Outlook for the proposed US tax reform (IV) – the US government releases new tax reform framework

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Issue 29

In brief

After the release of the administrative principles of the tax reform by the US Treasury Secretary and White House National Economic Council (NEC) in April this year (hereinafter referred to as “the Principles”) and the release of the joint statement outlining the key principles and goals for comprehensive tax reform by the US government and Congressional Republican leaders later in July (hereinafter referred to as “the Joint Statement”), how the US is going to push forward the tax reform has attracted a lot of attention. On September 27, the US government, House Ways and Means Committee and Senate Finance Committee jointly released a unified framework for the tax reform (hereinafter referred to as “the Framework”), aiming to build a taxation regime that could promote the economic growth of the US, reduce the tax burden of middle-class families and protect jobs in the US.

In detail

The highlights of the Framework include (please refer to Appendix for the detailed comparison between current tax regime and the Framework):

Corporate income tax reform

- The Framework proposes to reduce the current corporate income tax (CIT) rate to 20%, which is below the 22.5% average of the industrialized world. Meanwhile, it calls for a maximum CIT rate of 25% for certain pass-through business income. It also plans to eliminate the corporate alternative minimum tax (AMT) and consider methods to reduce the double taxation of corporate earnings.
- Regarding expenses items, the Framework proposes to allow the immediate write off (or expense) of cost of new investments in depreciable assets other than structures made after September 27, 2017, for at least five years. Moreover, the deduction for net interest expense incurred by C corporations is proposed to be partially limited, while no relevant details are disclosed.

Cross-border taxation

- The Framework states that the current US worldwide tax system will be replaced by the territorial tax system. In which case, dividends received by a US company from foreign subsidiaries (in which the US parent owns at least a 10% stake) will be exempted from CIT. This aims to encourage US companies to repatriate foreign earnings.
- Border Adjustment Tax (BAT) is not included in the Framework this time, which is consistent with the declaration in the Joint Statement that BAT would not be considered in the tax reform.

Individual income tax reform

- The Framework proposes to reduce the current seven individual income tax (IIT) brackets to three, with the rates set at 12%, 25% and 35%, while leaving open the possibility of providing a fourth higher tax bracket for upper-income individuals to keep tax fairness. The Framework also calls for repealing the individual AMT and estate tax.
Regarding deduction items and tax breaks, the Framework plans to double the annual standard deduction and increase child tax credit. While the Framework considers to repeal most itemized deductions, tax incentives for mortgage interest and charitable donations generally will be preserved.

As for carried interest which is currently taxed at capital gains rates, it was once proposed to be taxed at ordinary rates in a previous tax reform plan but it is not mentioned in the Framework this time.

The Framework basically extends the main proposals in the Principles and Joint Statement and offers a number of detailed guidelines for tax reform. It is worth noting that the Framework serves as a template for the House and Senate Tax Writing Committees to develop legislation, which needs to be negotiated by House Ways and Means Committee and Senate Finance Committee and then voted by the Senate, and finally signed into law by the President. Therefore, attention needs to be paid on whether the details of the tax reforms may change. Nevertheless, every step of the US tax reform will affect all economics in the world, including China.

The takeaway

Currently, a lot of countries other than the US have moved their own tax reform forward. China has also reconsidered and improved its own tax system, as well as its tax administration environment, with the following objectives:

- Attracting continuous foreign investments to China;
- Promotion of growth and business activities in China; and
- Improving competitiveness of “Made in China” products and services overseas.

In recent years, China has been steadily advancing and improving its tax system. The Business Tax to Value Added Tax (VAT) reform has been completely implemented in 2016 to reduce the tax burden of enterprises and China is now moving onto IIT reform and updating the Tax Collection and Administration Law; in addition, amendments to other tax legislation are also on the pipeline. Meanwhile, the Chinese government has also issued a series of incentives to attract foreign investments and make administration environment friendly. In particular, the recently released 22 Measures⁴ proposes a tax deferral treatment for the direct reinvestment of profits derived within China by foreign investors in the State’s encouraged projects provided that certain conditions are met. It also extends the scope of Service Outsourcing Demonstration Cities. We believe that, besides short term measures to deal with the impact of the US tax reform, the Chinese government would keep moving forward at its own pace to achieve its own established goals and strategies.

From the perspective of multinational enterprises (MNEs), enterprises trading with or having investments in the US need to assess what challenges and opportunities the US tax reform may bring, especially during the process of deciding the place of markets, location of production and R&D centre, investment mode, capital structure and the repatriation of capital, etc. In this regards, they may need to restructure or adjust their business models to adapt to the new tax environment in the US.

We will share our observations on the tax impact on MNEs brought by the changes of the US tax rules and how they should react in our future News Flash. Meanwhile, our US Individual Tax team will introduce the details of IIT reform in the Framework and its potential impact in a separate News Flash. Please stay tuned.

Endnote

1. For the details of the Principles, please refer to our News Flash [2017] Issue 12.

2. For the details of the Joint Statement, please refer to our News Flash [2017] Issue 27.

3. For the details of the Framework, please refer to the link: https://waysandmeans.house.gov/uploadedfiles/tax_framework.pdf

4. For the details of the 22 Measures, please refer to our News Flash [2017] Issue 28.
### The comparison between current Tax Law and the Framework

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<thead>
<tr>
<th></th>
<th>Current Tax Law</th>
<th>The Framework</th>
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<tbody>
<tr>
<td><strong>C-Corporation Tax Rate</strong></td>
<td>35%</td>
<td>20%</td>
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<tr>
<td><strong>Pass-through entities</strong></td>
<td>Taxed at individual rates, max of 39.6%</td>
<td>25% for small and medium sized pass-through businesses</td>
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<tr>
<td><strong>Alternative Minimum Tax (AMT)</strong></td>
<td>AMT imposed on individuals, estates, trusts (up to 28%), and corporations (20%) on tentative minimum tax liability in excess of regular tax liability</td>
<td>Repeal corporate and individual AMT</td>
</tr>
<tr>
<td><strong>Cost recovery</strong></td>
<td>Depreciation with Modified Accelerated Cost Recovery System (MACRS) or Alternative Depreciation System (ADS)</td>
<td>Fully expense the cost of new investments in depreciable assets other than structures made after September 27, 2017 for at least five years.</td>
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<td><strong>Domestic production</strong></td>
<td>Section 199 deduction: 9% exclusion for domestic manufacturing, production, cultivation and mining.</td>
<td>Repeal Section 199 deduction</td>
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<td><strong>Interest expense</strong></td>
<td>Deductible as incurred</td>
<td>Partially limit the deduction for net interest expense incurred by C corporations</td>
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<td><strong>Individual - Tax rate</strong></td>
<td>Seven rate brackets (10%, 15%, 25%, 28%, 33%, 35%, 39.6%)</td>
<td>Three rate brackets (12%, 25%, 35%) (possibly a fourth higher tax bracket for upper-income individuals)</td>
</tr>
<tr>
<td><strong>Individual - Standard deduction</strong></td>
<td>$6,300 for single filers/$12,600 for joint returns (2016)</td>
<td>$12,000 for single filers/$24,000 for joint returns</td>
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<td><strong>Individual - Itemized deductions</strong></td>
<td>Itemized deductions phased-out begins at $311,300 for joint filers and $259,400 for single filers (2016)</td>
<td>Repeal most of the itemized deductions, except for mortgage interest and charitable contributions deductions</td>
</tr>
<tr>
<td><strong>Estate tax</strong></td>
<td>Maximum 40% rate for taxable estates exceeding $5.45 million (2016)</td>
<td>Repeal estate tax</td>
</tr>
<tr>
<td><strong>Repatriation “toll tax”</strong></td>
<td>No provision. Previously untaxed foreign earnings subject to 35% corporate rate when repatriated</td>
<td>All previously untaxed foreign earnings subject to one-off mandatory US income tax with the specific rate to be determined later</td>
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<tr>
<td><strong>General income tax regime</strong></td>
<td>Worldwide Tax System with foreign tax credits to mitigate double taxation</td>
<td>Territorial System with a full tax exemption for dividend from foreign subsidiaries (in which the US parent owns at least a 10% stake)</td>
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News Flash — China Tax and Business Advisory

Let’s talk

For a deeper discussion of how this issue might affect your business, please contact a member of PwC’s US Tax Consulting Team:

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Our US Tax Consulting Team offers a wide range of US tax consulting and compliance services in Hong Kong and China, with a significant portion of clients which are private equity funds, real estate funds, hedge funds, as well as multinational corporations. We provide solutions to help our clients improve tax efficiency and meet their US tax obligations.

We are the largest team of US tax consulting professionals in Asia, with over 80 members in Hong Kong, Shanghai and Beijing serving local and offshore clients. Members of our team are proficient in Cantonese and/or Mandarin.

In the context of this News Flash, China, Mainland China or the PRC refers to the People’s Republic of China but excludes Hong Kong Special Administrative Region, Macao Special Administrative Region and Taiwan Region.

The application and impact of laws can vary widely based on the specific facts involved. Before taking any action, please ensure that you obtain advice specific to your circumstances from your usual PwC’s client service team or your other tax advisers. The materials contained in this publication were assembled on 28 September 2017 and were based on the law enforceable and information available at that time.

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