US Tax Reform
Understanding the impact to mobility and rewards programs
Tax reform has been a key priority of Congress and President Trump in 2017 and represents the largest changes to the US tax system in over 30 years. The changes are largely focused on reducing the tax burden on individuals and companies; core elements include reducing corporate, passthrough, and individual tax rates and encouraging the “on-shoring” of profits and jobs to the US. The potential impact of tax reform on US companies is a high priority issue and the effect to HR and global mobility programs should not be overlooked.

The below summary highlights key provisions of the US tax reform legislation passed by the House and Senate (formally referred to as “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018”) ("New Law" or “the Act”) that may impact company mobility and rewards programs.

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Key provisions impacting mobility programs

Lowering of individual income tax rates

**Current Law:** Individual marginal rates and brackets as listed below.

<table>
<thead>
<tr>
<th>Tax rate</th>
<th>Single</th>
<th>Heads of household</th>
<th>Married filing joint</th>
<th>Married filing separate</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>$0–$9,525</td>
<td>$0–$13,600</td>
<td>$0–$19,050</td>
<td>$0–$9,525</td>
</tr>
<tr>
<td>15%</td>
<td>$9,526–$38,700</td>
<td>$13,601–$51,850</td>
<td>$19,051–$77,400</td>
<td>$9,526–$38,700</td>
</tr>
<tr>
<td>25%</td>
<td>$38,701–$93,700</td>
<td>$51,851–$133,850</td>
<td>$77,401–$156,150</td>
<td>$38,701–$78,075</td>
</tr>
<tr>
<td>28%</td>
<td>$93,701–$195,450</td>
<td>$133,851–$216,700</td>
<td>$156,151–$237,950</td>
<td>$78,076–$118,975</td>
</tr>
<tr>
<td>35%</td>
<td>$424,951–$600,050</td>
<td>$424,951–$424,950</td>
<td>$240,025</td>
<td>$240,025</td>
</tr>
<tr>
<td>39.6%</td>
<td>$426,701+</td>
<td>$453,351+</td>
<td>$480,051+</td>
<td>$240,026+</td>
</tr>
</tbody>
</table>

Current law also provides for an alternative minimum tax ("AMT") to ensure that individual taxpayers pay a basic amount of federal income tax. This AMT is determined by setting aside certain "preference" items that are otherwise deductible in determining a taxpayer’s federal income tax.

**New Law:** Adjusts tax rates and brackets as listed below, including a reduction of the top tax rate from 39.6% to 37%. These rates will sunset after 2025.

<table>
<thead>
<tr>
<th>Tax rate</th>
<th>Single</th>
<th>Heads of household</th>
<th>Married filing joint</th>
<th>Married filing separate</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>$0–$9,525</td>
<td>$0–$13,600</td>
<td>$0–$19,050</td>
<td>$0–$9,525</td>
</tr>
<tr>
<td>12%</td>
<td>$9,526–$38,700</td>
<td>$13,601–$51,800</td>
<td>$19,051–$77,400</td>
<td>$9,526–$38,700</td>
</tr>
<tr>
<td>22%</td>
<td>$38,701–$82,500</td>
<td>$51,801–$157,500</td>
<td>$77,401–$315,000</td>
<td>$38,701–$157,500</td>
</tr>
<tr>
<td>24%</td>
<td>$82,501–$157,500</td>
<td>$157,501–$200,000</td>
<td>$165,001–$400,000</td>
<td>$82,501–$200,000</td>
</tr>
<tr>
<td>32%</td>
<td>$157,501–$500,000</td>
<td>$200,001–$500,000</td>
<td>$315,001–$600,000</td>
<td>$157,501–$500,000</td>
</tr>
<tr>
<td>35%</td>
<td>$200,001–$500,000</td>
<td>$500,000</td>
<td>$400,001–$600,000</td>
<td>$200,001–$300,000</td>
</tr>
<tr>
<td>37%</td>
<td>$500,001+</td>
<td>$500,001+</td>
<td>$600,001+</td>
<td>$300,001+</td>
</tr>
</tbody>
</table>
The Act also increases exemption amounts and phase-out levels for individual AMT.

**Observation:** Tax reimbursement costs for tax equalized assignments could change, potentially increasing or decreasing, depending on the mix of assignees inbound and outbound to the US, and tax rate regime of host country (i.e., high-tax or low-tax countries). Companies may consider projecting the overall impact of this lowering of rates on their projected tax reimbursement costs for cost accrual and/or planning purposes. Additionally, the increased exemption amount for AMT will result in fewer taxpayers subject to AMT.

As a result of lower individual income tax rates and a reduction in AMT, the personal tax obligation of assignees tax equalized to the US will change and companies may wish to consider updating hypothetical tax calculations and educating this group on the impact the changes will have on their net pay.

**Increased standard deduction and repeal of personal exemptions.**

**Current Law:** Individual taxpayers are entitled to both a standard deduction and personal exemption. The current law allows a standard deduction of $6,350 for single individuals, $9,350 for single filers with a qualifying child, and $12,700 for joint filers. A personal exemption of $4,050 is available for each member of a household, phasing out above certain thresholds.

**New Law:** The Act increases the standard deduction to $12,000 for single individuals, $18,000 for single filers with a qualifying child, and $24,000 for joint filers, and repeals all personal exemptions, except the additional standard deduction for the elderly and the blind. There are no phase-outs of these amounts. These changes will sunset after 2025.

**Observation:** This change will also impact the personal tax obligations of assignees, similar to the reduction in tax rates and will result in the same considerations outlined above. Further, the repeal of personal exemptions may result in increased tax reimbursement and tax preparation costs for companies sending employees on business travel or assignments to the US. 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 would be taxable in the US on the first dollar of income earned in the US. As a result, more individuals travelling to the US would be required to file a US tax return. Companies should consider the impact of any additional tax reimbursement and compliance costs on their global mobility program.
Changes to itemized deductions.
Several changes were made to itemized deductions. Those that impact mobility assignees are described below:

**Current Law:** The law currently allows an unlimited itemized deduction for state and local income tax, property tax, and/or sales tax. Current law also allows an itemized deduction for interest paid on acquisition indebtedness of up to $1 million associated with a primary residence and up to one additional residence. Additionally, the law allows a deduction on interest paid with respect to a home equity loan of up to $100,000.

**New Law:** The Act places substantial new limits on the ability of taxpayers to deduct state and local taxes. Specifically, it only allows a deduction of only up to $10,000 for state and local income, sales, and/or property taxes. No deduction is allowed for foreign property taxes paid on a nonbusiness property (e.g., a personal residence).

The Act lowers from $1 million to $750,000 the maximum amount of indebtedness on a qualified residence to be considered deductible acquisition indebtedness; this limit applies to new loans secured after December 15, 2017, and continues to apply to a primary residence and a second home. Existing loans will be subject to the prior limitations. However, interest on home equity indebtedness will no longer be deductible.

These provisions will sunset after 2025, after which time acquisition indebtedness – regardless of when it was acquired – will be subject to current law, as will state and local tax payments.

**Observation:** Changes to itemized deductions will directly impact the tax liability of assignees, on both an actual and hypothetical basis, with a significant impact for individuals in high tax states. Companies may consider updating hypothetical tax calculations and educating this group on the impact the changes will have on their net pay. The restriction of the property tax deduction to US properties will limit the ability of assignees who own a home in a foreign jurisdiction to deduct the related expenses.

Further, when combined with the increased standard deduction described above, companies may want to review their tax equalization policy to consider how they currently handle itemized deductions for hypothetical purposes and whether that policy should be updated to reflect the new law.
Expanded child tax credit.

Current Law: Current law allows for a $1,000 credit per child under age 17. This credit is phased out for taxpayers with adjusted gross income ("AGI") greater than $110,000 for joint filers and $75,000 for other taxpayers.

New Law: The Act expands the credit to allow for $2,000 per child under age 17 and $500 per non-child dependent per family. The credit is phased out for joint filers with AGI greater than $400,000. In addition, up to $1,400 of the credit per qualifying child is refundable. The refundable portion of the credit requires the taxpayer to provide a Social Security number (SSN) for the child; however, a child who is ineligible to receive the credit because the child does not have a SSN may still qualify for the non-refundable $500 credit. These changes are scheduled to sunset after 2025.

Observation: The higher AGI limit for the phase-out will allow a greater number of taxpayers to avail themselves of the credit. However, the requirement to provide a SSN may limit the overall benefit of the credit to assignees working temporarily in the US, whose children are often not eligible for a SSN. With the repeal of personal exemptions and inability to claim the maximum child tax credit without a SSN, the tax benefits of applying for an Individual Taxpayer Identification Number (ITIN) will be significantly reduced, and taxpayers may choose to forego this application for their children. Companies should consider the overall impact that this change will have on their program costs for US inbound assignees and also weigh the costs of obtaining ITINs against the potential tax benefits.

Repeal of exclusion for qualified moving reimbursement.

Current Law: Qualified moving expenses are deductible by taxpayers for certain work-related moves; qualified moving expenses reimbursed or paid by an employer may be excluded from taxable income.

New Law: The Act repeals the deduction for moving expenses for individuals and the exclusion for qualified moving expense reimbursements paid by an employer, with an exception for members of the armed forces on active duty. The changes are effective in 2018, but sunset after 2025.

Observation: Companies currently assisting with moving expenses for domestic and international moves will need to choose whether to continue to do so on an after-tax basis, determine whether the same level of benefits will be provided, and also decide if the tax obligation will be placed on the employee or if the company will fund this cost via gross-up. The international tax impacts should also be considered; although moving costs will be taxable income in the US, there may still be tax preferential treatment in a foreign jurisdiction. As a result of this change, companies may want to review and refresh their overall company relocation policy to reflect the new law and policy.
Key provisions impacting rewards programs

Reduced corporate tax rates.
**Current Law:** The corporate tax rate is a graduated rate with a 35% top rate (on taxable income above $10 million).

**New Law:** The Act replaces the graduated corporate tax rate with a flat rate of 21% for tax years beginning after 2017.

**Observation:** Companies may want to consider accelerating corporate tax deductions into 2017 to preserve the value of their deductions. With respect to a company's rewards programs, there may be opportunities to accelerate deductions relating to compensation plans that will settle early in 2018 such as bonus programs, certain equity incentive programs, pension contributions, and VEBAs. As a result of the 2018 effective date of change, calendar year taxpayers may need to take certain action before the 2017 year end. Non-calendar year taxpayers will have additional time to take action, if necessary.

Modification of limitation on excessive employee remuneration.
**Current Law:** Code section 162(m) limits corporate compensation deductions for compensation paid to “covered employees” in excess of $1 million in a year. The limit includes exceptions for commissions and for “performance-based compensation” including performance-based bonus plans, stock options, and stock appreciation rights. Current IRS guidance defines “covered employees” as the CEO at the close of the year and the three highest-paid officers determined with reference to regulatory securities rules.

**New Law:** The Act expands the current limitation on deduction of compensation paid to “covered employees” under Code section 162(m) by (1) eliminating the exclusions for commissions or performance-based compensation, (2) expanding “covered employee” to include anyone serving as CFO or CEO at any point during the year, as well as the 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 Act also expands the definition of entities covered by the provision. The Act is effective for tax years beginning after 2017, though it includes a transition rule for compensation paid pursuant to certain written binding contracts in place on November 2, 2017 which are not materially modified.

**Observation:** Companies may want to consider the impact of potentially lost deductions, identify situations where transition relief may apply, and reconsider the structure of compensation packages provided to covered employees. In addition, companies may want to consider the impact on deferred tax assets and the related income tax and financial accounting implications.
Passthroughs: rewards in a revised structure.

**Current Law:** Sole proprietorships, partnerships, LLCs and S corporations are not subjected to federal income tax at the entity level; rather, income and deductions are allocated to owners, who are taxed at their individual marginal rate.

**New Law:** The Act allows the individual owners of sole proprietorships, partnerships, LLCs, and S Corporations to take a deduction of up to 20% of qualified business income. Limitations on this deduction apply based on W-2 wages (of the taxpayer and allocated to taxpayer by structure), capital assets, and participation in any “specified services” (e.g., accounting, law, consulting). Notably, limitations apply as to the entities that may benefit from the deduction.

**Observation:** As organizations (including corporations and existing passthrough businesses) begin considering changes in entity structure in order to optimize corporate and individual tax opportunities, it is important to evaluate the impact upon compensation and benefit programs and the fresh opportunities that may emerge.

Deferral of income for qualified equity grant.

**Current Law:** Nonstatutory stock options granted at fair market value are taxable upon exercise of the option if the service recipient receives fully vested stock. Statutory stock options may be taxable as compensation or capital gains depending on whether an optionee satisfies specific holding period requirements. Additionally, restricted stock units (RSUs) that are exempt from, or comply with, the nonqualified deferred compensation rules under section 409A are generally not taxable until delivery of fully vested stock.

**New Law:** The Act will allow for certain employees in private corporations to elect to defer taxation for up to 5 years from the date substantially vested shares are delivered to an employee in connection with broad-based compensatory nonstatutory and statutory stock option or RSU programs. For equity grants meeting specific new criteria, the election is available for stock attributable to options exercised or RSUs settled after 2017.

**Observation:** Private companies with broad based compensatory equity programs may want to evaluate the structure of their programs and determine whether facilitating “qualified equity grants” elections can offer additional value to their employees. Notably, statutory awards subject to the new deferral election will cease to be treated as statutory awards (i.e., incentive stock options would no longer benefit from the preferential treatment afforded to these types of options).
Credit for paid family and medical leave.

**Current Law:** While the federal government mandates that certain employers offer unpaid family and medical leave, it does not mandate paid family or medical leave.

**New Law:** The Act provides a credit of between 12.5% and 25% of the wages paid to qualifying employees on family or medical leave of up to 12 weeks where the rate of payment is at least 50% of normal wages. Amounts paid that are mandated by state or local government or provided directly by state or local government are not taken into account for purposes of the credit. The provision is effective for wages paid in taxable years beginning in 2018, but the provision will expire after 2019.

**Observation:** Companies may wish to evaluate whether their voluntary paid leave policies conform to the new requirements to entitle them to the credit. If not, they may wish to determine whether program changes are desired and cost effective.

Repeal of exclusion for certain fringe benefit programs.

**Current Law:** The Code allows certain employee benefit programs to be provided on a pre-tax basis.

**New Law:** The Act repeals the exclusion for qualified bicycle commuting reimbursements for tax years beginning after 2017, though this change sunsets after 2025. The Act also clarifies/narrows the definition of what may be provided as a tax-free “employee achievement award” effective for amounts paid or incurred after 2017. The clarification notes that things like cash, cash equivalents, securities, and vacations (among other items) may not fit within the tangible property that can be awarded on a tax-preferred basis.

**Observation:** Companies may wish to review the impact these changes may have on their payroll system and programs and determine whether they remain beneficial to the employee experience if offered on an after-tax basis.
**Changes to deductions associated with meals and entertainment**

**Current Law:** The Code allows employers to deduct up to 50% of expenses associated with certain entertainment activities or facilities.

**New Law:** The Act disallows deductions for entertainment activities and facilities as well as deductions for most non-business transportation (e.g., qualified transportation fringe benefits) beginning in 2018. The Act subjects costs associated with meals for the convenience of the employer or provided at an on-premises eating facility to a 50% deduction limit beginning in 2018, but will end deduction for these meal expenses after 2025.

**Observation:** Companies may wish to review the impact these changes may have on their formal and informal entertainment offerings. Additionally, companies may want to review employee dining facilities and re-evaluate whether they remain cost effective.

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**Deemed repatriation of deferred foreign income.**

**Current Law:** Foreign income earned by a foreign subsidiary of a US corporation is not subject to US tax until income is distributed as a dividend to a US shareholder.

**New Law:** US shareholders of specified foreign corporations will include in income for the last taxable year beginning before 2018, the shareholder’s pro rata share of undistributed, previously untaxed historic foreign earnings of the corporation (since 1986). This income will effectively be taxed at reduced rates, and the tax payment 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 Code section 404A. These rules may allow employers to reduce their E&P for contributions made, or liabilities accrued, with respect to certain foreign retirement plans.
Additional considerations

**Payroll considerations.**
The Act updates the individual marginal rates and brackets, which will affect the withholding tax rates, including those for supplemental wage purposes. At this point, the Internal Revenue Service anticipates issuing the initial withholding guidance (Notice 1036) in January reflecting the new legislation. However, the expectation is that the current 25% optional flat rate and the 39.6% mandatory flat rate will be adjusted to correspond to the updated individual marginal rates.

While employers await withholding guidance, they should continue to withhold as normal and utilize the existing Forms W-4 on file. For those employees that wish to file an updated Form W-4 for 2018 before final guidance is issued, the employer should implement the Form W-4 based on the standard timeline (i.e., no later than the start of the first payroll period ending on or after the 30th day from the date they received the replacement Form W-4).

Employers should ensure that their earning/deduction codes are updated to reflect the various changes to certain fringe benefits (e.g., moving expenses).

**Affordable Care Act.**
Although not a direct impact to mobility or rewards programs, one additional noteworthy provision included in the Act is the reduction to zero of the penalty imposed on individuals who do not have adequate health insurance coverage (the “individual mandate” enacted in the Patient Protection and Affordable Care Act of 2010). This change will be effective for months beginning after December 31, 2018.

However, it is important to note that the Act does not include changes to the employer mandate, which requires employers to offer healthcare coverage to 95% of full-time employees. Employer information reporting requirements (i.e., Forms 1095-B, 1095-C) remain in-place.

**New excise taxes on tax exempt organizations’ compensation.**
The Act includes a new section of the Code that levies an excise tax on tax-exempt organizations, somewhat analogous to the $1 million dollar compensation limit under IRC § 162(m), as well as the limit on “excess parachute payments.” Where top-paid “covered employees” receive more than $1 million in a taxable year, the excess above $1 million is subject to an excise tax of 21%, the new corporate income tax rate, paid by the employer. Similarly, where certain top-paid “covered employees” receive a severance-related payment of more than three times a personalized average, the excess above that average is subject to an excise tax of 21% paid by the employer. Once an individual has been on the “covered employee” list, that person’s compensation will always be considered for whether excise tax is owed. The provision is first effective for tax years beginning in 2018.
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