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GMS Flash Alert

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United States - Administration's Unified Framework for Comprehensive Tax Reform Released

On September 27, 2017, the White House, Republican leaders of the U.S. House and Senate, and the chairs of the House and Senate tax-writing committees released a "Unified Framework for Fixing Our Broken Tax Code" (the Framework).[1]

The document contains a statement of goals which indicates that the Framework "serves as a template for the tax-writing committees that will develop legislation through a transparent and inclusive committee process. The committees will also develop additional reforms to improve the efficiency and effectiveness of tax laws and to effectuate the goals of the framework."

WHY THIS MATTERS

While the Framework does not include any significant technical details or effective dates, and provides that the U.S. Congress will flesh out most, if not all, of the actual tax provisions, it does provide an indication of what changes may be in store for American taxpayers. The Framework declares that it intends to provide tax relief for middle-class families and to not increase the tax burden on lower-income taxpayers, but it does not provide enough details to permit a realistic evaluation of these claims.

Individual Tax Proposals

The Framework follows up on the Trump administration's tax plan announced in April 2017 that outlined the president's vision for tax reform.[2]

The Framework includes the following proposals of relevance to individuals:

Individual Tax Rates and Indexing – The Framework proposes reducing the existing seven bracket structure, ranging from 10 percent to 39.6 percent, to three brackets at 12 percent, 25 percent, and 35 percent. However, the Framework expressly leaves open the possibility that the tax-writing committees could create a fourth top bracket, noting that "an additional top rate may apply to the highest-income taxpayers." Additionally, the income thresholds applicable to the new tax brackets are not specified, leaving those details to the tax-writing committees.

The Framework also notes that the "use of a more accurate measure of inflation for purposes of indexing the tax brackets and other tax parameters" is envisioned, although no details regarding the nature of that more accurate measure is provided.

Standard and Itemized Deductions – The standard deduction would be almost doubled to $12,000 (single filers) and $24,000 (married filing jointly) under the Framework. However, personal exemptions for taxpayers, spouses, and dependents would be eliminated.

While this change is heralded as a significant increase in the deduction available to the middle-income taxpayer, it should be noted that under current rules the combined standard deduction and personal exemptions for a married couple filing jointly in 2017 would be $20,800 ($28,900 if they had two dependent children).

The Framework proposes the elimination of "most" itemized deductions but specifies that the tax incentives for home mortgage interest and charitable contributions would be retained.

KPMG NOTE

The plan to eliminate most itemized deductions presumably includes some limitation, if not repeal, of the deduction for state and local taxes. Elimination of that deduction, when combined with the increased standard deduction, would have the effect of eliminating the benefit of itemizing deductions for many taxpayers who currently itemize. Any change to the permissible itemized deductions could have a significant impact on hypothetical "stay-at-home tax" calculations for international assignees, as well as actual tax liabilities for inbound U.S. assignees.

Small and family-owned businesses conducted as sole proprietorships, partnerships and S corporations – The Framework proposes limiting to 25 percent the maximum tax rate applied to pass-through business income from small and family-owned businesses conducted as sole proprietorships, partnerships, and S corporations. It also contemplates that the tax-writing committees will "adopt measures to prevent the recharacterization of personal income into business income to prevent wealthy individuals from avoiding the top personal tax rate."

KPMG NOTE

Although the Framework indicates that the maximum tax rate for pass-throughs and sole proprietorships would apply to "small" and "family-owned" businesses, it does not expressly state that this rate would apply *only* to such entities. Further, the Framework does not specify what kinds of measures the tax-writing committees might adopt to prevent recharacterization of "personal" income into business income, although it certainly suggests that such measures will be included. Thus, pass-through entities such as law firms and accounting firms as well as sole proprietorships will need to watch how the tax-writing committees address the scope of the pass-through rate proposal (e.g., whether the rate might apply only to certain pass-throughs and what "anti-abuse" rules might be provided).

Alternative Minimum Tax – The Framework proposes the repeal of the individual Alternative Minimum Tax (AMT). However, given the proposed reduction in the number of tax brackets and the elimination of most itemized deductions, it is not clear at this point whether the elimination of the AMT would result in a tax savings for most taxpayers currently subject to it.

Other Individual Income Tax Items – The Framework identifies a number of other reform proposals and goals affecting individual taxpayers, although few details are provided. These items include:

- A "significantly" increased child tax credit, with the first $1,000 refundable and modified phase-out income thresholds.
- A nonrefundable $500 non-child dependent credit which replaces the $4,050 non-child dependent exemption deduction. Note that the value of the dependent exemption for a taxpayer in the 12-percent bracket is approximately $500. As a result, the tax value of a non-child dependent for a taxpayer in the higher 25-percent or 35-percent bracket will be less as compared to current law.
- Retention of tax benefits (such as deductions and credits) that "encourage work, higher education and retirement." The Framework notes that the tax-writing committees are encouraged to simplify and improve these benefits and to work to maintain or increase worker participation in retirement plans and resource availability.
- The repeal of many other exemptions, deductions, and credits to "make the system simpler and fairer" and to allow for lower rates.

Estate and Generation-Skipping Transfer Taxes – The Framework would repeal the estate tax and the generation-skipping transfer (GST) tax. No details are provided regarding whether any changes will be made to other related matters, such as stepped-up basis for inherited assets or whether the gift tax would be retained in its current form or at all.

KPMG NOTE

For a discussion of the business and multinational business tax proposals contained in the Framework, see "KPMG report: Unified framework for comprehensive tax reform, initial observations" (September 27, 2017).

Given the vicissitudes associated with the legislative process, it remains uncertain whether significant tax legislation will be enacted in the near future. Whatever details any final legislation may contain, these will likely cause significant changes in tax rates, deductions, and credits for all U.S. taxpayers. Such changes will likely impact U.S. inbound and outbound assignment costs.

FOOTNOTES:

1 To access the text of the nine-page document, “Unified Framework for Fixing Our Broken Tax Code,” click here.

For the White House press release “Unified Framework for Fixing Our Broken Tax Code, (September 27, 2017), click here.

2 For related coverage, see GMS *Flash Alert* 2017-081 (April 28, 2017).

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