KPMG

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Regular commentary from our experts on topical tax issues

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US Tax Reform Framework

Snapshot

The White House and the Republican Party leaders in Congress have agreed on a framework for reforming the US tax system. Called the "Unified Tax Reform Framework" it proposes:

- Reducing from seven to three – 12.5%, 25% and 35% – the number of tax brackets for individuals and replacing specific deductions with a higher standard deduction.
- Repealing taxes that apply on death and the US Alternative Minimum Tax.
- Reducing the US corporate tax rate from 35% to 20%.
- A 25% maximum tax rate for small and family owned US businesses.
- Allowing US businesses to immediately expense their US capital investments.
- Replacing the taxation of US multinationals' worldwide income with a territorial system and deemed repatriation of accumulated profits held offshore.

Much of the detail is still to be worked through. The US political process will also impact what may ultimately be achievable. For New Zealand business, it is a case of keeping a watching brief on US developments.

The release of the framework is the starting point in the US tax reform debate

It proposes significant changes to the US corporate tax rate and how US multinationals will be taxed

For NZ business, it will be a case of keeping a watching brief on US tax developments

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The US Tax Reform framework proposes…

Individual taxation

- Reducing the number of income tax brackets from seven (10%, 15%, 25%, 28%, 33%, 35% and 39.6%) to three (12.5%, 25% and 35%). There is provision in the framework for an additional top rate to apply to the highest-income individuals, if required, to ensure they pay no less tax than currently.
- A "zero" tax bracket for the first US$24,000 of income for married joint filers (and US$12,000 for single filers) through doubling of the standard deduction.
- Removing certain itemised deductions, although the mortgage interest and charitable contribution deductions will remain. The deduction for state and local taxes may be removed or limited.
- Repealing estate taxes and the US Alternative Minimum Tax. The US Alternative Minimum Tax is a top-up income tax liability for certain individuals.

Business taxation

- Reducing the US corporate tax rate from 35% to 20% and removing the corporate equivalent to the Alternative Minimum Tax.
- Business will be able to immediately write-off the cost of new US assets (other than buildings) acquired after 27 September 2017 for at least 5 years.
- Removing/limiting interest deductibility for corporate entities. The treatment for non-corporate business taxpayers is to be considered further.
- Limiting the maximum tax rate for business income of small and family owned businesses conducted by a sole trader, partnership or "look through" corporation to 25%. Rules are proposed to stop wealthy individuals avoiding personal tax at higher rates by structuring through these entities.
- Modernising the special tax regimes for certain industries and sectors.
- Replacing the worldwide taxation of US multinationals with a territorial tax system with an exemption for dividends from foreign subsidiaries.
- As a transitional measure, deeming the repatriation of accumulated earnings held offshore, with payment of tax on those earnings spread over several years.
- Rules to prevent shifting of US profits to offshore tax havens.

The Unified Tax Reform Framework is available **here**. KPMG US's initial observations are available **here**.

What does this mean for New Zealand business?

At this stage, it's a case of keeping a watching brief.

The framework will be a starting point for the US tax reform debate, with many of the details to still be negotiated. Whether the package, or some variation, will be enacted also remains uncertain. However, it does provide some food for thought.

For individuals

- The aim is to flatten the US individual tax brackets, but still retain progressivity for higher income earners. Some of the proposed measures, such as repeal of taxes on death may arguably reduce this progressivity.

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- Another proposal is to replace (most) deductions against income for individuals with effectively a (higher) tax-free threshold. The non-deductibility of expenses for individuals will be familiar to New Zealanders, but it is not the norm for many countries.

For business

- A significant reduction in the US headline corporate rate is proposed. The impact will depend on the proposed removal of interest deductions for companies and other (unspecified) tax loopholes. This will vary by business, capital structure and industry sector. Successful lobbying by particular industries or companies may also affect this.

- The proposal to move away from taxing the worldwide income of US multinationals is significant. Presently, US tax is only paid when US multinationals repatriate their foreign profits. The proposal is to tax only currently accumulated foreign earnings (at a "to be determined" rate). Future dividends would not be taxed. How this fits with proposals to tax multinationals more widely is uncertain.

What's missing?

The trillion dollar question is the cost of this latest tax reform plan and how it will be funded.

The disappearing Border Adjustment Tax?

Previous versions of the Trump and Republican Congress tax plans had an offsetting Border Adjustment Tax ("the BAT"). Under the BAT, deductions would be allowed for US manufactured goods but not for goods manufactured outside the US. Income from exported goods would not be taxable. The BAT, therefore, operates like a GST on imported goods, with exports zero-rated.

The obvious concern for NZ business will be how this would affect their direct US sales and any operations they may have in the US. It appears that the BAT has been discarded for now. However, it may be revived as part of the future detail to address concerns about the revenue gap.

Economic growth

Otherwise, the framework relies on the growth of the US economy to ensure that the tax cuts fund themselves. That approach has normally been viewed with some scepticism in New Zealand. Tax rate cuts here have generally been accompanied by either broadening of the base (increasing income or adding new taxes) to ensure budget neutrality.

The US position, as with the fate of the tax reform proposals themselves, remains unclear.

For further information

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