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Pelosi Bill Includes a Number of Tax Changes Impacting Individuals and Corporations

On October 29, 2009, Nancy Pelosi, Speaker of the U.S. House of Representatives, introduced comprehensive health care reform legislation that, if passed by both houses of Congress and signed into law by President Obama, could have broad ramifications for high-income U.S. expatriates and foreign-based multinational corporations with operations in the U.S. Though Democrats have a majority in both houses of Congress, many commentators believe that a majority vote is not assured.

The following discussion will not cover all aspects of the proposed legislation. Rather, it will focus on issues of particular interest to U.S. expatriates living in Canada and Canadian-based multinationals with U.S. activity.

Legislation Impacting High Income Individuals

The proposed legislation would apply a 5.4% surcharge on the income of married taxpayers filing a joint return with “modified” adjusted gross income of $1 million or more. For all other taxpayers, the threshold for the surcharge is reduced to $500,000. The threshold will not be indexed for inflation.

There are some adjustments for taxpayers living abroad but the most draconian impact of the legislation is the inability to use alternative minimum tax carryforwards, foreign tax credits and other credits to deflect the tax.

If this legislation is passed in its current form, high income U.S. taxpayers residing in Ontario will be subject to a marginal rate of over 50% on income over the threshold. In an ironic twist, US taxpayers abroad, living in high-tax jurisdictions with public health care such as Canada, will be forced to subsidize a public health care system in a second country (i.e. the U.S.) where they no longer reside.

Employer Requirements of the Plan

For years beginning after 2012, employers with payrolls in excess of $750,000 will be forced to pay an excise tax of 8% on their payrolls if they do not provide health coverage to employees. The excise tax would be reduced incrementally for payrolls of between $500,000 and $750,000. For lower payrolls, the excise tax will not apply.

There is also a $100 per employee per day penalty imposed on employers who do not provide medical insurance to employees and do not make the election to pay the excise tax. There are caps and specific rules proposed for reasonable cause exceptions for mitigating the penalty which are beyond the scope of this discussion.

In order to offset the costs involved, small business owners will be allowed a credit of 50% of the insurance premiums paid. Credits will be phased out based on the size of the business. As well, there will be no credit allowed for insurance paid on behalf of highly compensated employees.

These measures requiring employers who do provide employees with health care coverage to incur additional costs, regardless of the profitability of their operations, could cause several US businesses that have been reluctant to move jobs offshore to reconsider their position. In a high unemployment environment where the U.S. is facing a hollowing out of its manufacturing base, this provision will likely be the most controversial. Legislators will be reluctant to face a voter base if the legislation plays a part (or is perceived to have played a part) in job losses in their districts or states. Given the current economic turmoil in the U.S., it would not be surprising to see many Democratic legislators suggest that this is the right idea but the wrong time.

Expansion of Information Reporting Requirements

For payments made after 2011, businesses would be required to file a Form 1099 to report payments to a corporation of $600 or more. Currently, this requirement only applies to non-corporate recipients.

Treaty Shopping

A foreign corporation will not be able to avoid high withholding tax on payments made to it from its U.S. subsidiary, if the payment is routed through a commonly owned subsidiary with a reduced treaty rate.

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