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AICPA Praises Simplified New U.S. Tax Rules on Expatriation Recently Signed into Law

Washington, DC (June 27, 2008) – New tax rules signed into law by President George W. Bush will require high-net worth Americans who renounce their citizenship to pay more in U.S. taxes through an “Exit Tax” and an “Inheritance Tax” on gifts to others. The new rules will raise \$411 million in revenue over the next 10 years to help pay benefits to military personnel provided by Public Law 110-245, the “Heroes Earnings Assistance and Relief Tax Act of 2008.”

“We’ve worked with congressional officials for more than 8 years on these changes that create a more workable system for expatriates,” said Tom Ochenschlager, vice president of taxation for the American Institute of Certified Public Accountants. “We are especially pleased that Congress adopted a withholding mechanism for expatriates. It will be helpful to taxpayers and make it easier for the government to administer the law.”

Staff members of the congressional tax-writing committees devoted much effort in working with the AICPA on this legislation. The new rules are more equitable and simpler than originally proposed years ago.

Under the new law, certain high-income and wealthy U.S. citizens and long-term permanent U.S. residents who expatriate will be taxed under a mark-to-market regime. A long-term permanent resident is an individual who has held a green card for any portion of at least 8 of the prior 15 tax years. To calculate the tax, much of the property of covered expatriates will be treated as sold for fair market value on the day before the expatriation date. Gains in excess of \$600,000, adjusted for inflation after 2008, will be included in income and taxed.

To close a loophole that allowed taxpayers who expatriated and subsequently made gifts to U.S. persons, a tax is imposed by the new law on U.S. citizens or residents who receive gifts or bequests exceeding \$12,000 (indexed for inflation) from a person who expatriates (i.e., gives up U.S. citizenship) after the effective date and who is subject to the new law. In addition, the new law imposes a 30 percent withholding tax on qualifying deferred compensation payments as well as distributions from non-grantor trusts that are paid to a covered expatriate.

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Additionally, the new law requires foreign subsidiaries of U.S. companies performing services under a contract with the U.S. government to pay Social Security and Medicare employment taxes, as well as increased penalties for failure to file an individual income tax return. Under prior law, U.S. government contractors could set up “sham” companies in foreign tax havens to avoid paying Social Security and Medicare taxes.

Expatriates are individuals who give up their U.S. citizenship or persons who are long-term permanent residents (i.e., people who hold their green cards for at least eight tax years) who abandon their green cards.

The proposal that led to the new current law signed by President Bush was introduced in 1999 in the 106th Congress to prevent the continued use of renouncing U.S. citizenship (or terminating long-term residency) as a device for avoiding U.S. taxes. Similar rules had been proposed in 1995 and were included in former President Bill Clinton's fiscal year 1996 and 2001 budget proposals.

The goal of the proposal was to close perceived loopholes in the expatriation tax law enacted in 1996 by imposing an “Exit Tax” at the time that an individual relinquishes U.S. citizenship or residence. In addition, a tax would be imposed on gifts and bequests from expatriates to U.S. persons, an “Inheritance Tax.”

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