the regime should establish a concrete rule and not allow the taxing authority or the taxpayer to choose. Most national exit taxes use the rate in effect at the time of expatriation, which achieves parity with individuals who pay the realization-based exit tax immediately. The second consideration is whether to charge interest on the deferred tax amount. On one hand, the state is forgoing revenue that it could collect immediately, and charging interest would incentivize taxpayers to pay immediately instead of deferring payment. On the other hand, depending on the rate and compounding method, the interest charge alone

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[229] If the destination state did not have an exit tax and thus did not provide a basis step-up, or did not impose personal income tax at all, the taxpayer would not receive the tax benefit of the loss and may even be subject to double taxation. Nevertheless, the departure state would have imposed tax only on the gain that accrued while in the departure state. The harsh double taxation result, however, can generally be ameliorated if the state incorporates a deferral or continuance option whereby only the final sales price is used to calculate the exit tax.

[230] *See* Kovács, *supra* note 31, at 13–14.

[231] *See* Kovács, *supra* note 31, at 12. For example, if a taxpayer's asset was valued at $10 million when they left the state and they later sold it for $1 million, the departure state exit tax should use $1 million to calculate the gain because that is what would be used for an identical taxpayer who never left the state.

could far exceed the gain on the underlying asset. The state could implement some type of interest cap, however, to protect against this scenario. The third consideration is whether the state will premise the deferral option on the individual providing some type of security to help ensure that the individual will ultimately pay the resultant tax. If so, the state must decide what qualifies as adequate security, such as a bond or letter of credit, and the adequate amount. Relatedly, the state could also offer a payment plan alternative to help assuage liquidity concerns.

The direction of a particular state's exit tax regime, including the features a state chooses from this discussion, depends on how the state views the regime's overarching purpose. Specifically, it depends on whether the state views the exit tax primarily as an anti-abuse provision or as a broader effort to better effectuate the benefit and progressivity theories, and to promote social gain by enhancing distributional equity. In making that determination, it is important for the state to consider its specific demographics and migration dynamics. At the federal level, those subject to the exit tax had a median age between 45–56 and earned high incomes, although the demographics at the state level may be much different.[232] State lawmakers should also consider the broader policy debate regarding the distributional aspects of mobility, which are quite complex.[233] The state's overarching purpose will inform whether the exit tax regime should apply to all prior residents or if it should incorporate an application threshold, and whether it should sunset.

A state can incorporate an application threshold to serve two purposes: to target the exit tax at the wealthy who may be utilizing sophisticated tax planning to avoid paying personal income tax in the state, and to exempt from the exit tax those with lower income or wealth because of liquidity and equity concerns.[234] The application threshold may not accomplish either of those goals, however. If the exit tax has a bright-line application threshold of total asset value or wealth, it may result in a severe notch effect.[235] The threshold may distort behavior and incentivize productive individuals to move out of the state as their wealth approaches the threshold. It may also discourage individuals above the threshold from leaving the state, which could be viewed as a benefit but in practice often results in those individuals planning around the tax. The wealth application threshold can ultimately diminish vertical equity because the wealthiest individuals can utilize a variety of techniques discussed below to avoid the tax, leaving the exit tax burden to

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[232] *See generally* Organ, *supra* note 43, at 16–23.

[233] *See supra* note 56 and accompanying text.

[234] *See supra* note 56. Instead of an application threshold, a state could also exempt a certain amount of wealth from the exit tax. This approach solves many of the problems with an application threshold but creates a host of new complexities if the taxpayer owns multiple assets. The exemption would need to be allocated between properties somehow if their aggregate value exceeded the exclusion amount.

[235] *See* Organ, *supra* note 43, at 5, 49.

be shouldered by the middle and upper-middle class. As such, an application threshold may leave the exit tax more susceptible to discrimination and uniformity challenges.

If the exit tax's purpose is primarily anti-abuse, it could be designed as a continuation tax that sunsets after a certain amount of time.[236] The current French exit tax is designed in this manner: "The new scheme will target asset sales made shortly after leaving France—two years—to stop people moving back and forth over a short period to optimize tax efficiencies on capital gains."[237] The previous United States exit tax also functioned as a continuation tax that sunset after ten years, which proved to be ineffective. Individuals could avoid United States tax by simply delaying the sale of property until the ten-year period expired.[238] Individuals, especially the wealthiest, could use several other strategies ranging from simple to complex, including borrowing against the assets instead of selling them.[239] Another failed iteration of the United States exit tax incorporated a subjective tax-avoidance standard. The exit tax regime required proof of tax avoidance as a principal purpose for expatriation, which was notoriously unworkable.[240] Thus, states that create an exit tax regime based on an anti-abuse motivation may find the tax ineffective at preventing tax planning and effectuating any of the theories discussed in Part II.[241]

Even with a broadly applicable regime without a sunsetting provision, there are several tax planning strategies that states must address. The first deals with the exit tax regime's implementation. If the regime is not retroactive, it may result in mass migration to avoid the tax before it becomes effective. When the United States converted to its current realization-based exit tax, there was a massive spike in ultra-wealthy individuals expatriating before the tax became effective.[242] California's recent wealth tax proposal would have imposed an annual tax on wealthy individuals for ten years after they departed the state to prevent this issue.[243] The second deals with the

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[236] *See e.g.*, Treas. Reg. § 1.367(r).

[237] *See France to Replace 'Exit Tax' on Capital Gains, Target Fiscal Cheats*, *supra* note 89.

[238] *See* Farkas-DiNardo, *supra* note 8, at 11; Westin, *supra* note 8, at 151–52.

[239] *See* Westin, *supra* note 8, at 150–60; *see also* Laura Davison and Kaustuv Basu, *Elon Musk's Untaxed Wealth Is Helping to Finance His Twitter Buyout*, BLOOMBERG (Apr. 26, 2022), https://www.bloomberg.com/news/articles/2022-04-26/musk-s-untaxed-wealth-opens-a-path-to-twitter-riling-democrats [https://perma.cc/F8N3-3RCH] (explaining how billionaires may be able to generate capital by borrowing against their stockholdings instead of a taxable sale).

[240] *See* Abreu, *supra* note 6, at 1104.

[241] By contrast, a state could exempt a taxpayer from the exit tax if the taxpayer were able to prove they had no tax avoidance motivation for the change of residence. A state could provide a narrow list of objectively verifiable circumstances that it deems to satisfy this standard, such as death of an immediate family member.

[242] *See* Organ, *supra* note 43, at 17–21, 42–43.

[243] *See generally* Galle et al., *supra* note 23; Patrick Gleason, *California Taxpayers Can Check Out Any Time They Like, but Lawmakers Still Want to Tax Those Who Leave*, FORBES (Aug. 31, 2020), https://www.forbes.com/sites/patrickgleason/2020/08/31/california-taxpayers-

wealthy individual transferring their appreciated assets before migrating out of the state. If an individual can transfer their assets to a trust or to a family member who resides in a different state, they may be able to easily avoid the exit tax. The individual needs to plan around the federal estate and gift tax, although that is not an unsurmountable hurdle currently. To prevent this tax planning strategy, the state may need to implement a standalone gift tax or a clawback provision for certain transfers.

There are also some non-traditional exit tax alternatives. Most of the difficulties discussed above, and the risk of multiple taxation, could be ameliorated with an expansive multistate compact. Although unlikely for many reasons, including divergent tax policies and values, uniformity would benefit state taxing authorities and taxpayers alike. States could create a centralized multistate administration that would oversee a unified filing and reporting system, which is being considered in other state and local tax contexts.[244]

Alternatively, the federal government could administer a nationwide system under which it would collect the exit tax and distribute the proceeds to the appropriate states. There are many reasons why this concept is also unlikely and objectionable, but if the federal government is attempting to preempt state exit taxes, states could argue that the federal government should attempt to remedy the underlying problem. Such a regime would likely impose an additional tax on the sale of certain assets at the federal level, the proceeds of which would then be apportioned and distributed to the states based on various potential metrics or proxies.[245]

Another option that has been suggested in the context of developing nations is imposing tax on remittances back to the departure jurisdiction.[246] Although not a likely replacement for a state exit tax, these remittance taxes do effectuate the benefit theory. The departure jurisdiction provided a benefit to the individual—generally education and other training—and the individual left the jurisdiction and was able to monetize the benefit provided by the departure state. If that individual remits parts of their income and wealth as gifts to family members in the departure state, the departure state arguably

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can-check-out-any-time-they-like-but-lawmakers-still-want-to-tax-those-who-leave/?sh=1c7d21722674 [https://perma.cc/6253-TFFQ].

[244] *See, e.g.*, Paul Williams, *Streamlined Tax Group Weighs Filing Portal, Rate Database*, LAW360 (Jan. 14, 2022), https://www.law360.com/tax-authority/articles/1452677/streamlined-tax-group-weighs-filing-portal-rate-database [https://perma.cc/XN98-4MJN].

[245] The apportionment could be based on the state's population, the general percentage of capital gains revenue the federal government derives from the state, or the years of residency in each state as reported by the taxpayer for federal income tax purposes.

[246] *See* Jagdish Bhagwati & Koichi Hamada, *The Brain Drain, International Integration of Markets for Professionals and Unemployment: A Theoretical Analysis*, 1 J. DEV. ECON. 19 (1974); Ariel Stevenson, *Recovering Lost Tax Revenue Through Taxation of Transnational Households*, 34 BERKELEY J. INT'L L. 100 (2016); Yariv Brauner, *Brain Drain Taxation as a Development Policy*, 55 ST. LOUIS L.J. 221 (2010).

has a justification to tax those remittances, although these taxes may be very difficult to enforce.[247]

Although this Article's focus is state exit taxes, there are localities that could similarly benefit from an exit tax regime. Interstate migration is quite easy, while intrastate migration is even easier, which leaves many localities such as New York City, San Francisco, and Seattle particularly vulnerable.[248] The options are fewer for localities, even those with the power to impose an income tax, and many localities' best option is piggybacking on a state exit tax. Localities could attempt to impose their own freestanding exit taxes, or creative exit tax alternatives that impose property tax or some other tax and grant credits in future years for the additional tax paid only if the taxpayer still resides in the state. These standalone options, however, are difficult to administer and susceptible to challenge.

Finally, states must consider how to label the exit tax and if it should be a standalone tax regime. This seemingly trivial consideration can have an enormous impact on the practical viability of the exit tax, particularly given the pejorative nature of the term itself. There is already political resistance, including a proposed federal bill that would preempt states from imposing an exit tax.[249] States can label the tax as a continuation tax, a benefit tax, trailing nexus, or simply not label it all. The exit tax would generally not be a standalone regime but would instead be an integral component of the state's existing personal income tax regime.[250] And if a state adopted a pure continuation tax approach, there would not be any new imposition of tax, just a new annual reporting obligation.

For states experiencing the greatest impact of the current migration trend, where an exit tax may be sufficiently worthwhile for the state and justify the administrative and enforcement costs, the recommended exit tax design would largely mirror the current United States federal level exit tax structure. The tax would deem the residency change to be a realization event and impose an immediate imposition of tax on all assets of a qualified individual. All types of assets would be included, but the tax regime would apply only if the individual had a net worth above a certain level, primarily for administrative efficiency purposes. The regime would include a deferral option, although the state would impose interest on the amount of tax deferred and require a bond or other method of security. The tax would incorporate an anti-abuse provision that would deem any assets transferred to a trust or to

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[247] *See* Stevenson, *supra* note 246, at 152–54.

[248] *See, e.g.*, Matt Day, *Amazon CEO, Citing 'Rougher' Patch with Seattle, Looks to 'Burbs*, BLOOMBERG (Oct. 5, 2021), https://news.bloombergtax.com/daily-tax-report/amazon-ceo-citing-rougher-patch-with-seattle-looks-to-burbs [https://perma.cc/9D3R-BTJ4]; McMahon, *supra* note 1.

[249] *See supra* note 106.

[250] Many states have a constitutional supermajority requirement to create or increase a tax, which would likely provide an insurmountable obstacle if such a state attempted to create a standalone exit tax regime. *See* Andrew Appleby, *Designing the Tax Supermajority Requirement*, 71 SYRACUSE L. REV. 959 (2021).

an out-of-state recipient within a certain number of years before the residency change to be included in the taxpayer's asset tax base. The tax regime would also allow a credit for personal income or exit taxes paid to other jurisdictions on the relevant asset gain.

If a state is to successfully implement an exit tax, it must very clearly signal the reasons for the tax and how the state will hypothecate the revenue in a manner that will appeal to current and future residents. Imposing new taxes on billionaires solely because they have the ability to pay is not convincing. Rather, state lawmakers should explain how the exit tax will effectuate the benefit theory, increase progressivity, and further distributional equity. If a state can articulate these theoretical and practical justifications, it can actually further the policy goal of attracting capital, both human and monetary, into the jurisdiction.

V. Conclusion

States cannot prevent people from moving, but states can prevent the tax base from moving with them. A state exit tax can disentangle the two and afford states the opportunity to impose tax on income that accrued within their state. State exit taxes are supported by a range of normative justifications and can promote social gain by enhancing distributional equity.

Although states have a solid theoretical and normative foundation to adopt an exit tax, states must incorporate proper design principles to align with prevailing policy goals and avoid constitutional infirmities. States must also be cognizant of broader policy and political concerns, particularly the possibility of discouraging migration into the state, to avoid offsetting the exit tax's positive effects with a long-term contraction of the state's tax base.