United States: Proposed individual tax reform – what is the potential impact for employers with mobile workforces?

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In brief

Congressional consideration of comprehensive tax reform in the United States for individuals and businesses is on the horizon for 2017, but the details for what changes could be coming – and when new rules would become effective – remain to be worked out. President Trump proposes to replace the current seven federal individual tax brackets with three brackets, with rates set at 12%, 25%, and 33%. He also proposes to repeal the net investment income tax, increase the standard deduction, repeal personal exemptions, cap itemized deductions, and eliminate the alternative minimum tax (AMT).

In addition, the House Republican 'Blueprint' for tax reform, released in June 2016, could provide some indication for how the Ways and Means Committee and the House could seek to change the individual tax regime. The Blueprint proposes similar lower income tax rates for individuals as President Trump, but offers different approaches on other individual tax provisions.

The bottom line is that these potential changes would impact multinational companies with globally mobile employees – those with US citizens and residents working abroad, and those with foreign nationals working in the United States. Employers that have adopted a tax-equalization or protection arrangement should review how these potential tax law changes could impact their tax reimbursement liabilities and gross-up costs for mobile employee populations.

Although there is an immediate tendency to conclude that because US federal individual income tax rates generally could be reduced, US federal income tax costs will go down, this may not be the case for all individuals; in fact, for some workers their US federal income tax liabilities may increase. As more information becomes available, companies may want to consider possible changes to tax reimbursement policies, taking into account that tax law changes may not begin to become effective until January 1, 2018.

Employers should also consider other proposals by President Trump that would alter US immigration rules. These changes could impact a multinational employer's ability to move talent in and out of the United States; as a result, employers may want to review the potential impact to their strategic talent plans and mobility processes.

In detail

Recent proposals to reform individual income tax regime

President Trump's campaign proposals

President Trump proposes to replace the current seven tax brackets with three brackets, with rates for joint filers set at 12% (less than $75,000), 25% (more than $75,000 but less than $225,000), and 33% (more than $225,000.) Brackets for single filers are proposed to apply at one-half of these amounts. Currently, tax brackets for individual income tax filers range from 10% to 39.6%. The existing 20% top rate on long-term capital gains and qualified dividends would be retained.

The standard deduction for joint filers would be increased to $30,000 from $12,600; the standard deduction for single filers would be $15,000. Personal exemptions are proposed to be eliminated, along with the head of household filing status. The proposal also includes a cap on itemized deductions at $200,000 for married filing jointly and $100,000 for single filers.

The current proposals are likely to be refined with the assistance of President Trump's appointments to key positions, such as Treasury Secretary.

House GOP Blueprint

The House GOP Blueprint proposes similar lower rates for individuals as the Trump plan, and also recommends repealing the individual AMT. However, it offers different approaches on other individual tax provisions.

The Blueprint suggests a reduced tax on investment income. The plan states that "[f]amilies and individuals will be able to deduct 50% of their net capital gains, dividends, and interest income, leading to basic rates of 6%, 12.5%, and 16.5% on such investment income depending on the individual's tax bracket," with the remaining 50% taxed at ordinary income rates. This is compared to the current top statutory rate of 20% for long-term capital gains and qualified dividends and 39.6% for most other investment income; under current law, such tax liabilities can be increased by the 3.8% net investment income tax and the so-called Pease limitation on itemized deductions.

Also proposed is a simplification of certain deductions and credits (to be adjusted annually for inflation) aimed at reducing the number of taxpayers who itemize deductions. The Blueprint proposes to consolidate all standard deductions and the personal exemptions for families and individuals. The new standard deduction would be larger – $24,000 for married individuals filing jointly; $18,000 for single individuals with a child in the household; and $12,000 for other individuals.

In addition, the child credit and personal exemptions for dependents would be consolidated into an increased child credit of $1,500. The first $1,000 of this will be refundable as under current law, and a non-refundable credit of $500 will be provided for non-child dependents.

The Blueprint recommends eliminating all itemized deductions for middle-income families, except for "a mortgage interest deduction" and the charitable contribution deduction. Other changes are contemplated but are not specifically explained. For example, the Blueprint states that unspecified "special-interest provisions" should be repealed to make the tax system simpler, fairer, and flatter for all families and individuals.

The above summary provides highlights and is not an exhaustive list of proposed changes. The House Ways and Means Committee staff is in the process of drafting bill language for tax reform, which may result in changes to some aspects of the Blueprint.

Possible impact on tax reimbursement costs

These proposed changes are significant and, if enacted, will likely impact multinational companies with globally mobile employees. This would include both inbound and outbound employees, i.e., those US citizens and residents working abroad, and those foreign national employees working in the United States.

Most companies utilize so-called tax equalization arrangements for their employees. In such an arrangement, the employer assumes the employee's obligation for actual taxes in exchange for the employee funding a so-called 'hypothetical tax'. Typically, an estimated hypothetical tax amount is calculated to approximate what the employee's stay-at-home tax liability would have been had he or she not relocated abroad. Such amount is retained by the employer as a salary reduction ('withheld' from the employee's paycheck); actual home and host country taxes then are funded by the employer and grossed-up. A year-end true-up is completed to reconcile the estimated hypothetical tax amount to a final hypothetical tax amount.

Companies must properly budget and account for tax equalization expense. The question is whether these costs could increase or decrease if tax reform is enacted in 2017, and whether changes would be made effective January 1, 2018, or possibly earlier.

Will US federal tax liability increase or decrease?

Companies should consider how the proposals could impact the actual or hypothetical US federal tax liabilities for mobile employees. For many employees, their US tax liabilities would be reduced. However, reduction cannot be assumed across the board as some would see an increase in US tax costs.

For example, a single individual is currently subject to the 33% rate of tax only on taxable income in excess of $190,150. Under President Trump's proposals, however, the 33% rate would apply to taxable income in excess of $112,500. Although the standard deduction would increase significantly, itemizers may see no benefit from such increase and may face a new limit on their itemized deductions (e.g., $100,000 for single filers) or removal of key deductions (e.g., real estate taxes and state/local income taxes). For those in the $100k-$400k range, costs could increase with the proposed changes, potentially impacting a significant portion of expat populations.

How will this affect the employee's overall tax arrangement?

Companies also should consider how changes to US federal tax liability could impact their overall costs. Assume that a mobile individual's US federal liability goes down when US tax reform occurs. If this is the case, companies may have *higher or lower tax equalization expenses* depending on the specific situation – e.g., inbound versus outbound assignments, and the tax burden in their home jurisdiction.

For example, assume a US citizen is working in France temporarily. The employee's US tax bill (hypothetical tax) may go down, which could result in an *unexpected increase in mobility costs*. As another example, assume a foreign national from the UAE is temporarily working in the United States. This could mean lower US tax costs for this equalized employee – *a potential benefit for companies* that are sending workers to the United States.

The takeaway

Proposed individual tax reform

Companies with mobile employees working in the United States, or US citizens or residents working abroad, should quantify and evaluate how reduced individual tax rates and other tax reform changes could impact resulting tax costs under their equalization policies. This analysis may require looking at specific individual facts and circumstances in order to recalculate hypothetical taxes and tax reimbursement costs. This should be done even where mobility costs are in the form of overhead allocated based on a fixed multiplier to projects.

Depending on the outcome of this analysis, and the final provisions and effective dates of tax reform legislation, mobility programs should consider reviewing and potentially revising tax equalization policies. The current tax equalization policy may have assumed certain variables that no longer might be appropriate for most assignees if lower rates are enacted.

Some additional questions to consider in advance of potential individual tax reform:

- If mobility costs will increase, how will these extra costs be recovered?
- How should tax equalization policies be reviewed and revised?
- Are there additional internal mobility-related controls that should be added if changes occur?
- Are the potential costs material enough to warrant communication to the C-suite?
- What communications should occur with mobile employees?

Other proposals could impact the ability to move talent

Proposed individual tax reform in the United States is an important issue for mobility programs, but companies with mobile workforces should also be focused on other changes – outside of tax – that President Trump has proposed. Most notably, the President's proposals regarding immigration could potentially disrupt or alter a company's current ability to move talent in and out of the United States.

The President has made public comments about placing tighter restrictions on certain visa programs (e.g., H-1B program) that are used by various industries such as technology to move talent into the United States. President Trump has also expressed a desire to remove the United States from the North American Free Trade Agreement (NAFTA), which enables the transfer of workers between NAFTA member countries using the NAFTA work permit category. If these changes occur, all employers that currently rely upon cross-border mobility for their employees could be impacted.

It is unclear what changes in immigration laws will take place under Mr. Trump's Administration. However, businesses should be thinking about how these proposals could impact their ability to get the right talent where they need it in a timely manner. Global mobility programs should consider a proactive stance now by re-evaluating their long-term talent strategies and identifying preparatory or contingent actions with respect to, for example, talent sourcing and mobility policies.

Let's talk

For a deeper discussion of how possible enactment of US tax reform in 2017 might affect your mobile workforces, as well as assessing the effectiveness of your mobility programs and processes, please contact your PwC Global Mobility Services engagement team or one of the following professionals:

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