Rising to the challenge

Challenge
Tax Case Competition
Official Case Materials
Case competition overview

Business is the place where theory is executed real time, where decisions are made, communication is key, and collaborative, team oriented thinking is a must. These are the conditions PwC seeks to create with our campus case competitions. PwC launched Challenge (formerly the xTREME Games) in 2002 to increase students’ exposure to professional services and the world of public accounting. Challenge cases address real business issues requiring students to be critical thinkers, collaborative team members and persuasive business advisors. No number crunching exercise, our tax-based case competition is focused on high-level issues designed to test and improve decision making skills. Detailed accounting or tax knowledge is not required to participate.

We are pleased to make materials from a past PwC Challenge Case Competition available for professors to use as they deem appropriate for their students. We hope this will be a valuable resource. Please direct any questions or comments to pwc.university.relations@us.pwc.com.
Re: Financing Health Care Reform

I am writing to follow up on our discussions over the last several weeks and to provide some additional background on the project at hand.

First, some background on our organization. As you may know, the Dutan Business Network was first organized in 1957 as the Dutan Agricultural Society, a largely social organization that provided networking and educational opportunities for our nation’s farmers and farming-related businesses. Over the last 56 years, our membership has expanded to include small businesses from virtually all of Dutan’s small business sector. As our membership has grown, so has our mandate. As the Dutan Business Network, we provide our membership with training and counseling, financial assistance, contracting assistance, disaster recovery assistance, and advocacy. In addition, we work closely with all levels of the Dutanese government to represent the needs of our nation’s small businesses.

It is that final point that has brought us to the project we would like to pursue with PwC.

During her inauguration in March, President Ponczek announced her intention to prioritize the reform of Dutan’s health care policies and programs. In subsequent speeches, she has laid out an 18-month plan for a governmental review of our health care system. The outcome of that review will be recommendations for “significant and far-reaching reform.”

Our membership enthusiastically embraces the concept of health care reform. We feel strongly that re-tooling the existing system is in the best interest of our member companies, their employees, and the Dutanese economy. We are concerned, however, about how President Ponczek’s “significant and far-reaching reform” will be financed. We want to ensure that any financing proposals truly represent the best interests of our membership.
To that end, we are in the process of developing a series of whitepapers that will form the basis of our lobbying efforts around health care reform. We are specifically interested in your insights into tax modifications that could be potential revenue raisers to finance health care reform and the impact of these modifications on Dutanese small businesses, our employees, the treasury, and our nation’s economy. We would like you to recommend three tax areas that could be created or modified to finance health care reform in our country. Do not feel limited in choosing your recommendations, but we are particularly interested in modifications to tax areas impacting health and welfare benefits, both from the perspective of small businesses and Dutan’s employee population. Your recommendations will become the centerpiece of our lobbying efforts with President Ponczek and members of the government.

We believe that for our lobbying efforts to be successful, they must:

• Include three tax areas that could be created or modified for the purpose of financing health care reform
• Include potential impacts of these tax modifications on small businesses, the country’s employee workforce, the treasury, and the economy

As you can imagine, my schedule is full and my time to meet with you is limited. In two weeks, I can arrange for a 25-minute meeting with your team and some of my colleagues at the Network. At that point, you will have 12 minutes to present three recommendations for modifications or additions to the current tax code as described in the previous paragraph. The remainder of the time will be reserved for questions and answers. Please prepare an executive summary that does not exceed two pages. The specific instructions on what should be included in that summary are included as an enclosure. Also, please ensure that everyone on your team has the opportunity to speak for at least one minute during your 12-minute allotted time. We are very interested in hearing from as many experts as possible.

I look forward to our meeting and to benefiting from your extensive and unbiased, external expertise.

Regards,
Trevor Tarkoni
Chairperson, Dutan Business Network

Attachments:

• Excerpts from The Dutan Advocate
• Excerpts from Dutan’s Tax Code
• Background on the Dutan economy from The Global View
• Executive Summary Standards
Since her inauguration, President Ponczek has continued to articulate her vision for health care reform in Dutan. Following are excerpts from recent speeches.

from her inaugural address
March 1, 2013

...Today, we are spending over D$850 billion a year on health care or 18% of our gross domestic product. And yet, for all this spending, more of our citizens are uninsured; the quality of our care is often lower; and we aren’t any healthier. Our rate of adult obesity is one of the highest in the world. 26% of our citizens are moderate to heavy smokers. While health club memberships are on the rise, we are still a nation of people who do not exercise regularly. These are the facts. We need to act and we need to act quickly to ensure the health of this and future generations.

...Health care reform is the single most important thing we can do for our population and for Dutan’s long-term fiscal health.

from a speech to the Association of Dutan Insurance Commissioners
August 3, 2013

...In this period of reform, it is important to remember that we are all facing this together. As patients, providers, insurers, and regulators, we all must be willing to rise to occasion and address the challenges before us and to make the tough decisions that may be necessary to ensure the medical and economic health of future generations.

from a speech to the Dutan Business Network
July 15, 2013

...Small business owners like Eli and Eustace Helzel right here in Patriots Point are also struggling. They've always wanted to do right by the workers at their family-run construction company, but have recently had to do the unthinkable and lay off a number of employees—layoffs that could have been deferred, they say, if health care costs weren’t so high. Across the country, over one third of small businesses have reduced benefits in recent years, and a growing number have dropped their workers’ coverage altogether since the early 90’s.

from a speech to the legislature
April 21, 2013

...Making health care affordable for all Dutan citizens will cost roughly an additional D$400 billion dollars over the next ten years. This is a significant amount of money by any measure. Remember though, that an unwillingness to face this challenge will cost us even more in the long term through lost economic growth and lower wages.

on the occasion of a visit from
U.S. President Barack Obama
August, 1, 2013

...I applaud President Obama’s efforts to reform health care in the United States. We share a vision of a three-pronged approach to this issue. Reform means investing in preventive care to avoid illnesses and disease. This requires a commitment from individuals, the medical community, and even employers like Econofoods that is rewarding workers for taking better care of their health while reducing health care costs in the process. Reform means upgrading our medical records systems so individuals and their physicians can easily access and share appropriate information on medical history and prescriptions. Finally, reform means reducing costs so every citizen of Dutan has access to the high quality health care they deserve.

...It is important to remember that high quality health care is first and foremost a personal responsibility. As individuals, we need to be more focused on preventive care. We need to lose weight, quit smoking, and exercise regularly. We all want to avoid getting sick. And, fellow Dutanis, it makes good sense to me that preventing illness is a lot less expensive than the cost of long term care.
Excerpts from Dutan’s Tax Code

The principles of Dutan’s system of taxation are contained in its Tax Code and accompanying Tax Regulations. The following are key excerpts of the applicable tax regulations.

**Individual Income Tax**

I.01: Gross Income: Gross income means “income from whatever source derived” except for certain items specifically exempt by statute. An individual’s Adjusted Gross Income (AGI) is determined by subtracting certain deductions from gross income. These deductions include contributions to a tax-qualified retirement plan and certain medical expenses including medical insurance premiums paid by the individual or indirectly on the individual’s behalf by his corporate employer and contributions to a Savings Account for Health Purposes (SAHP). Also, there are special deductions for fitness/health club membership expenses, cost of prenatal and pediatric care, certain moving expenses, and alimony payments.

I.02: Personal Exemption: In order to determine taxable income, an individual reduces AGI by any personal exemption deductions and either the applicable standard or itemized deductions. Personal exemptions generally are allowed for the taxpayer, his or her spouse, and any dependents. The deduction for personal exemptions is eliminated for taxpayers with incomes over a certain threshold, which is indexed annually for inflation. For 2013, the personal exemption is D$1,000, and the personal exemption is eliminated for an individual with income over D$50,000.

I.03: Exclusion/Deduction for Cost of Health Insurance

(A) Exclusion from Employee’s Income if Employed by Corporation: An employee may exclude from his or her gross income the value of corporate employer-provided health insurance. The exclusion of the value of corporate employer-provided health insurance extends to the employee as well as the employee’s spouse and dependents.

(B) Treatment of Self-Employed Individuals: Self-employed individuals may deduct from self-employment income the cost of health insurance for themselves and their spouse and dependents. The deduction applies only to the cost of insurance, i.e., it does not apply to out-of-pocket expenses that are not reimbursed by insurance.

I.04: Standard Deduction or Itemized Deductions: A taxpayer also may reduce AGI by the amount of the applicable standard deduction or aggregate itemized deductions, whichever are greater. For 2013, the amount of the standard deduction is D$3,000 per each individual taxpayer. An additional standard deduction is allowed with respect to any individual who is elderly, defined as anyone 60 years of age or older. For 2013, the additional standard deduction for the elderly is D$1,000. The amounts of the basic standard deduction and the additional standard deductions are indexed annually for inflation.

I.05: Itemized Deduction for Medical Expenses: Individuals may claim an itemized deduction for unreimbursed medical expenses. Individuals cannot deduct expenses which are paid for or reimbursed by a corporate employer. Expenses are deductible under this provision of the Code only in excess of the standard deduction. If the cost of health insurance is excluded from income by operation of Code section I.03, the cost of such health insurance cannot be deducted again under this provision.

I.06: Special Deduction for Fitness/Health Club Memberships: Individuals may claim an additional deduction for their costs (including initiation fees and monthly membership fees) of using a fitness or health club. An individual will qualify for this deduction only if the fitness or health club facility is licensed by the Dutan government. The deduction cannot exceed D$500 per tax year. This deduction is available regardless of whether the individual uses the standard deduction or itemized deductions.
I.07: Special Deduction for Prenatal and Pediatric Medical Expenses: The amount expended by an individual for purposes of prenatal and pediatric medical care qualifies for a double deduction from the individual’s income, i.e., the amount spent on prenatal and pediatric medical care is doubled to arrive at the deductible amount. Expenditures for pediatric medical care will qualify for this special double deduction only if the medical care is for a child of the taxpayer (including adopted children). The deductible amount under this Code section cannot exceed Δ$4,000 (after the medical expenditures have been doubled). This deduction is available regardless of whether the individual uses the standard deduction or itemized deduction.

I.08: Tax Rates: A taxpayer’s net income tax liability is the individual income tax liability reduced by allowable credits.

To determine an individual’s tax liability, a taxpayer generally must apply the tax rate schedules to his or her taxable income. The rate schedule is broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer’s income increases. There are no separate rate schedules based on an individual’s filing status, i.e., tax rates are the same regardless of a taxpayer’s marital status.

### 2013 Individual tax rate schedule—Amounts in Dutan dollars

<table>
<thead>
<tr>
<th>If taxable income is:</th>
<th>Over</th>
<th>But not over</th>
<th>Pay +</th>
<th>% on excess</th>
<th>Of the amount over</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0</td>
<td>$6,000</td>
<td>$0</td>
<td>10%</td>
<td>$0</td>
<td></td>
</tr>
<tr>
<td>6,000</td>
<td>25,000</td>
<td>600</td>
<td>15</td>
<td>6,000</td>
<td></td>
</tr>
<tr>
<td>25,000</td>
<td>50,000</td>
<td>3,450</td>
<td>25</td>
<td>25,000</td>
<td></td>
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<tr>
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<td>9,700</td>
<td>30</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td>200,000</td>
<td>........</td>
<td>54,700</td>
<td>35</td>
<td>200,000</td>
<td></td>
</tr>
</tbody>
</table>

**Corporate Income Tax**

C.01: Taxable Income: A corporation pays tax on its “taxable income.” Taxable income is the corporation’s total income for the year (such as gross receipts, interest, rents and royalties) minus the corporation’s deductions for the year (such as compensation and salaries paid, repairs, maintenance, rents paid, interest paid, depreciation, advertising and deductible amounts paid into pension and profit-sharing plans, and other employee benefit programs including contributions to health and welfare benefit plans).

Corporate earnings are taxed twice. First, a corporate income tax is imposed on its net earnings and then after the earnings are distributed to shareholders as dividends. Each shareholder must pay taxes separately on his or her share of the dividends.

C.02: Tax Rates: A corporation’s net income tax liability is the corporate income tax liability reduced by allowable credits.

To determine a corporation’s tax liability, a corporation generally must apply the tax rate schedules to its taxable income. The rate schedules are broken into two ranges of income, known as the income brackets, and the marginal tax rate increases in the second bracket when a corporation’s income increases to the next bracket level.
## 2013 Corporate tax rate schedule—Amounts in Dutan dollars

If taxable income is:

<table>
<thead>
<tr>
<th>Over</th>
<th>But not over</th>
<th>Pay</th>
<th>% on excess</th>
<th>Of the amount over</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0</td>
<td>$100,000</td>
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<td>8%</td>
<td>$0</td>
</tr>
<tr>
<td>$100,000</td>
<td>........</td>
<td>$8,000</td>
<td>+12%</td>
<td>100,000</td>
</tr>
</tbody>
</table>

C.03: Deduction for Amounts Paid by Corporations for Health Care Expenses of Employees: As with other compensation, the amount paid by a corporation for health care of its employees is deductible by the corporation from corporate taxable income. The deduction applies both in the case in which corporations absorb the cost of their employees’ medical expenses not covered by insurance (i.e., a self-insured plan) as well as corporations’ payments to purchase health insurance. There is no limit on the amount of corporation-provided health coverage that is deductible.

SAHP.01: Savings Account for Health Purposes in Lieu of Insurance: Individuals who have no other health insurance plan, either corporation-provided or private insurance, may establish and make tax-deductible contributions to a Savings Account for Health Purposes (“SAHP”). Contributions by an individual to an SAHP are deductible in computing the individual’s adjusted gross income. Accordingly, the contributions are deductible whether or not the individual itemizes deductions.

SAHP.02: Permissible Health Care Expenditures: The amount contributed to a SAHP can be withdrawn to be spent only for eligible health care expenses, which include costs of doctors’ visits, hospital visits (including emergency room services and surgical procedures), and laboratory and diagnostic tests. Eligible health care expenses do not include the cost of medicine (whether or not prescribed by a doctor), home health care expenses, or expenses of a long-term stay facility such as a nursing home.

SAHP.03: Deduction for Corporate Contributions: Similar to the provisions in Code section C.03, corporate employer contributions to an individual’s SAHP are deductible from the corporation’s taxable income.

SAHP.04: Excise Tax for Improper Use: Amounts contributed to a SAHP may only be withdrawn to pay for eligible medical and health care expenses of the account holder (the individual, spouse, or dependents). If amounts are withdrawn from a SAHP and used for some other purpose, the amount used will be included in the account holder’s taxable income for that calendar year. In addition, a 10% penalty excise tax will be assessed on the amount used for purposes other than medical and health care expenses.
Government Insurance and Employment Tax

GICA.01: Employer Liability: Employers are required to withhold and pay taxes pursuant to the Government Insurance Contribution Act (GICA, “Government employment taxes”) with respect to wages paid to their employees. GICA funds Dutan’s trust for providing government-sponsored health care to eligible old-age recipients (individuals over 60 years of age).

GICA.02: Tax Rate: The GICA tax is equal to 5% of wages paid to employees. The tax is payable by the employer.

Excise Taxes

EX.01: Tobacco Products: There shall be imposed an excise tax on the retail sale of any tobacco product (including cigarettes, cigars, and chewing tobacco). The rate of tax is 10% imposed on the retail sales price. The excise tax shall be collected from the purchasers at the point of sale and remitted by the seller to the government. If not collected from the purchaser, the seller becomes liable for the excise tax.

EX.02: Food Sold at Certain Restaurants: An excise tax is imposed on the sale of food at restaurants providing for the quick purchase and delivery of meals (“fast food”). This excise tax is in addition to any other sales tax and is equal to 5% of the sales price. The definition of restaurants providing fast food means any establishment which does not have a wait staff and has an average time for the delivery of food from the point of sale of less than 5 minutes.

EX.03: Monosodium Glutamate and High Fructose Corn Syrup: An excise tax is imposed on the use of monosodium glutamate or high fructose corn syrup in food for human consumption. The excise tax is equal to 5% of the cost of the raw materials (monosodium glutamate and high fructose corn syrup). The tax is imposed on and payable by the food manufacturer that purchases such products and uses them in food for human consumption.
Dutan has a diversified industrial capitalistic economy with roughly the same total and per capita output as Levenia and Slobia. With a population of 45,564,223, the country is divided into a developed industrial west and a less-developed, agricultural east. 10% of Dutan's population is unemployed.

Both public and private businesses contribute to Dutan's economy. Businesses are organized primarily as corporations and individual sole proprietorships. Most raw materials needed by industry and more than 75% of energy requirements are imported.

Over the past decade, Dutan has pursued a tight fiscal policy and has benefited from low interest and inflation rates. The current government has enacted numerous reforms aimed at improving competitiveness, long-term growth, and global competition.

Dutan is growing as a global player with significant cross-border investment. Dutan has moved slowly to implement needed internal structural reforms. Dutan’s official debt remains above 100% of GDP, and the fiscal deficit (1.5% of GDP in 2012) could approach 3% in 2014 as political pressure to stimulate the economy and the costs of servicing Dutan's debt rise.

Real median individual income remained unchanged between 2011 and 2012 at D$31,000. At the same time, the nation's poverty rate rose from 10.25% in 2011 to 10.85% in 2012. It is expected that the economy will continue to contract through 2014 as the global demand for exports drops.

### Percentage Employed According to Size of Employer in Similar Sized Economies

<table>
<thead>
<tr>
<th>Country</th>
<th>1–9</th>
<th>10–99</th>
<th>100–999</th>
<th>Over 1000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dutan</td>
<td>23.2</td>
<td>31.2</td>
<td>29.9</td>
<td>15.7</td>
</tr>
<tr>
<td>Levenia</td>
<td>19.2</td>
<td>27.0</td>
<td>36.5</td>
<td>17.3</td>
</tr>
<tr>
<td>Tarafina</td>
<td>12.4</td>
<td>21.7</td>
<td>41.1</td>
<td>24.8</td>
</tr>
<tr>
<td>Slobia</td>
<td>13.2</td>
<td>22.6</td>
<td>36.0</td>
<td>28.2</td>
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</tbody>
</table>
Dutan’s system of taxation is premised on an individual income tax, which provides the vast majority of the government’s tax revenue.

Individuals can exclude from taxable income amounts provided by their corporate employers for health care expenses including insurance premiums. This exclusion is the largest tax expenditure under the current Dutan tax system.

Corporations are taxable on income and supply the government with its second largest source of tax revenue. However, Dutan has a low corporate tax rate compared to countries of similar size (maximum rate of 12%).

Present law includes few requirements or limitations on the design of corporate employer-provided health care plans. In particular, and in contrast to most other Dutan tax benefits, there is no limitation on the amount of health benefits that a corporate employer can provide on a tax-free basis. This effectively allows corporate taxpayers to control the amount of their tax benefit. Corporate employer-provided health plans are not required to cover all employees or to provide the same benefits to all employees. In addition, the tax exclusion is not predicated on coverage of certain illnesses or conditions.

Self-employed individuals can deduct the cost of his or her health insurance and the cost of health insurance for his or her family.

In addition to the income tax, all employers are required to pay a 5% payroll tax which funds the health care of Dutan’s elderly population. This system is the only government-sponsored health care system and is available only to individuals over 60 years of age.
Corporate employers are the primary providers of health insurance coverage for Dutan's population.

If a corporation does not offer corporate employer-provided health insurance, or if a self-employed individual does not purchase private insurance, a supplemental Savings Account for Health Purposes (SAHP) can be created by either the corporation, employee, or self-employed individual. To date, this benefit has not been widely embraced by the Dutan population because of the risk that health care costs may exceed the amount available in the SAHP.

Traditional corporate employer-provided health insurance remains popular. Nearly ½ of all Dutanis (48.7%) receive health insurance through their corporate employers. While the share of workers relying on corporate employment-based health care coverage has declined from its peak of 55.8% in 2004, access to adequate, affordable health care for a majority of Dutanis is still contingent on their employment status with a corporation. Employees working for the self-employed individual are offered far fewer tax benefits for health care as compared to employees of corporations.

The number of uninsured Dutanis continues to rise as corporations are shedding thousands of jobs every month. The percentage of the nation's population without health insurance coverage grew from 17.9% in 2011 to 18.3% in 2012.

Because most of Dutan's health care benefits are tied to corporate employment, the Dutan government-based health system provides few benefits for the indigent and unemployed population who receive most of their health care from charitable hospitals or free clinics.

### Dutani Mortality Rates

<table>
<thead>
<tr>
<th>Year</th>
<th>Death Rate</th>
<th>Country Rank</th>
<th>Percent Change</th>
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<tbody>
<tr>
<td>2007</td>
<td>10.2</td>
<td>65</td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>10.3</td>
<td>63</td>
<td>1.78%</td>
</tr>
<tr>
<td>2009</td>
<td>10.3</td>
<td>61</td>
<td>0%</td>
</tr>
<tr>
<td>2010</td>
<td>10.4</td>
<td>61</td>
<td>0.97%</td>
</tr>
<tr>
<td>2011</td>
<td>10.5</td>
<td>62</td>
<td>0.96%</td>
</tr>
<tr>
<td>2012</td>
<td>10.6</td>
<td>61</td>
<td>1.05%</td>
</tr>
</tbody>
</table>

### Average Employee Premium per Enrolled Employee for Corporate Employer-Based Health Insurance, 2011

<table>
<thead>
<tr>
<th></th>
<th>D $</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee Contribution</td>
<td>1,004</td>
<td>16%</td>
</tr>
<tr>
<td>Corporate Contribution</td>
<td>5,320</td>
<td>84%</td>
</tr>
<tr>
<td>Total</td>
<td>6,324</td>
<td>100%</td>
</tr>
</tbody>
</table>
Re: Executive Summary

Please prepare an Executive Summary that will be distributed at the meeting. As you develop your Executive Summary, please comply with the following standards:

• Layout
  - Limit content to 2 pages only. Be succinct.
  - Use a size 12 font
  - Format the materials in a way that the reader can easily scan for key points

• Content
  - Identify the 3 tax areas that you suggest be created or modified to finance health care reform in Dutan
  - Summarize the potential impacts on small businesses, the country’s employee workforce, the treasury, and the economy that are discussed in your presentation
  - Within your 2-page summary, include supporting data or commentary that may help the reader understand your recommendations
  - List all resources used in the project

Thank you,
Trevor