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TAX REFORM PLAN OF THE UNITED STATES

To live up to his election campaign's promises of reforming the tax system, strive for a sustained 3 percent growth for the American economy, create jobs, provide tax relief to American families, lower business tax rate and to simplify the tax code, U.S. President Donald Trump unveiled his 2017 Tax Reform for Economic Growth and American Jobs proposal on April 26, 2017. The proposal is a broad outline which does not explain in details on how the goals can be achieved, leaving an impression that the proposal is bold but vague. It is possible that President Trump has done this purposely to just lay down broad principles so as to leave room for Republicans in the House of Representatives to continue crafting a plan. Nonetheless, the Trump Administration promised to hold listening sessions with stakeholders to receive their input and to work with the House of Representatives and the Senate to develop details to the proposal. The White House Budget Director Mick Mulvaney had pledged to follow up the proposal with more details in June 2017.

On 27 September 2017, the US President, Donald J. Trump released the US tax relief plan to strengthen the middle class, grow the economy and unleash America's economic comeback. The plan calls for a comprehensive tax reform that will lower both business and individual tax rates. For individuals, the focuses are on:

1. Providing tax relief for American families, especially middle income families by:
   - reducing the 7 tax brackets to 3 tax brackets of 12%, 25% and 35%
   - Increasing the standard deduction for individuals to US$24,000 for a married couple and US$12,000 for an individual;
   - providing tax relief for families with child and dependent care expenses

2. Simplifying the code by:
   - eliminating targeted tax breaks that mainly benefit the wealthiest taxpayers
   - protecting the home ownership and charitable gift tax deductions
   - repealing the Alternative Minimum Tax (AMT)
   - repealing the Estate Tax

On the business tax reform side, the targets are:

- to lower business tax rate to 20%
- to adopt a territorial tax system to level the playing field for American companies
- to introduce a one-time low tax rate for American companies to bring back their trillions of dollars held overseas.
- to eliminate tax breaks for special interests
- For the next five years, American businesses will be able to immediately write off the cost of their equipment and other capital investments.

Certain points included in the Plan are worth noting:

Territorial tax system

Adopting a territorial system for taxing foreign profits of U.S. companies is a bold idea. Currently, foreign profits being repatriated by a U.S. parent company to the U.S. is subject to a 35% domestic tax rate, which if not the highest is among the highest corporate tax rate in the world, with a credit for tax paid in the foreign jurisdictions. This undoubtedly discourages many U.S. companies in bringing home their overseas after-tax profits.

Trump's Plan calls for a one-time tax rate of about 10% for US companies to bring back their previously accumulated cash sitting in foreign accounts; and all future foreign profits to be repatriated with no federal income tax. Trump is hoping that big companies like Apple, which has $240 billion in cash and equivalent held overseas, would bring home their offshore holdings and use them to hire more American workers at home.

To avoid paying high U.S. corporate taxes on foreign profits, American companies have often reinvested their money abroad instead of repatriating it to U.S. shores. U.S. companies hold an estimated $2.8 trillion in earnings offshore, according to Audit Analytics. This plan will stop the "Offshoring Model," which penalizes companies for incorporating in the United States.

The House Republicans released their blueprint for tax reform in June 2016 which proposes to repeal certain part of the "subpart F" regime that subjects certain foreign base company income of controlled foreign corporations to current U.S. taxation. The part of the subpart F rules being focused on are those intended to discourage U.S. multinational companies from conducting certain activities overseas. If the U.S. will indeed move towards a territorial tax system whereas income will be taxed based on where goods are sold or services are performed, the tax reason to locate business activities outside of the U.S. would no longer exist and thus making certain parts of the subpart F regime unnecessary. Therefore, adopting a territorial tax system will have tremendous implications on the current subpart F rules.

Lower corporate tax rate

The current 35% corporate tax rate is the highest rate among all developed economies. The high tax rate has tempted many US companies to use tax inversion transactions to change their domicile so they can take advantage of lower tax rates in other jurisdictions. Lowering the corporate tax rate from the current level to a thrilling 20% and eliminating the AMT are exciting.

Individual partners of partnerships and individual owners/sole proprietorships will also benefit from the proposed 25% business tax rate as this rate will also apply to pass-through entities.

Repeal Estate Tax

The federal estate and gift tax exemption for 2017 is US$5.49 million. A U.S. person who dies during 2017 with assets worth more than the exemption amount can be subject to a marginal estate tax rate of 40%. Repealing the Estate Tax certainly will be warmly welcomed by wealthy American families. Whether this is a true repeal and will there be any replacement measures introduced would require further observation. Specific issues shall be taken into consideration in the legislation, such as whether the step-up in basis to fair market value for transfer of property at death will continue to be allowed, and if allowed, inherited gains will not be subject to tax as well.

Simple, Fair “Postcard” Filing

By simplifying the tax codes, resources can be shifted from preparing tax returns and interpreting tax codes to more value creating activities. Upon implementation of the proposed changes, most taxpayers will be able to file their taxes on a form as simple as a postcard. This could be achieved by:

- Eliminating the confusing maze of special interest deductions that add complexity for families and keep rates artificially high for all taxpayers;
- Lowering tax rates across the board for individuals and families and reducing the number of tax brackets from seven to three;
- Increasing the standard deduction so that the vast majority of taxpayers don’t have to deal with the hassle of itemizing; and
- Preserving and simplifying important provisions that support families, including those that help Americans buy a home, send their kids to college, and donate to their local church or charity.

Process and timing of enacting tax legislation

Under the U.S. Constitution, all legislation concerning taxes must originate in the House of Representatives. The House must take action on the legislation before the Senate can begin its consideration. Legislation begins in the House Ways and Means Committee (“Committee”), which is responsible for considering all tax legislation.

As the President’s tax reform plan is light on details and many points coincide with those included in the blueprint, the Committee will likely use the House of Representatives Republican Tax Reform Task Force blueprint which was released on June 24, 2016 as the starting point and schedule hearings of testimony. A blueprint is a high-level conceptual document. The Secretary of the Treasury Steven Mnuchin should be the first to testify and the Director of the Office of Management and Budget Mick Mulvaney may follow.

When the Committee concludes its hearings, the Committee members meet in executive sessions to "mark up" a proposal. As the Committee reaches tentative decisions on the proposals, it will draft them into legislative language and also prepares a detailed report on the proposed Legislation. The report presents the Committee's reasons for recommending the bill. The Internal Revenue Service and the courts may use this Committee report as an interpretation of the legislation. Once the bill and the report are completed, the full House will vote on the Committee’s bill.

The Senate Finance Committee is responsible for all Senate legislation dealing with tax matters. This Committee begins its formal work on the legislation after the House has passed its version of the bill. It holds hearings similar to those held earlier by the House Ways and Means Committee to consider the bill passed by the House. Witnesses appear at the Senate Finance hearings in the same order as in the Ways and Means Committee.

After the hearings are finished, the Senate Finance Committee marks up the House bill and then reported to the full Senate for floor action. A report gets filed along with the bill. The report explains in detail the amendments made by the Finance Committee. The entire Senate then debates the bill.

In the Senate, a bill requires a supermajority vote of 60 votes in order that the bill can move forward in the Senate. Republicans currently hold 52 seats in the Senate, in order to get a bill to pass the Senate with a supermajority vote; Republicans will need support from some Democratic Senators. Only when a supermajority vote is received from the Senate, a bill which passed the House and signed by the President can become a permanent law; otherwise, the law will be temporary.

Where a supermajority vote cannot be obtained, budget reconciliation rules allow legislation to be moved forward in the Senate with only a simple majority vote. Under budget reconciliation, legislation generally cannot create a deficit beyond 10 years. Therefore, if budget reconciliation is used to pass a tax reform bill, phase-outs, sunset schedules and other means may need to be incorporated into the bill so as to comply with the budget reconciliation requirements. Phasing out reforms after 10 years is not ideal as some businesses may consider a 10-year tax cut too short a period for the long-term commitments they require for investment and expansion decisions.

If the Senate passes the House version of the bill, without amendments, it gets sent directly to the President. However, the Senate usually passes its amended version of the House bill. Then, there is further Congressional action required to resolve the two versions of the bill into one.

The bill with the Senate amendments gets returned to the House of Representatives. Next, the House usually will disagree with the Senate amendments. A Conference Committee then gets appointed to resolve the differences and produce a conference agreement. The House and Senate then would vote on the conference agreement and send the legislation that they pass to the president for his signature or veto.

The 1986 Tax Reform Act took about 13 months to be enacted. We anticipate that it will take at least the same amount of time for the 2017 tax reform bill to work its way through the House and Senate before being signed into law by the U.S. President.

RSM Tax Advisory (Hong Kong) Limited

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- Review existing cross-border investment structures, advise on identified deficiencies, quantify any potential exposure from such deficiencies, and further advise on restructuring approach and procedures
- Assist clients to discuss and clarify matters with tax officials, including transfer pricing and advance rulings
- Act as client representative in tax audits and tax investigations
- Provide transaction support services on mergers and acquisitions, including tax due diligence, deal structure advice, tax health checks, related human resources arrangements and other tax compliance and consultation services
- Advise on human resources and structuring employment arrangements in a tax-efficient manner
- Advise on tax equalization schemes
- Provide tax compliance services for individual and corporate clients in Hong Kong and China

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