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Tax Cuts and Jobs Act: Mobility and Rewards

House Ways and Means Committee summary of key provisions

November 6, 2017

Overview

On November 2, 2017, the House Ways and Means Committee released details of their proposed tax reform bill, referred to as the "Tax Cuts and Jobs Act" ("the Act"). This much-anticipated draft legislation provides details of various potential tax law changes, most of which would be effective January 1, 2018. As expected, the bill contains provisions geared towards lowering income tax rates for corporations and individuals, an increase in standard deduction for individuals, and the simplification of the tax code by repeal of various deductions and the alternative minimum tax.

Refer to the November 3, 2017 Tax News and Views publication for a detailed discussion of the Act.

Key provisions impacting Mobility programs

Lowering of individual income tax rates

Proposal*:* Reduce number of tax brackets to four, 12%, 25%, 35%, and 39.6%, and increase income thresholds applicable at the lower levels.

At a high level, the brackets cover income at the following levels:

- 12% - Income up to $44,999 for single/Married Filing Separately (MFS) and $89,999 for Married Filing Jointly (MFJ)
- 25% - Additional income up to $199,999 for single/MFS and $$259,999 for MFJ
- 35% - Additional income up to $499,999 for single/MFS and $999,999 for MFJ
- 39.6% - Income over the 35% bracket, with some modifications

Observation: As a result, tax reimbursement costs for tax equalized assignments would change, depending on the mix of assignees inbound and outbound to the U.S., and also to high or low-tax countries. Companies may consider projecting the overall impact of this compression of brackets and lowering of rates on their projected tax reimbursement costs.

Increased standard deduction and repeal of personal exemptions

Proposal: Increase standard deduction to $12,000 for single individuals, $18,000 for single filers with a qualifying child, and $24,000 for joint filers, and repeal all personal exemptions.

Observation: The repeal of personal exemptions would potentially result in increased tax reimbursement and tax preparation costs for companies sending employees on business travel or assignments to the U.S. Nonresident and dual-status resident taxpayers are not entitled to a standard deduction, and without a personal exemption, a nonresident or dual-status resident individual will be taxable in the U.S. on the first dollar of income earned in the U.S. As a result, more individuals traveling to the U.S. would be required to file a U.S. tax return. Companies should consider the impact of any additional tax reimbursement and compliance costs on their global mobility program.

Reduced mortgage interest deduction

Proposal: The bill limits the deduction for mortgage interest to only the taxpayer's principal residence, as opposed to the current law which allows mortgage interest to be deducted on the principal residence and one other property. Further, the maximum amount of indebtedness to be considered acquisition indebtedness is reduced from $1 million to $500,000. Finally, interest on home equity indebtedness incurred after the effective date of the bill will no longer be deductible.

Observation: Taxpayers on assignment who maintain homes in both their home and host countries would see limits on the amount of interest that can be deducted further increasing tax costs. Companies should consider how these increased costs would impact current and future international assignments.

Modified IRC Sec. 121 gain from sale of a principal residence

Proposal: The exclusion of gain from the sale of a principal residence is still available, but the provisions and conditions have changed. To exclude the gain, an individual would have to own and use a home as the individual's principal residence for five out of the previous eight years. Further, the exclusion would only be available once every five years. Finally, the exclusion is phased out by one dollar for every dollar by which a taxpayer's adjusted gross income exceeds $500,000 ($250,000 for single filers).

Observation: This provision requires taxpayers to live in their homes for a longer period in order to exclude gain, and additional provisions may lower the benefit of this exclusion. As a result, fewer taxpayers would qualify to exclude the full gain on the sale of their home. Companies should recognize that this provision may impact an employee's decision on whether to accept a global assignment and may need to review their tax reimbursement policies to address this situation.

Repeal of deduction for moving expenses and exclusion for qualified moving expense reimbursement

Proposal: The provision repeals moving expense deduction and exclusion for qualified moving expense reimbursements.

Observation: Moving expense reimbursements paid by an employer to an employee that in the past were not taxable to the employee will now be taxable. Companies may see an increased tax cost relating to the gross-up of these reimbursements.

Limitation on exclusion for employer-provided housing (not housing exclusion under Sec. 911)

Proposal: Under current law, housing and meals provided to an employee living on a property provided by the employer and for the convenience of the employer are excluded from income if the meals are on the business premises of the employer and the employee is required to accept lodging on the premises of the employer as a condition of employment.
The bill limits the exclusion for housing provided for the convenience of the employer and for employees of education institutions to $50,000 ($25,000 for a married individual filing a joint return) and would phase out for highly compensated individuals.

Observation: The limitation on the exclusion for employer-provided housing could have a greater impact in certain industries where companies send individuals to work in remote locations (such as, oil and gas, construction or engineering). These employees live in campsites provided by the employer for the convenience of the employer and for security purposes. Under the proposed tax bill, employers in these types of industries may see an increase in tax reimbursement costs for the housing provided.

Key provisions impacting Rewards programs

Reduced corporate tax rates

Proposal: The bill reduces the corporate tax rate from 35% to a flat rate of 20% for tax years beginning after 2017.

Observation: Companies may want to consider accelerating corporate tax deductions into 2017 to increase the value of their deductions in the event of a future rate decrease. With respect to a company's rewards programs, there may be opportunities to accelerate deductions relating to bonus programs, restricted stock units, pension contributions, and VEBAs. Some of the accelerations require that companies take action before year end.

Additional qualified retirement plan choices

Proposal: The bill allows additional flexibility with respect to in-service distributions (while employees are still actively working), hardship distributions, and loan repayments for terminated employees. The bill also makes certain modifications to the so-called "nondiscrimination" testing rules that would allow certain "closed" defined benefit plans to more easily satisfy the nondiscrimination testing rules. These provisions would generally be effective for plan years beginning after 2017.

Observation: Plan sponsors may want to revisit their plans and determine whether they wish to take advantage of these new design choices. Alternatively, plan sponsors may want to rethink their older defined benefit plans in light of the greater ability of frozen plans to pass discrimination testing.

Limitation on nonqualified deferred compensation programs.

***Proposal**:* The bill provides that employees are subject to tax on compensation (including equity compensation such as options and stock appreciation rights) once no longer subject to a requirement to provide future service. The bill would be effective for amounts attributable to services performed after 2017 and would apply to existing arrangements to the extent that services are required in 2018 or later to earn previously deferred compensation. Other arrangements could continue to defer compensation under existing law until the last tax year beginning before 2026.

***Observation**:* The bill would significantly curtail an employee's ability to defer vested compensation in a tax-efficient manner. Companies may want to review existing executive compensation programs to determine potential impact.

Modification of limitation on excessive employee remuneration.

***Proposal**:* The bill expands the current limitation on deduction of compensation paid to 'covered employees' under section 162(m) by (1) eliminating the exclusions for commissions or performance-based compensation, including performance-based bonus plans, stock options, and stock appreciation rights, (2) including the CFO as a covered employee subject to limitation, along with the CEO and three most highly compensated officers as shown in SEC disclosures, and (3) providing that status as a covered employee continues to apply if the person was ever a covered employee. The provision would be effective for tax years beginning after 2017.

***Observation**:* Companies may want to consider the impact of potentially lost deductions and reconsider the structure of compensation packages provided to covered employees.

Repeal of exclusion for certain fringe benefit programs.

***Proposal**:* The bill repeals the exclusion for certain benefit programs typically offered by employers, such as dependent care assistance programs, adoption assistance programs, and employee achievement awards. These provisions would be effective for tax years beginning after 2017.

***Observation**:* Companies may wish to review the impact these changes would have on their total rewards strategy and determine whether alternative programs or modifications would help meet employee needs.

Deemed repatriation of deferred foreign income.

***Proposal**:* U.S. shareholders owning at least 10% of a foreign subsidiary, generally, would include in income for the subsidiary's last year beginning before 2018, the shareholder's pro rata share of historical earnings and profits ("E&P") of the subsidiary to the extent such amounts have not previously been subject to US tax. This income will be taxed at special rates and may be spread over a period of 8 years.

***Observation**:* As companies calculate their E&P under this new provision, one complex area that is often overlooked and may have a significant impact on the determination of E&P relates to the deduction of foreign pensions under IRC Sec. 404A. Generally, these rules allow employers to reduce their E&P for contributions made, or liabilities accrued, with respect to certain foreign retirement plans.

Deloitte's view

Although tax reform has been a key focus of political discussion since the presidential campaign and throughout President Trump's first year in office, the release of the Tax Cuts and Jobs Act draft bill represents one of the most significant steps towards passage that we have seen yet.

Procedurally, it is important to note that the legislation is only a draft presented by the Ways & Means Committee. There are still several steps that must be completed before this bill becomes law. Nevertheless, it represents the first substantive release from Congress that articulates potential tax reform provisions. Congress and the President remain committed to passing tax reform before the end of the year and global organizations should continue to stay aware of developments to be able to plan for potential changes.

The impact to global mobility and rewards programs should not be overlooked. Although the Act is aimed at reducing tax burdens for individuals and organizations, certain benefits or deductions must also be reduced to meet Congressional budgetary requirements and certain company departments or individuals may actually see an increase in overall tax burdens. These changes could have a significant impact on mobility and rewards programs and may motivate companies to revisit their current policies.