Obama submits FY 2016 budget to Congress

Proposal includes taxation system reform for US companies' foreign earnings and higher tax on capital gain for upper income taxpayers

Summary

- *US President Barack Obama submitted his budget plan for the 2016 fiscal year to Congress on 3 February 2015.*
- *The budget proposal includes a fundamental reform of the taxation system for US companies' foreign earnings, which is expected to raise USD 474 billion over 10 years.*
- *The budget proposal would impose a minimum tax on foreign earnings above a risk-free return on equity invested in active assets.*
- *It would also impose a one-time 14 percent tax on earnings accumulated in controlled foreign corporations that have not previously been subject to US tax.*

On 3 February 2015, US President Barack Obama submitted his FY 2016 budget to Congress. The budget contains the administration's recommendations to Congress regarding spending and taxation for the fiscal year beginning 1 October 2015.

The US president's submission of the budget to Congress marks the start of the US budget process. While the president's budget proposal is lengthy and contains many of the proposals made in prior budgets, a few of the key proposals that may be of interest to Hong Kong and China taxpayers are summarised below.

The budget proposal includes a **fundamental reform of the taxation system for US companies' foreign earnings**, which is expected to raise USD 474 billion over 10 years. Under current US tax law, earnings of controlled foreign corporations (CFCs) are not generally subject to tax until repatriated in the form of dividends or upon the disposition of the shares in such subsidiary. The Subpart F rules are an exception to this general rule – under these rules, passive income (i.e. interest, dividends and investment income) and income earned from certain related party transactions by the CFC are currently taxed.

In place of the current system of deferral, the budget proposal would impose a minimum tax on foreign earnings above a risk-free return on equity invested in active assets. The minimum tax, imposed on a country-by-country basis, would be set at 19 percent less 85 percent of the per country foreign effective tax rate. The new minimum tax would be imposed on a current basis, and foreign earnings could then be repatriated without further US tax liability.

As part of the transition to the new system of taxation for foreign earnings, the budget would also impose a one-time 14 percent tax on earnings accumulated in CFCs that have not previously been subject to US tax. A foreign tax credit would be allowed for foreign taxes associated with those earnings, reduced in proportion to the one-time tax rate relative to the maximum corporate rate. The transition tax would be payable rateably over five years.

If these proposals were to be enacted, the earnings of US companies' subsidiaries located in China and Hong Kong may need to be repatriated to the US to fund the tax liability.

For US individuals, one of the key sets of revisions proposed by the US president involves **reforms to the taxation of capital gains for upper income taxpayers**. The highest tax on capital gains would be increased from 23.8 percent (including the 3.8 percent net investment income tax) to 28 percent. In addition, a transfer of appreciated property would generally be treated as a taxable sale of the property. Under current law, the transfer of appreciated property by gift or at death is not subject to tax. Thus, the donor or deceased owner of an appreciated asset would be subject to capital gains tax on the excess of the asset's fair market value on the date of the transfer over the transferor's basis. The proposal provides a USD 100,000 per person exclusion for gains realised by reason of death, and would continue the current law exclusion for principal residences.

Further insights

An analysis of the US president's budget can be found here.

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