United States tax reform
Will possible changes impact your globally mobile workforce?

Thought leadership from Global Mobility and Tax Policy Services

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Executive summary
Lawmakers are eyeing reform of the US tax system, which would surely affect multinational companies with globally-mobile workforces. Although it is presently uncertain when any reforms will be enacted, it is clear that reforms will not occur before January 2015. But what general goals are lawmakers trying to achieve and what are some of the complicating factors?

A potential roadmap for tax reform has been released that could help shape the debate. Proposed legislation by Dave Camp (R-MI), the Chairman of the House Ways and Means Committee (hereinafter Chairman Camp) was announced earlier this year. This 979-page legislative discussion draft is aimed at comprehensive reform of both individual and corporate levels of taxation. For individuals, imagine that the tax rates went down but more people and more types of income were subject to tax – that is precisely what this proposal outlines.

A surprising fact is that the impact of Chairman Camp’s proposals, if enacted, will vary greatly. The impact will depend upon the attributes of a company’s assignee population and any potential workforce shifts across borders. Although individual income tax rates are proposed to be lowered, many other reforms are also suggested – an important takeaway is that the changes in their entirety could result in increased tax costs, tax savings, or even a neutral impact.

To get some in-depth insight, PwC’s Global Mobility team sat down with Rohit Kumar, a principal with PwC’s US Washington National Tax Services.

Rohit brings a unique perspective to the issues surrounding tax reform after serving for over a decade on Capitol Hill with three different Senate leaders, most recently deputy chief of staff to Senate Republican Leader Mitch McConnell. Rohit also served as director of policy and senior counsel to Senate Majority Leader Bill Frist and he was the senior policy advisor and general counsel for Senate Republican Leader Trent Lott. In all of these roles, he has worked in close collaboration with Senate leaders to develop and implement all aspects of domestic policy, including tax, trade, budget and health care.
Perspectives from the Hill
Q: Rohit, why are lawmakers eyeing tax reform now?
A: In short, lawmakers are seeking simplicity and economic growth. Chairman Camp’s discussion draft is one of the latest sets of proposals from lawmakers regarding a long-standing goal that has enjoyed bipartisan support – reforming and simplifying the US tax code in order to help spur economic growth. What reforms should occur, however, is a significant question and the devil is in the details. Specifically with respect to individual tax reform, there are many complicating factors.

Q: Is there a tie between individual and entity level reform?
A: While there are separate tax rules for corporate entities and individuals, the debate of how to simplify the US tax code has included both. The reason is that there are a large number of businesses that take the form of so-called ‘pass-through’ entities. Pass-through entities have become increasingly popular for small and new businesses and therefore how and how much the individual owners of these businesses should be taxed is a critical part of the debate.

Q: What is the broad policy issue at play?
A: The broader issue is whether reforms should be comprehensive with respect to both entity and individual level taxes, or whether it should be completed through a piecemeal approach. Although an argument may be made either way, the current discussion has focused on a comprehensive approach to tax reform if such reform occurs. If certain reform provisions are instead ‘cherry picked’ and attached to various pieces of legislation without a comprehensive approach, this situation could create even greater complexity for taxpayers and erode the quality of the fundamental reforms down the road.

Q: Should individuals or entities bear the greatest burden?
A: A little known fact is that about 85% or so of all US federal tax revenue comes from the individual income tax (roughly 50%) and payroll taxes other than income tax (roughly 35%), the latter of which is split between employer and employee obligations. Due to current government fiscal deficits and the need for revenue, the question arises as to what the enduring revenue picture should look like. In other words, what groups should bear what amount of burden and should the tax burden be shifted to more corporate entities rather than individuals?

Q: What is the right mix of tax revenue?
A: Reasonable minds differ as to what the right combination should be, however, some lawmakers believe that the burden should be shifted more towards corporate entities. Many lawmakers agree that regardless of what group bears the burden, the current revenue levels should stay the same or even rise to meet the government’s need for money if tax reform is enacted. Chairman Camp’s discussion draft is designed to be generally revenue neutral over the first ten years but appears to shift some of the tax burden from the individual tax base to corporate taxpayers.

Q: Are lawmakers seeking a broader base of taxation for individuals?
A: With respect to individual taxation, some lawmakers may believe that in order to have more sustainable tax revenues, the United States should have lower rates of taxation while broadening the base of taxation. Currently, the US tax code for individuals contains a myriad of deductions and special credits that create a narrow base of taxation. Almost half of US individuals do not pay any US federal individual income tax – the top quintile generally bears the greatest burden.
Q: How do legislators approach this issue?
A: Some lawmakers also have the perception that broadening the base of taxation and eliminating many of these preferences enables a greater ‘sharing’ of the overall tax burden and is thus overall, better tax policy. The rationale is that a narrow tax base or a tax burden borne disproportionately by high income earners could lead to large swings in government revenue depending on the economy. Moreover, some lawmakers may also believe that a fairer tax system is one that has more people paying into the system and thus a greater perceived ‘stake’ in the government.

Q: Achieving simplicity is a great goal, but are there barriers to achieving it?
A: Another challenge surrounding tax reform is the current complexity of the US tax code. Members of both parties and the public at large have expressed a desire for simplicity. However, doing this may mean getting rid of some very popular provisions, mandating the need for tough political choices. Individual taxpayers in the United States have come to accept certain exclusions and deductions. These include for example, the deductions for amounts contributed to 401(k) and other retirement plans, charitable giving deductions, mortgage interest deductions, and state and local tax deductions. Lawmakers know that proposals to limit or even eliminate these popular provisions may face strong opposition.
Shaping the tax reform debate going forward
**Shaping the tax reform debate going forward**

**Q: What could individual tax reform look like?**

**A:** Lawmakers may have some common vision as to what attributes a reformed individual tax system should embody, but what specific changes should occur is uncertain at this time. And crafting changes that will achieve the appropriate balance for all stakeholders, while addressing the challenges noted above, will be a formidable task. Nonetheless, proposals under Chairman Camp’s discussion draft are expected to shape the debate going forward.

**Q: Does Chairman Camp’s proposal include minimal or sweeping changes?**

**A:** While other tax-related proposals have been released such as the Obama Administration’s FY 2015 budget proposal (click here for more details), Chairman Camp’s proposal is one of the most comprehensive, addressing both corporate and individual taxation. It incorporates information from a number of stakeholders (e.g., Congressional hearings, bipartisan working groups, and public comments.) For these reasons, it may serve as a potential starting point for what tax reform changes may be on the horizon, if tax reform occurs at all.

**Q: Are individual tax rates proposed to be changed?**

**A:** Chairman Camp’s discussion draft proposes that the top US individual income tax rate of 39.6% and the current marginal tax brackets (between 10% and 39.6%) will be reduced. Instead of the current seven bracket regime, only three brackets would be used – 10, 25, and 35%, with the 35% rate applying to a more broadly defined modified adjusted gross income (MAGI). The 10% rate would cover income up to $71,199 for married taxpayers filing jointly and surviving spouses (half that amount for other filers); the 25% rate would cover income from $71,200 up to $450,000 (married taxpayers filing jointly) and $400,000 (all others).

**Q: Are there complications with how the rates apply?**

**A:** Some complexity arises with respect to how these three brackets apply. The 10% rate is phased out for taxpayers with MAGI over $300,000 for married taxpayers filing jointly and surviving spouses and $250,000 for all others (but not including estates and trusts). In effect, a single 25% rate would occur for those married filing jointly taxpayers with MAGI above $300,000 but below the $450,000 threshold for the top 35% rate.

**Q: Are there any special adjustments?**

**A:** Those taxpayers subject to the higher 35% rate would calculate MAGI by adding back certain excluded or exempt income. For example, any amounts excluded under Section 911 (foreign earned income and housing exclusions) must be added back. Certain other income that would otherwise be excluded from income under the other tax brackets would also be added back to calculate MAGI. These include for example, tax-exempt interest, employer-sponsored health insurance payments, pre-tax contributions to defined contribution retirement plans, and social security benefits.

**Q: Does the alternative minimum tax (AMT) regime remain the same under the proposal?**

**A:** A significant change in Chairman Camp’s discussion draft is the elimination of the AMT regime. Individuals currently must compute their income under both the regular and AMT regimes and pay the higher amount of tax. The AMT calculation disallows certain items of ‘tax preference’ or exclusion items that are tax-exempt or tax-deferred for regular income tax purposes.
**Shaping the tax reform debate going forward**

**Q:** How will the proposed AMT change impact tax revenues?

**A:** The proposed repeal by Chairman Camp could help to simplify tax return preparation, but could also reduce the amount of taxes owed by many individuals. In recent years, the number of people subject to the AMT has increased – according to US Joint Committee on Taxation, AMT affected about four million families in 2013. This number is expected to rise sharply over the next few years if no change occurs, causing some policy makers to question whether its application still fits its original objectives.

**Q:** Would many assignees continue to itemize deductions?

**A:** Under current law, individuals can reduce their adjusted gross income by personal exemption deductions and either the applicable standard deduction or that person’s itemized deductions to determine taxable income. Often times, a person’s itemized deductions exceed the standard and thus taxpayers choose the former to obtain a lower tax liability. Chairman Camp proposes that the standard deductions are consolidated and significantly increased to $22,000 for joint filers and $11,000 for other individual filers. These would begin to be phased out for taxpayers with MAGI over $513,600 (married) and $356,800 (all others.)

**Q:** What is the rationale for this proposal?

**A:** According to Chairman Camp, the rationale for this proposed change is that these increased standard deductions would enable roughly 90% of taxpayers to claim the standard deduction without losing higher tax benefits that would otherwise result from itemizing their deductions. The hope is that this would reduce complexity for filers.

**Q:** Would many current law deductions be repealed?

**A:** Chairman Camp is also proposing to limit or repeal many current-law deductions. For example, state and local taxes currently allowed as an itemized deduction (not related to a trade or business) would no longer be deductible. Chairman Camp’s discussion draft also changes the current law deduction for mortgage interest at or below the $1 million cap. Several restrictions for charitable contribution deductions are proposed including a new floor equal to two percent of the individual’s contribution base. And, the child care credit would no longer be a refundable credit for any year in which Section 911 exclusions are claimed.
Q: What other popular deductions would be affected?

A: Moreover, Chairman Camp suggests that the deductions for moving expenses, alimony, medical expenses and unreimbursed employee business expenses be repealed. Various education and other credits would also be repealed. Exclusions for employee fringe benefits (e.g., no additional cost services) as well as employee achievement awards would be repealed. The current-law exclusion for housing and meals provided to an employee for the convenience of the employer would also be subject to an overall limit.

Q: Are there many other proposed changes?

A: Chairman Camp’s discussion draft includes a plethora of other proposals that could affect globally mobile workforces not mentioned above. For example, there is a proposed repeal of certain FICA tax exemptions that are provided to certain foreign workers (including certain students and trainees present in the US), exemptions provided to nonresident aliens earning income while on passenger cruise ships is proposed to be repealed, and various provisions apply to restrict certain beneficial retirement tax rules. Chairman Camp’s proposals also increase the penalty structure applied to a taxpayer that fails to file correct information returns with the IRS.

Q: Would these proposals affect global mobility programs similarly?

A: The answer is likely ‘no’ – Chairman Camp’s proposals, if enacted, promise to have varying impacts depending upon the facts. Although not an exhaustive list, two important variables include the work locations of assignees as well as the tax reimbursement policies that are utilized by the employer.

Q: Thanks, Rohit, this has been a great discussion. Any final words of wisdom for mobility program managers?

A: Stay tuned… the tax debate is far from over!
Mixed impact on global mobility programs
Mixed impact on global mobility programs

Proposed tax changes can have a varying impact on mobility programs and the cost for employers, depending on industry, assignee mix and non-US locations. Consider the following examples:

Example 1: Outbound employees working in lower tax jurisdictions
Consider a multinational company that has a large population of employees on assignment to jurisdictions with a much lower foreign tax burden (e.g., Hong Kong, United Arab Emirates). Assignees who are US citizens or residents temporarily working in lower tax jurisdictions may be more likely to claim Section 911 exclusions. The proposed provision in Chairman Camp’s discussion draft, if enacted, may serve to limit the application of these Section 911 exclusions to those employees in the 25% bracket. Specifically, the proposal would eliminate Section 911 exclusions for those assignees that have income exceeding the $400,000 or $450,000 thresholds for the 35% bracket.

Companies may currently have different policies as to whether the employee or the company reaps the financial benefit of these Section 911 benefits. If the proposed change is enacted, increased costs may result for the employer. For example, if the employer has enjoyed the benefit, the company must then incur the resulting financial cost. If, however, the employee has historically enjoyed the Section 911 benefits, employees may seek additional remuneration from the employer for the loss of this benefit.

Example 2: Increase in an assignee’s US tax liability a company cost?
Assume the same facts as above (i.e., a US citizen is working abroad on a temporary assignment.) Under Chairman Camp’s proposals, the individual’s US federal tax liability may become higher than under current law. The company’s tax reimbursement policy may state that the employee is responsible for his/her US federal tax liability (under a so-called US hypothetical tax calculation), but could have a carve-out for a change in US tax laws that occurs during an assignment. The policy could thereby potentially increase mobility program costs for the company.

A similar situation may arise where the Chairman Camp proposals cause a resulting increase in US federal tax liability for the assignee, however, there may be sufficient foreign tax credits to offset this liability. Does the company’s tax reimbursement policy provide that the hypothetical tax calculation, which usually dictates what tax liability the employee must bear, take into account foreign tax credits? If not, the employee may bear added US tax costs.

Example 3: Assignees with larger state tax liabilities
Consider a multinational company that has foreign nationals working in the United States, particularly in a state with high state tax levies (e.g., California.) These assignees may currently have to pay AMT due to their higher deduction amounts for state and local income and property taxes. The result is that their overall US federal tax liability will increase because the person will need to pay the higher AMT amount than their tax calculated under the regular federal tax rules.

Chairman Camp’s proposal to eliminate the itemized deduction for non-business related state and local taxes could cause an individual’s US federal tax liability to increase. However, the corollary elimination of the AMT regime could provide an offsetting reduction in tax liability such that the net tax result could be near neutral, depending upon the individual’s particular income and deduction amounts. Note that this assumes that non-business related state and local taxes imposed on compensation and investment income would not be considered business-related. The discussion draft is not entirely clear, although another interpretation could render the proposal relatively meaningless.
**Rate reductions may not mean less US tax**

An important takeaway is that proposed US federal income tax rate reductions (if enacted) may not necessarily equate to less US tax relating to a globally mobile assignee and in fact may result in an increase. The potential decrease of US federal tax rates for individuals would need to be considered alongside the other proposed reforms that may offset this benefit. As expected, there will be situations where US federal tax liability for an individual will go down if such proposals are enacted. For example, a higher income taxpayer could reap tax savings if they did not claim significant deductions under current law.

**Mobile individuals more likely to pay at a higher rate**

The proposed changes that would result in higher taxable income for those individuals at the higher 35% rate will unfortunately be felt more by individuals who are crossing borders to work. Typically their gross income not only includes salary but also a larger amount of income attributable to employer provided benefits – often resulting in taxable income of more than double their regular salary. So-called ‘gross-ups’ of benefits are aimed at making the individual whole from a cost perspective, however, they could also cause the individual to move into a higher rate of tax.

**Craft a broad conclusion as to impact**

Reforms will not be enacted before January 2015, but companies should be aware that change could be coming and understand the broad potential impact of the proposals being debated. When the promise of individual tax reform becomes more imminent, multinational companies may consider analyzing the specifics of how proposed changes such as Chairman Camp’s discussion draft could affect globally mobile program costs for their population at that time. In the meantime, companies may wish to perform a broader statistical sampling and review to gauge if Chairman Camp’s proposals would have a significant impact on their overall mobility costs.

**Help shape the dialogue**

*Lawmakers are seeking comments.* If specific proposals promise to have a significant adverse impact, companies may want to help shape the dialogue now surrounding potential tax reform. This may include submitting written comments and liaising with lawmakers. Although the discussion draft reflects significant feedback from Congressional hearings, bipartisan working groups, and public comments, Chairman Camp continues to seek additional input from affected taxpayers and plans to hold public hearings.

The Senate Finance Committee is also seeking comments. In a November 2013 discussion draft regarding international business tax reform, former Chairman of the Senate Finance Committee (Max Baucus) stated that the Committee is seeking comments about needed reforms to simplify the international tax rules addressing US citizens living overseas and foreign nationals moving to the United States. Their goal is to appropriately tax such individuals and they are seeking input regarding the scope and mechanics of potential reforms.
Suggesting a balanced approach.
Participating in the tax reform dialogue now may be a proactive approach and could help to decrease costs down the road for those companies that expect their workforces to become increasingly mobile in the future. But submitting comments may be more challenging than expected. To have more impact, they should take into account how politicians are likely to approach the challenges described above – a difficult task given the significant interests of relevant stakeholders.

The bottom line is that companies should be aware that changes are being discussed, understand the general impact of the proposals being debated and consider how to get involved in the debate. When tax reform becomes more imminent, companies may consider more specific analyses to determine how changes affect tax equalization and administration costs to current assignee populations, and whether and what changes to tax reimbursement policies should be considered.
Let’s talk
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For a deeper discussion of these issues, please contact a member of your International Assignment Services (IAS) engagement team or the following persons:

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**Additional information**

PwC Tax Insight, Overview of Ways and Means Chairman Camp’s tax reform discussion draft, February 28, 2014.
Thank you