TAXATION AND MIGRATION
edited by REUVEN S. AVI-YONAH AND JOEL SLEMROD

David L. Sjoquist

Upon first hearing the title of this book, I assumed, incorrectly, that it was a collection of empirical papers exploring the effect of taxes on migration. Actually, the chapters are mostly about the implications of migration on tax policy, particularly how tax policy should be designed in light of migration.

Taxation and Migration consists of papers presented at a conference sponsored by the American Tax Policy Institute held in Washington, DC in October 2014. There are seven chapters, two by economists and five by lawyers, all prominent scholars. Two of the chapters were previously published and a third is drawn from a prior publication. The chapters cover a broad mix of issues, contain some thought-provoking discussions, and present an abundance of information.

The primary focus of the book is on the migration of individuals, but the migration of corporate headquarters, that is, corporate inversions, is the subject of one chapter. One of the “economics” chapters discusses issues associated with optimal tax models that allow for mobility of workers. The other “economics” chapter, which is the only empirical chapter, explores special provisions for the elderly in U.S. federal and state income taxes.

Migration raises a variety of issues that have implications for tax policy, which is the general theme of the five chapters written by lawyers. The issues addressed are:

(1) What should tax policy be if labor is more mobile than capital? (2) How should taxes be designed in the face of the migration of skilled workers from less developed countries? (3) What is the appropriate tax treatment of tax deferred pension programs when an individual migrates to another country? (4) Given free mobility of individuals within the European Union (EU), how does the EU ensure equality of tax treatment for commuters and migrants? and (5) What are the implications of corporate inversions?
Migration and taxation is the broad umbrella under which the papers fall, but there is no central or overriding issue that ties the papers together. That makes it impossible to write a review that integrates the contributions of the chapters. The result is that the review is more like seven separate reviews.

Rather than discussing the chapter in serial order, I first discuss the two chapters written by economists since they differ so much from the other chapters. Chapter 2, by John D. Wilson, is one of the shortest chapters and the most technical. Wilson’s chapter concerns models of optimal taxation when individuals are mobile. While optimal tax models are theoretical and mathematical, there are few equations in the paper and those are relegated to the appendix. The result is a presentation that is accessible to readers unfamiliar with the optimal tax literature.

Wilson’s chapter begins with a brief overview of Mirrlees’ seminal optimal income tax model and a short discussion of some of the papers that have altered the basic assumptions of that model and that have tried to derive optimal tax structures. While there is agreement on some aspects of the what an optimal income tax rate structure should look like, the profession is clearly not in overall agreement, as illustrated clearly by the recent contributions of Mankiw, Weinzierl, and Yagan (2009) and Diamond and Saez (2011).

However, as Wilson points out, there is even less agreement or understanding of what the optimal income tax rate structure should be in an open economy. Wilson explores several issues associated with attempts to model optimal taxation in a world with migration, such as how the government’s objective function should be specified, and discusses the ways that those issues have been handled by various authors. One of these issues, the concept of equilibrium, has not received much attention. Wilson points out that nearly all of the existing papers that present an optimal tax model with an open economy do not model equilibrium correctly, in particular, they ignore that in an optimal tax model with an open economy, if one jurisdiction changes its tax policy and as a result workers migrate, the other jurisdictions will have to change their tax structure to maintain a balanced budget. In the appendix he explains how the proper treatment of the Nash equilibrium in such models changes the expression for the optimal tax system.

In the final substantive section, Wilson discusses the implications for tax competition of the different ways that states treat earnings when the state-of-residence and state-of-employment differ. While I found the chapter useful, there is not much that is original.

Karen Smith Conway and Jonathan C. Rork (Chapter 6) explore aspects of special income tax provisions for the elderly under the U.S. and state income tax systems. Conway and Rork have written extensively on issues associated with the tax treatment of the elderly, and they draw, in part, on their previous publications. The chapter includes a lot of numbers, covers much ground, and contains a substantial amount of detailed information regarding these provisions.

Most states provide some special provision for the elderly as part of the state’s income tax system, including special but modest deductions or exemption based on age and favorable tax treatment for Social Security benefits. But in addition, many states have added pension exemptions for seniors; the extent of these exemptions differ widely across states. One of the interesting factoids in the chapter is that the first state to exempt
pension income was Vermont in 1931, which did so because they neglected to include pension income in the list of taxable income — in other words, tax policy by oversight, perhaps not an uncommon occurrence.

The chapter begins with a history of the income tax treatment of the elderly, and a summary of the motives for adding special provisions for the elderly. I found this material of interest. Concern with equity was an important factor at the federal level, but states generally adopted the provisions in order to maintain their ties to the federal income tax structure. The desire to attract or retain the elderly was an important motivation at the state level for exempting pension income. Georgia, for example, phased in legislation for the express purpose of attracting and retaining the elderly. Originally it was intended to have exempted all non-wage income, but subsequent fiscal analysis discovered that the revenue loss would be huge, which led the state to cap the exemption.

Conway and Rork provide estimates by state of the magnitude and distribution of elderly tax breaks as well as estimates of the revenue effects of possible changes to these tax provisions. The magnitudes of these special provisions differ dramatically across states. Not surprisingly, they find the exemption of Social Security benefits and pension income accrue mainly to moderate- to upper-income seniors. They find that eliminating special income tax treatment for seniors would increase state revenue by an average of 7.6 percent, not an insignificant amount, particularly given the fiscal problems facing many states. What is missing in the chapter is a discussion of the effect on the horizontal and vertical equity of the tax system.

While, as Conway and Rork point out, some states are reducing senior exemptions, the exemptions are generally growing. Combining that with the projected increase in the size of the senior population, the implications for state revenue could potentially be momentous. Providing forecasts of the revenue effect would have been helpful.

The chapter’s only link to the theme of the book is the authors’ discussion of the effects on the migration of the elderly and their work incentives from exempting Social Security benefits. The discussion draws on existing literature and provides no new evidence. There are other possible incentive effects, such as on saving and investment, that could have been discussed.

Yariv Brauner (Chapter 1) explores the link between tax policy, migration policy generally, and migration policy toward high-skilled workers, with a focus on the “brain drain.” After a discussion of the implications of immigration on the home country and the migrant, Brauner goes on to discuss how high-skilled immigrants are currently taxed. This includes a discussion of residency rules, the conditions under which the home and host country can tax earnings of non-residents, and the taxation of remittances.

Brauner believes that countries need to pay greater attention to the linkage between the three policies when designing or reforming them. While the first two policies are clearly linked, Brauner claims they are normally not developed together. It also seems clear that migration policy is not linked to tax policy in any meaningful way.

Brauner notes that developed countries compete for skilled workers and that they engage in tax competition. The implications of this competition leads him to call for greater international cooperation and coordination of tax policy vis-à-vis migration.
Unfortunately, he doesn’t provide details on how to increase cooperation on tax and migration policy. As Wilson points out in Chapter 2, there are optimal tax models for an open economy, but there is no consensus for what objectives, or principles, should drive the link between tax policy and migration policy, and Brauner does not suggest any.

Brauner sees the “Bhagwati tax” as a good example of cooperative policy. First proposed by Jagdish Bhagwati in the 1970s, and based on the moral argument that developed countries should compensate less developed countries for the loss of high-skilled individuals, Bhagwati proposed that developing countries impose a tax on the earning of immigrants, with the revenue being sent to the worker’s home country. While such a tax might reduce the migration of high-skilled workers, its main purpose was to generate development funds for less developed countries. Although it has been discussed over the past 40 years, no developing country has implemented such a tax. Brauner is a supporter of such a tax (he lays out the case in Brauner, 2010), and argues that recent trends and events, such as the financial collapse and the changing international tax regime, provides an opportunity to revisit the proposal. Brauner discusses the motivation for, design of, and subsequent analysis of the Bhagwati tax, as well as alternatives, including exit taxes and revenue sharing.

The applicable income tax depends on residence rules, and so determining when someone would be subject to a Bhagwati tax is complicated. Presumably a foreigner who resides in the United States for a “short period” would not be classified as a migrant for tax purposes, but how long is a “short period?” Some countries impose an exit tax on immigrants. While such a tax has the same effect as a Bhagwati tax, that is, it generates revenue for the home country and provides a disincentive to leave, Brauner is critical of such taxes, calling them “extreme measures.” Bhagwati called them inefficient and inequitable. But if an exit tax is designed to compensate a country for the cost of investing in the human capital of a potential migrant, it is not clear why such a tax would be inequitable.

Brauner admits that foreign aid has not been very successful, yet he optimistically calls for a new foreign aid program built on the foundation of cooperation. But unless both countries see an advantage in cooperating, and Brauner does not suggest how that might occur, asking developed countries to adopt a Bhagwati tax is akin to asking for a charitable contribution. While social justice may provide the basis for supporting a Bhagwati tax, the practical issues in designing such a tax and the small likelihood that any developed country would adopt it, would seem to make it an unrealistic proposal.

Chapter 3, by Reuven S. Avi-Yonah, is based on the author’s article in *Tax Law Review* (Avi-Yonah, 2014). The standard assumption in models of international tax competition, at least until recently, is that labor is perfectly immobile across jurisdictions, while capital is perfectly mobile. Such an assumption is adopted to make the models more tractable, not in the belief that labor is in fact immobile. However, I suspect that most economists would still argue that capital is more mobile internationally than labor. Avi-Yonah takes exception to this assumption, arguing that for individuals, capital is not more mobile than labor. He sets up as a foil a recent proposal by Edward Kleinbard (2010) to tax income from capital at lower rates than income from labor, a proposal
based on the assumption that capital is mobile but labor is not. But Avi-Yonah argues that a U.S. citizen cannot avoid U.S. taxation on capital without changing his residence. That is true — if I receive dividends from a French firm, I pay the same tax in the United States as I would if they came from a U.S. firm. Thus, Avi-Yonah argues, there is no reason to tax dividends, interest, and capital gains differently than wages.

But that is not the same as saying that capital is immobile. I can call my broker and have her sell my stock in Apple and buy stock in a Swiss firm, or I can sell my house and use the proceeds to buy a condo in downtown Atlanta and another in the hills of Santiago. Of course, I will pay the same tax rate on dividends from the Swiss firm as from Apple. But the issue is whether the U.S. and Swiss tax systems yield different net profits to the two firms, and thus different dividends. If so, then I would move my financial capital to the firm with the lower tax on profits. Capital mobility ensures that the difference in the risk-adjusted, net-of-tax rates of return between two countries will be small.

Certainly, as Avi-Yonah suggests, labor has become more mobile, particularly within the EU, or at least for now. But outside of the EU, one would be hard pressed to suggest that labor is even highly mobile, much less perfectly mobile. (Syrians currently trying to immigrate are not finding perfect mobility!) Avi-Yonah asserts that labor is mobile, but does not present any empirical evidence to support this assertion. If workers are mobile, net-of-tax wage rates for a given skill level will not differ across countries. But, wage rate differentials do not come close to being zero, and immigration policies seemed designed to keep it that way.

Given his conclusion that labor is mobile and that individuals cannot avoid taxes on capital without moving, Avi-Yonah advances the argument that countries should base their fiscal policies on the Tiebout theory that individuals will simply move to the country that best satisfies their preferences. Based on this he suggests a set of policies for the United States: (1) do not tax returns to capital (dividends, interest, and capital gains) differently than wages, (2) hold an election every four years on the proper tax rate, and (3) those who do not like the result should be allowed to move overseas, following Tiebout, and pay the tax in their new home country while retaining their U.S. citizenship.

While Avi-Yonah dismisses the argument made by Kleinbard in support of a dual tax system, the optimal tax literature suggests that the tax rate on the return to capital should be zero (Chamley, 1986), although this conclusion has been challenged (Golosov et al., 2013; Straub and Werning, 2015). The second policy suggestion, voting on a national tax rate, I would classify as thinking outside the box, far outside the box.

Corporate inversions is the topic covered in Chapter 4, written by Omri Marian. The chapter is a reprint of an article that appeared in the *Washington Law Review* (Marian, 2015).

Because the United States has a worldwide corporate tax system, U.S. corporations are subject to a residual U.S. tax upon repatriation of the earnings of their foreign subsidiaries. By inverting, a corporation becomes a foreign company and thus no longer owes American tax on its foreign profit. The first reported inversion was in 1982, but there have been several inversions of large, prominent U.S. corporations since 2000. Desai
and Hines Jr. (2002) present an incomplete list of inversions that took place between 1982 and 2002; Rao (2015) notes there were at least 48 inversions since 2002. Given the prominence of the firms that have proposed or implemented recent inversions, they have become a prominent topic for public discussion, which recently led the U.S. Department of the Treasury to issue new rules making it more difficult for corporations to invert.

The focus of this chapter is on the motivation for inversions and the consequences on the level of real economic activity in the original country of residence. Marian presents five case studies to explore these two issues. The five case studies, which represent an interesting mix of inversions, allow Marian to explore both the causes of inversions and their consequences. The public debate seems to assume that the only motivation for inversions is tax savings. But Marian suggests that the decision to invert is more nuanced, as he reports that some inversions are driven by a desire to change the location of the corporate headquarters in order to be better situated in the global market place. In some cases, there is a tension between where to best locate to exploit the market and to minimize taxes.

There has been little research in the economics on corporate inversions. Marian discusses the literature that explains inversions, such as Voget (2011) (but see also Desai and Hines Jr., 2002). He concludes that the literature does not support the hypothesis that inversions result in a change in real economic activity.

A recent paper by Rao (2015) is the only article of which I am aware that explores the effect of inversions on real economic activity. Rao finds that inverting firms have higher shares of their employees and capital expenditures located abroad after inversion, relative to changes experienced by similar non-inverting firms. Contrary to Rao, Marian finds through his case studies that tax-motivated inversions do not lead to meaningful changes in real economic activities in the original country of residence. However, Rao does not distinguish inversions by the motivating forces, and Marian’s conclusion is based on just five case studies.

Marian explains the current (as of 2014) tax rules for inversions and then presents a policy discussion for how to change the taxation of corporations to prevent or reduce inversions. The policy options run the gamut of shifting to a territorial tax system to making it harder and less beneficial to invert, which is what the U.S. Department of the Treasury did over the past couple of years.¹

Carlo Garbarino (Chapter 5) explores the tax treatment associated with commuting and migration within the EU. He specifies three standards of tax neutrality for commuting and migration. First, if all countries had the same tax system and tax rates, then tax differentials would be zero and thus have no effect on mobility. Second, while tax

¹ Among other things, the U.S. Department of the Treasury strengthened the requirement that former owners of the U.S. entity must own less than 80 percent of the new combined entity by limiting the ability to (1) count passive assets to inflate the new foreign parent’s size and (2) reduce size of the U.S. corporation by issuing extraordinary dividends. See U.S. Department of the Treasury, “Treasury Announces Additional Action to Curb Inversions, Address Earnings Stripping,” April 4, 2016, https://www.treasury.gov/press-center/press-releases/Pages/jl0405.aspx, as well as the additional documents cited in the press release.
systems and tax rates differ across countries, a second standard of tax neutrality would require that the taxpayer be subject to the tax rates in the country in which the earnings or capital gains were earned. He refers to this as a second best form of tax neutrality. Third, this second best tax neutrality would be violated if taxpayers are subject to tax restrictions, such as exit taxes or differences in defining the tax basis of assets. Garbarino explores whether the second-best version of tax neutrality applies to the EU.

Garbarino distinguishes various ways that commuting and migration of workers could occur. For example, a worker could perform physical work in one country and live in another, or the worker could sell his services in one country but never perform physical work in that country. The main focus of the chapter is on how these various events might be taxed within countries of the EU. The tax issues are similar to those faced by interstate commuters and migrants in the United States. For each of these events Garbarino discusses the limitations that EU law and court cases impose on the tax policies and rules that countries can impose. The presentation of the laws and court cases is extensive and detailed. It is also descriptive, not prescriptive. One thing that becomes clear in reading the chapter is the difference in how the EU governs the application of taxes across countries compared to how the U.S. governs interstate taxation.

The tax treatment of tax-deferred pension programs is the subject of Chapter 7 by Cynthia Blum. The chapter is a reprint of an article she published in the *Florida Tax Review* (Blum, 2015).

There are many types of retirement savings programs, but most can generally be classified into two categories. With employer pension programs and individual 401(k) plans, the contributions are made from pre-tax income, the earnings are exempt, and withdrawals are fully taxed. On the other hand, contributions to a Roth IRA are made from after-tax income, but earnings and withdrawals are not taxed. Blum addresses two broad questions. What is the fair and efficient tax treatment of these plans when the retiree moves to another country? What tax policies should the work country and the retirement country adopt, and how should the two countries coordinate their tax treatment of a migrating retiree?

Blum first explains how the U.S. tax system treats such a retiree, both when the United States is the work country and the retirement country. She describes the many ways a migrating retiree might be taxed, and then suggests ways to improve the tax situation. Improvement in her view would mean that the tax treatment would be “more in line with the expectations” of the individual. “Being in line with expectations” is an interesting criterion for designing a tax system, and not one that is included in the standard list of criteria for evaluating a tax system.

Presumably the application of this criteria implies that the individual should be treated the same in his retirement country as if he retired in his work country. At the extreme this would mean that each retirement country’s tax system would have to allow for differential treatment according to the retiree’s work country and retirement program. Imagine how complicated that would be. Would the work country object to not getting any of the deferred tax revenue? And would the current residents of the retirement country consider that fair? On the other hand, if the work country could tax withdraw-
als from tax-deferred plans for individuals who emigrate, then individuals would be taxed according to their expectations. But this means that all of the tax revenue would go to the work country and none to the retirement country, which is providing all of the public services for the individual going forward.

The taxation of pensions of migrants is not something I had previously thought about. To design the optimal tax treatment of a migrating retiree, it is necessary to specify the criteria or objective function that should be used. Perhaps “being in line with expectations” is not an unreasonable criterion, but I am not convinced it is a criterion that would result from additional thinking about this rather complex issue.

To summarize, it seems likely that migration will grow, and thus the importance of confronting the tax policy issues associated with migration will increase. Several of the chapters in this book examine such issues, exploring how tax policy currently addresses migration issues and discussing how that policy might be improved. Migration involves two countries, and thus it seems clear, as was suggested in several chapters, that tax policy would benefit from greater coordination. What I found lacking in the book, however, was a thorough discussion of how to achieve coordination and of the general principles that should guide the development of tax policy related to migration.

REFERENCES


