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Realigning the code: Tax provisions in the Build Back Better Act

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Introduction

Momentum appears to be growing on Capitol Hill for passage of the Build Back Better Act, the tax-and-spending package that President Biden and congressional Democrats hope to move through the House and Senate under filibuster-proof budget reconciliation protections.

The House of Representatives on November 6 voted along party lines to approve a rule paving the way for floor consideration of Build Back Better legislation that was unveiled by Democratic leaders just two days earlier. House Speaker Nancy Pelosi, D-Calif., hopes to begin debate on the bill and hold a vote on final passage the week of November 15, and then send it to the Senate, where Majority Leader Charles Schumer, D-N.Y., likewise hopes for swift consideration and passage.

Overview of House bill tax provisions

The House bill (like a prior version released on October 28) reflects the tax policy priorities that the Biden administration laid out in its recent Build Back Better framework, which was informed by the president's view that the benefits of 2017's Tax Cuts and Jobs Act (TCJA, P.L. 115-97) were skewed to large corporations and wealthy individuals and that the federal income tax system needs to be realigned to ensure that these taxpayers are contributing "their fair share."

It's worth noting, though, that the framework is also the product of compromises struck between the administration and some congressional Democrats, such as Sens. Joe Manchin D-W.Va., and Kyrsten Sinema, D-Ariz., who have pushed for a more limited legislative package than the president and other Democratic lawmakers had originally envisioned. In one particularly notable compromise with Sen. Sinema, the White House framework abandoned the president's previous calls for tax rate increases on corporations, upper-income individuals, and long-term capital gains and dividends—a concession that is reflected in the measure headed to the House floor.

On the revenue-raising side, the House bill proposes tax increases—other than through marginal rate hikes—on corporations, multinational enterprises, and upper-income individuals that would offset the cost of proposals such as new and expanded tax incentives to promote clean energy and climate change mitigation; extensions of the expanded earned income tax credit, the child tax credit, and Affordable Care Act premium credits; plus spending provisions aimed at expanding access to pre-kindergarten education, child care, elder care, Medicare and Medicaid benefits, and affordable housing.

The Joint Committee on Taxation (JCT) staff has estimated that the tax provisions in the bill would, on net, increase federal receipts by $944.5 billion over 10 years, although that score does not reflect some last-minute modifications that were made to the bill after the estimate was released. A full score of the impact on the deficit of both the tax and spending provisions will be provided by the Congressional Budget Office (CBO). One of the reasons the measure was not debated and passed in the House after the rule for its consideration was approved was the objection by a small group of moderate House Democrats to voting on the measure before the official CBO estimate was available.

Corporate and international tax provisions: The House legislation would raise roughly $814 billion (net) through corporate and international tax reforms such as a 15% minimum tax on the "adjusted financial statement income" of certain large corporations, a 1% excise tax on certain publicly traded corporations that buy back stock from their shareholders, additional limitations on the deduction for business interest, and new limitations on the deduction by publicly held corporations for excess employee remuneration. It also would extend expensing of research and experimentation expenditures under section 174 four years (through 2025).

The new legislation, like the prior bill, also would tighten current-law tax rules governing the treatment of global intangible low-taxed income, the deduction for foreign-derived intangible income, and the determination of foreign tax credits, and make changes to the base erosion and anti-abuse tax.

Green energy and economic development incentives: The House bill carries over from the prior version a slate of production and investment tax credits for renewable and alternative energy property and for production of certain alternative fuels; business- and consumer-focused incentives for energy-efficient buildings; incentives to promote alternative fuel vehicles for consumer and commercial use; and credits to develop a "green" workforce, all as part of the Biden administration's larger effort to mitigate climate change.

The legislation also proposes several economic and community development incentives, including enhancements to the low-income housing tax credit; a new federal tax credit to encourage the rehabilitation of deteriorated homes in distressed communities; and provisions to promote infrastructure development among US Indian tribes. These provisions are part of a broader package of economic development incentives that were included in a tax title to the Build Back Better Act that the House Ways and Means Committee approved in September, but were left out of the House legislation released on October 28.

Individual tax provisions: On the individual side of the tax code, the House proposal—like the prior version—would raise revenue through a new surtax on certain upper-income individuals, estates, and trusts; broaden the application of the net investment income tax to include trade or business income of certain upper-income taxpayers; and permanently disallow excess business losses for noncorporate taxpayers.

The House bill also adds revenue-raising provisions that seek to limit the accumulation of multi-million dollar balances in certain retirement accounts—so-called "mega IRAs"—and other restrictions intended to curb the ability of wealthy taxpayers to use IRAs and other qualified plans as tax planning tools. These provisions were included in the Ways and Means – approved tax title in September but were not in the October 28 version unveiled by House leadership.

Neither the current nor the October 28 House version of the Build Back Better Act includes proposals to change the current-law tax treatment of carried interest income.

A significant new tax ***relief*** provision in the House bill would increase the limitation on the deduction for state and local taxes (SALT) from $10,000 to $80,000 for nine years, return it to $10,000 for another year, and then repeal it thereafter.

"Tax gap" provisions: The House bill, like the draft released on October 28, proposes to beef up the Internal Revenue Service's enforcement and technology modernization budgets in an effort to close the "tax gap"—the difference between the amount of taxes owed and the amount actually paid. It also includes changes to procedural requirements for the assessment of penalties and changes to the rules related to backup withholding on payments by third-party settlement organizations.

Like the legislation released on October 28, the latest House bill does ***not*** include a much-discussed proposal from the president's fiscal year 2022 budget blueprint to require financial institutions to report to the IRS certain inflows and outflows from specified customer accounts.

Find out more

This publication looks at the proposed revenue raisers and tax incentives in the House's Build Back Better proposal, considers some of the potential challenges ahead as the bill moves through the legislative process, and discusses issues taxpayers should consider in the event that these proposals become law.

Corporate and international tax provisions

The House bill includes many provisions that would tighten current-law tax rules that the White House and congressional Democrats have argued provide incentives for companies to locate investment in foreign jurisdictions and move US-based jobs and production activities offshore. In addition, the legislation includes a provision originally proposed by President Biden in his fiscal year 2022 budget blueprint that would impose a 15% minimum tax on the book income of certain corporations.

Importantly, many (but not all) of the provisions in the House bill have deferred effective dates, which should give taxpayers time to adjust for the impact of these significant changes.

Corporate minimum tax

The House bill includes a corporate alternative minimum tax (AMT) proposal that would impose a 15% minimum tax on "adjusted financial statement income" (AFSI) of applicable corporations. Under the proposal, an applicable corporation's minimum tax would be equal to the amount by which the tentative minimum tax exceeds the corporation's regular tax for the year. An applicable corporation generally is any corporation (other than an S corporation, regulated investment company, or a real estate investment trust) with three-year average annual AFSI that exceeds $1 billion.

Tentative minimum tax is determined by applying a 15% tax rate to the AFSI of the corporation for the taxable year (computed taking into account financial statement net operating losses) reduced by the AMT foreign tax credit. For this purpose, AFSI is the net income or loss of the taxpayer stated on the taxpayer's applicable financial statement with certain modifications, including adjustments to: (1) align the period covered to the taxpayer's taxable year, (2) disregard any federal or foreign taxes taken into account, and (3) disregard certain direct-pay tax credits provided in the Clean Energy for America Act received by the taxpayer.

The proposal also adds an adjustment to AFSI for an applicable corporation whose financial results are reported on the applicable financial statement for a group of entities that includes one or more partnerships (although this provision arguably only applies when the Secretary publishes regulations). Specifically, in this case, the earnings of these partnerships must be included in the same proportion as the taxpayer's distributive share of partnership items required to be included in gross income. Lastly, Treasury is granted authority to provide guidance to carry out the purposes of this section, including guidance relating to the effect of the rules of this section on partnerships with income taken into account by an applicable corporation.

In addition, the Secretary is granted regulatory authority to provide adjustments to: (1) prevent the omission or duplication of any item, (2) appropriately address corporate reorganizations and transactions related to partnership contributions and distributions, and (3) take into account the ownership of a corporation or a partnership who is not a member of a group. Adjustments are also made with respect to certain cooperatives and Alaska Native Corporations and to provide consistent treatment with respect to mortgage servicing income of a corporation other than a regulated investment company. Further, special rules apply in the case of related corporations included on a consolidated financial statement and in the case of taxpayers filing a consolidated return.

The AFSI of a corporation includes income from dividends and certain other amounts required to be included by such corporation for tax purposes. In the case of a corporation that is a US shareholder of a controlled foreign corporation (CFC), AFSI includes the corporation's pro rata share of the AFSI of such CFC. For this purpose, the AFSI of CFCs are aggregated globally, and a loss by one CFC may offset income of another CFC. However, net overall losses of CFCs may not reduce AFSI of a US corporation, but may be carried forward and used to offset the global CFC income in future years.

As under the rules applicable to the regular corporate income tax, AFSI may be reduced by financial statement net operating losses, not to exceed 80% of AFSI determined before taking into account such net operating losses. Financial statement net operating losses are determined by taking into account adjusted financial statement losses for taxable years ending after December 31, 2019. In addition, tentative minimum tax may be reduced by a corporate AMT foreign tax credit, which takes into account foreign income taxes that are paid or accrued (for federal income tax purposes) and taken into account on an applicable financial statement. For purposes of this provision, foreign income taxes paid or accrued by CFCs are subject to a single global limitation equal to 15% of the net aggregate AFSI of all CFCs, while foreign income taxes paid or accrued directly by a domestic corporation, such as withholding taxes or the taxes paid on income of a foreign activity conducted directly by the corporation, are not subject to a limitation. Excess corporate AMT foreign tax credits may be carried forward for five years.

As under the current rules, general business credits of a corporation (such as research and development, clean energy, and housing tax credits) may generally offset up to approximately 75% of the sum of a corporation's normal income tax and alternative minimum tax. As with the AMT tax credit under pre-2018 corporate AMT and the AMT currently in effect for individuals, corporations would be eligible to claim a tax credit for AMT paid in prior years against normal income tax, to the extent normal tax exceeds the tentative minimum tax for such taxable year.

A special rule is included for foreign-parented corporations. In such a case, the $1 billion three-year average annual AFSI requirement is determined by aggregating the AFSI for all members of the international financial reporting group (as defined in section 163(n) enacted as part of the House bill) in which the applicable corporation is a member. Accordingly, both US-parented and foreign-parented corporations are tested on their global income for purposes of this $1 billion requirement. However, if the international financial reporting group of a foreign-parented corporation meets this $1 billion requirement, a corporation that is a member of that group is not treated as an applicable corporation unless it meets an additional $100 million threshold by looking solely to the AFSI of the US group. For this purpose, all members under common control are aggregated, except the AFSI of a foreign corporation under common control is included only if the income would be effectively connected applying the principles of section 882 or the income is derived by a CFC.

Once a corporation is determined to be an applicable corporation, it remains an applicable corporation unless, as a result of an ownership change or a consistent reduction in AFSI below a yet to be determined applicable threshold, the Secretary determines that it would not be appropriate to continue to treat such corporation as an applicable corporation.

The proposal would be effective for taxable years beginning after December 31, 2022.

New tax on stock buybacks

The House bill would add a new section 4501 to provide that a covered corporation is subject to a tax equal to 1% of the fair market value of any stock of the corporation that is repurchased by such corporation (and certain of its affiliates) during any taxable year (subject to certain exceptions). A covered corporation would mean a domestic corporation, the stock of which is traded on an established securities market. For purposes of calculating the tax, the fair market value of the repurchased stock would be reduced by the fair market value of any stock issued by the covered corporation during the taxable year, including stock issued to employees. Purchases of covered corporation stock by specified affiliates (more than 50% direct or indirect ownership of stock of a corporation or more than 50% direct or indirect ownership of an interest in the capital or profits of a partnership) would be treated as repurchased by the covered corporation.

The new proposal would also be applicable to (1) an acquisition by a domestic corporate subsidiary of the stock of a foreign parent corporation where the foreign parent stock is traded on an established securities market, and (2) a repurchase of stock of a covered surrogate foreign corporation (as determined under section 7874(a)(2)(B) with certain modifications) by such covered surrogate foreign corporation (or a specified affiliate).

Exceptions would include repurchases of stock (1) where the repurchased stock is exchanged for stock of an acquiring corporation in a reorganization under section 368(a) and no gain or loss is recognized by the exchanging shareholder, (2) where the repurchased stock (or an amount equal to its fair market value) is contributed to an employee pension plan, employee stock purchase plan (ESOP), or a similar plan, (3) by a regulated investment company (RIC) or real estate investment trust (REIT), or (4) to the extent treated as a dividend under the code. New section 4501 would apply to repurchases of stock made after December 31, 2021.

Limitation of deduction of business interest expense

In addition to the existing limitation on business interest deductions under section 163(j), the House bill would impose an additional limitation under new section 163(n) designed to limit interest deductions for a domestic corporation that is a member of an international financial reporting group. Under this provision, the interest deduction is limited to an allowable percentage of 110% of the net interest expense reported on the group's applicable financial statement.

A domestic corporation's allowable percentage means the ratio of such corporation's allocable share of the group's reported net interest expense over such corporation's reported net interest expense.

A domestic corporation's allocable share of the group's reported net interest expense would be determined on the basis of that corporation's share of the group's total EBITDA (that is, earnings before interest, taxes, depreciation, and amortization as reported on the group's applicable financial statement).

Only domestic corporations whose three-year average net interest expense exceeds $12 million would be subject to the new limitation. The limitation would apply for taxable years beginning after December 31, 2022, and would allow an unlimited carryforward of disallowed deductions.

Modifications to limitation on deduction of excess employee remuneration

Section 162(m) generally limits the deduction allowed to a publicly held corporation for compensation paid to covered employees for a taxable year to $1 million. A covered employee is defined as (1) the principal executive officer (PEO) and the principal financial officer (PFO) at any time during the taxable year (and any individual acting in that capacity); (2) the three highest-compensated executive officers for the taxable year, other than the PEO and PFO; and (3) any individual who was a covered employee in any preceding taxable year beginning after December 31, 2016. The American Rescue Plan Act of 2021 expanded the definition of covered employees under section 162(m) to include the next five highest-compensated employees for taxable years beginning after December 31, 2026, other than the individuals described in (1) and (2) above. This group of the next five highest-compensated employees is not intended to be subject to the rules that provide covered-employee status carries forward in subsequent tax years (i.e., the next five highest-compensated employees are not subject to the "once a covered employee, always a covered employee" rules).

Under the updated House bill, section 162(m)(1) would be amended to apply an aggregation rule that is similar to the rule applicable to certain health insurance providers under section 162(m)(6). The aggregation rule under section 162(m)(6)(C)(ii) provides that two or more persons who are treated as a single employer under section 414(b), (c), (m), or (o) are treated as a single employer, except that paragraphs (2) and (3) of section 1563 are disregarded. The result of the carveout of paragraphs (2) and (3) is that the brother-sister controlled group and combined group rules under section 1563(a) are disregarded.

In addition, the proposed legislation provides that the Secretary shall prescribe regulations and guidance that may be necessary or appropriate to prevent the avoidance of the application of section 162(m), such as the performance of services other than as an employee or compensation paid through passthrough or other entities.

Lastly, the proposed legislation amends the definition of "applicable employee remuneration" to clarify that such remuneration includes performance-based compensation, commissions, post-termination compensation, and beneficiary payments, whether or not paid directly by a publicly held corporation, as defined under section 162(m)(2).

The amendments are effective for taxable years beginning after December 31, 2021.

OBSERVATIONS:

While prior legislative text released in September 2021 from the House Ways and Means Committee included an amendment to accelerate the provision under the American Rescue Plan Act of 2021, which adds five new employees to the group of covered employees of a publicly held corporation, the House bill does not include this provision. Accordingly, at this time, the effective date for the expanded roster of covered employees would be taxable years beginning after December 31, 2026.

If enacted in its current form, a likely result of the new provision applying an aggregation rule "similar" to the aggregation rule of section 162(m)(6)(C)(ii) could be to subject an affiliated group that includes two or more publicly held corporations to one $1 million deduction limitation, as opposed to a separate $1 million limitation for each publicly held corporation in the affiliated group.

Additional guidance will be required to refine the rule and to clarify the application of the aggregation rule.

The introduction of the new aggregation rule coupled with the new provision authorizing the Secretary to prescribe regulations and guidance as outlined above appears to signal an intent to expand the deduction disallowance rules to include compensation paid by entities currently outside the scope of section 162(m). For instance, if enacted, provisions of this nature could potentially impact a publicly held corporation that owns an interest in a partnership that wholly owns a subsidiary and potentially subject all compensation paid to covered employees of the publicly held corporation to section 162(m) regardless of which entity pays the compensation to the covered employee, even if outside the publicly held corporation's affiliated group as defined under section 1504.

GILTI

The House bill, consistent with the provisions of the prior House Ways and Means package, would take steps to tighten the rules for global intangible low-taxed income (GILTI) put in place by the TCJA, albeit not quite to the extent proposed by some other Democratic lawmakers.

Specifically, the legislation would reduce the section 250 deduction from 50% to 28.5%—yielding a headline GILTI rate (given the retained 21% top corporate rate) of about 15%, up from the current headline rate of 10.5%. (Under current law, the GILTI deduction is scheduled to fall to 37.5% in 2026.) The reduction of the section 250 deduction is effective for taxable years beginning after December 31, 2022, with a special rule for taxable years that include December 31, 2022, but do not end on that date.

In addition, the House bill would, consistent with the prior House Ways and Means legislation, provide for the calculation of GILTI on a country-by-country basis. Under the provision, a US shareholder's GILTI would be determined separately with respect to each country in which any CFC taxable unit of the United States shareholder is a tax resident. Other items and amounts including net CFC tested income, net deemed tangible income return, qualified business asset investment (QBAI), and interest expense shall be determined on a country-by-country basis as well. The provision also adds a favorable country-specific net CFC tested loss carryover rule.

A CFC taxable unit is defined by reference to new section 904(e)(2)(B). In general, under this provision, a CFC taxable unit includes: (1) the CFC, (2) an interest in a passthrough entity, including a disregarded entity, held by the CFC, if such passthrough entity is a tax resident of a country other than the CFC, or (3) a branch of the CFC that gives rise to a taxable presence in a country other than the country with respect to which the CFC is a tax resident.

Additionally, the House bill would modify the formula for calculating GILTI to reduce—from 10% to 5%—the allowable return on foreign tangible investment (so-called QBAI), though the change would not apply to income earned in a US territory, such as Puerto Rico.

Further, the measure would relax the current GILTI rules by reducing the "haircut" on foreign tax credits attributable to GILTI such that taxpayers would receive 95% of the value of their credits rather than 80% as under current law. This haircut is reduced to zero (i.e., taxpayers would receive 100% of the value of their credits) for taxes paid or accrued to US territories. In addition, a provision is included that would limit the ability to claim a foreign tax credit on distributions of previously taxed earnings attributable to prior GILTI inclusions. This provision disallows 20% of any such foreign tax credit for taxable years beginning after the date of enactment of the House bill and then is modified to disallow only 5% of any such foreign tax credit for taxable years beginning after December 31, 2022.

In addition, the rules are modified to include in the definition of a "tested foreign income tax" foreign taxes paid or accrued attributable to tested losses. As a result of this change, a US shareholder of a CFC will be able to claim a deemed paid foreign tax credit for taxes of a CFC with a net tested loss.

Further, the House bill would grant the IRS and Treasury regulatory authority to allow a US shareholder of a CFC to claim a foreign tax credit for certain taxes paid or accrued by a foreign corporation (other than a CFC) that owns, directly or indirectly, 80% or more of the stock of the domestic corporation but only if: (1) the taxes are properly attributable to amounts taken into account as tested income or loss in computing GILTI, and (2) no credit is allowed, in whole or in part, for such foreign taxes in the foreign jurisdiction.

Finally, the bill retains certain favorable changes to the foreign tax credit limitations with respect to GILTI. One change provides that for purposes of determining the foreign tax credit limitation with respect to GILTI, and except to the extent the Secretary determines otherwise, only deductions that are directly allocable to GILTI, such as the section 250 deduction, are taken into account in determining foreign source taxable income.

The legislation also would repeal the exemption for foreign oil and gas extraction income (FOGEI) and expand the definition of FOGEI to include oil shale and tar sands.

Except as noted above, these changes would apply to taxable years of foreign corporations beginning after December 31, 2022, and to taxable years of US shareholders in which or with which such taxable years of foreign corporations end.

FDII

The House bill would reduce the section 250 deduction for foreign-derived intangible income (FDII) from 37.5% to 24.8%—yielding a headline FDII rate (given the retained 21% top corporate rate) of about 15.8%, up from the current headline rate of 13.125%. (Under current law, the FDII deduction is scheduled to fall to 21.875% in 2026.) The reduction in the section 250 deduction would be effective for taxable years beginning after December 31, 2022, with a special rule for taxable years that include December 31, 2022, but do not end on that date.

The legislation also retains the FDII's exclusion of a deemed tangible return on QBAI—at the TCJA-enacted 10% level, not the 5% level as proposed for the GILTI regime.

Importantly, the House bill also makes changes to the definition of deduction-eligible income, relevant for purposes of determining FDII, similar to the changes included in the prior House Ways and Means proposal. Under the changes, deduction-eligible income would not include any passive income (as defined in section 904(d)(2)(B), determined without regard to whether it is subject to a high rate of foreign tax) or disqualified extraterritorial income (which was an amount excluded from income by reason of prior section 114 repealed effective January 1, 2005). In addition, the House bill provides that, except as otherwise provided by the Secretary, deduction-eligible income does not include any gains or income from the sale or other disposition of property giving rise to rents or royalties derived in the active conduct of a trade or business. These changes, unlike the changes to the section 250 deduction, would apply to taxable years beginning after the date the rules in the House bill are enacted.

Foreign tax credits

The House bill proposes to amend section 904 to require foreign tax credit determinations on a country-by-country basis for purposes of sections 904, 907, and 960. These foreign tax credit computations entail assigning each item of income and loss to a taxable unit of the taxpayer that is a tax resident of a country (or, in the case of a branch, has a taxable presence in such country).

The proposal defines taxable units of the taxpayer as: (1) the person that is the taxpayer, (2) a foreign corporation with respect to which the taxpayer is a United States shareholder, (3) interests held by the taxpayer or any CFCs in a passthrough entity, including a disregarded entity, if the passthrough entity is a tax resident of a country other than the country of the taxpayer or the CFC, and (4) each branch whose activities are carried on by the taxpayer or any CFC and which give rise to a taxable presence in a country other than the country in which the taxpayer or CFC are resident. Additionally, this provision would repeal the foreign branch income separate category.

Conforming amendments are made with respect to the overall foreign loss rules and the separate limitation loss rules, consistent with the country-by-country foreign tax credit determination, including a provision which provides that separate limitation losses first offset and reduce income in separate categories other than GILTI, prior to reducing GILTI separate limitation income.

In addition, the House bill would repeal the limitation on foreign tax credit carryforwards for GILTI but limit any carryforward of excess GILTI foreign tax credits to five succeeding taxable years (compared with ten years applicable to other separate categories of foreign tax credits.). Further, the foreign tax credit carryback would be repealed (compared with the one-year carryback under current law). The limitation applicable to the carryforward and carryback period for GILTI foreign tax credits generally applies to taxes paid or accrued in taxable years beginning after December 31, 2022 and before January 1, 2031.

In addition, as discussed above, the foreign tax credit limitation rules would be amended to provide that, for the purpose of determining the foreign tax credit limitation with respect to the GILTI separate category, the taxpayer's foreign-source income is determined by allocating only deductions that are directly allocable to such income (i.e., section 250 deduction).

The House bill includes an "anti-abuse provision" which provides that in the case of any covered asset disposition, the principles of section 338(h)(16) shall apply in determining the source and character of any item for purposes of the foreign tax credit. A covered asset disposition means any disposition of assets that is treated as a disposition of stock of a corporation (or disregarded) for purposes of the tax laws of the relevant foreign country. This provision applies to transactions occurring after the date the House bill is enacted. An exception is included for transactions that are undertaken pursuant to a written binding contract in effect as of September 13, 2021 and not modified in any material respect thereafter.

Finally, the House bill would make certain changes applicable to situations in which a foreign tax is redetermined, modifying current section 905(c), including changes for taxes not paid within two years. Changes are also proposed to be made to provisions applicable to the time made for claiming a credit or deduction. Special effective date provisions are included for some of these changes.

In general, other than the specific provisions noted above, the changes to the foreign tax credit would apply to taxable years beginning after December 31, 2022.

BEAT

The House bill would retain the base erosion and anti-abuse tax (BEAT), with certain modifications.

In particular, the House bill would amend the BEAT rate structure such that:

- A 10% rate would apply in taxable years beginning after December 31, 2021 and before January 1, 2023;
- A 12.5% rate would apply in taxable years beginning after December 31, 2022 and before January 1, 2024;

- A 15% rate would apply in taxable years beginning after December 31, 2023 and before January 1, 2025; and
- An 18% rate would apply in taxable years beginning after December 31, 2024.

The legislation would also make a number of changes related to how modified taxable income is computed under the BEAT regime and would provide that outbound payments subject to US tax, as well as payments subject to an effective rate of tax in the destination jurisdiction at least equal to the lesser of 15% or the then-current BEAT rate, would not be subject to additional tax under the BEAT.

Finally, the BEAT rules would be modified to treat as a base erosion payment amounts paid to a foreign related party that are required to be capitalized into inventory under section 263A, as well as amounts paid to a foreign related party for inventory that exceed the costs of the property to the foreign related party. A safe harbor is available under which 20% of the amount paid to the foreign related party as indirect costs is an amount that is not a base erosion payment.

The amendments made to BEAT would apply to taxable years beginning after December 31, 2021.

Modification to section 958(b) and "new" section 951B

Consistent with the prior House Ways and Means legislation, the House bill includes a provision reinstating section 958(b)(4). Under the provision, section 318(a)(3)(A), (B), or (C) shall not be applied so as to consider a US person as owning stock that is owned by a person who is not a US person. As a result, this provision would "turn off" downward attribution that has applied since the TCJA was enacted and which has resulted in certain foreign corporations being treated as CFCs.

In addition, the House bill adds new section 951B, a version of which was first proposed by House Ways and Means Committee ranking member Kevin Brady, R-Texas, in a 2019 discussion draft of TCJA technical corrections and included in the prior House Ways and Means legislation, which will apply to certain foreign-controlled foreign corporations that would be CFCs but for the application of section 958(b)(4). Under the new provision, any "foreign controlled US shareholder" of a "foreign controlled foreign corporation" would be subject to the anti-deferral provisions of subpart F, including the GILTI regime, with respect to the income of such foreign controlled foreign corporation.

For this purpose, a foreign controlled US shareholder is any US person that would be a US shareholder (as defined in section 951(b)) with respect to such foreign corporation, if such person would own more than 50% of the vote or value of the stock of such foreign corporation applying the attribution rules of section 958(b) without regard to newly re-enacted section 958(b)(4)—that is, if such US person would be a US shareholder who owns more than 50% of the stock in such foreign corporation applying the downward attribution rules of section 318(a)(3)(A), (B) or (C). A foreign controlled foreign corporation is any foreign corporation, other than a CFC, that would be a CFC, substituting foreign controlled US shareholder for US shareholder in the definition of a CFC in section 957(a)(1) and applying section 958(b), without regard to newly re-enacted section 958(b)(4).

In addition, the House bill contains an election that would allow a foreign corporation that would not otherwise be a CFC to elect to be treated as a CFC. For such an election to be effective, it must be made by the foreign corporation and by all US shareholders of such foreign corporation. The election is irrevocable and binding on any US person that becomes a US shareholder of such foreign corporation.

These provisions would be effective for taxable years of foreign corporations beginning after enactment of the House bill and taxable years of US persons in which or with which such taxable years end.

Modification to pro-rata share rules and section 961

The House bill includes additional provisions, also included in the original House Ways and Means proposal, that would impact certain other provisions under subpart F. First, the House bill would modify section 961(c) to provide that rules similar to those in section 961(a) and (b) are made for income inclusions arising under subpart F to stock in lower-tier CFCs and property through which a CFC owns lower-tier CFCs. This change would ensure that additional gain would not be recognized for purposes of section 951 on the sale or exchange of such stock or such other property (for example, a partnership interest through which such stock is held).

Second, the House bill would modify the pro-rata share rules of section 951(a). Under the modified provision, the rules related to computing a US shareholder's inclusion under subpart F are changed and special rules are provided in situations where a US shareholder owns stock during the taxable year of a foreign corporation but does not own the stock on the last day of such taxable year on which the foreign corporation is a CFC.

These provisions would be effective for taxable years of foreign corporations beginning after December 31, 2021, and taxable years of US shareholders in which or with which such taxable years end.

Repeal of election for one-month deferral in determination of taxable year of specified foreign corporations

The legislation would strike section 898(c)(2), which previously allowed the choice of a taxable year beginning one month earlier than the majority US shareholder year. The amendments made by this section would apply to taxable years of specified foreign corporations beginning after November 30, 2022.

In addition, the House bill includes a transition rule (modified from the prior House Ways and Means draft) that provides additional guidance on this provision. Importantly, it provides that the IRS and Treasury shall issue regulations or other guidance for allocating foreign taxes that accrue in the first taxable year following the required change between such taxable year and the prior taxable year. This change is important to ensure the appropriate matching of income and foreign taxes of the foreign corporation in the transition year.

Other international changes

Changes to foreign base company sales and services income: The House bill, through a change in the definition of "related person," would limit foreign base company sales and services income to income from transactions in which the related persons are: (1) US residents, (2) branches located within the United States, or (3) subject to tax by reason of the person's activities within the United States. However, the provision includes a broad grant of regulatory authority to, among other things, treat a passthrough entity or branch directly held by a CFC (whether tax resident or located inside or outside the country in which the CFC is tax resident) as a wholly owned subsidiary of the CFC.

Further, the House bill proposes to modify the provisions of the foreign base company sales and services rules to apply certain exceptions (commonly referred to as the "same-country exceptions") of those provisions by reference to the country in which the particular CFC is tax resident, as opposed to looking to the country in which the CFC is created or organized.

This provision would be effective for taxable years of foreign corporations beginning after December 31, 2021, and taxable years of US shareholders in which or with which such taxable years end.

Deduction for foreign-source portion of dividends limited to controlled foreign corporations: Currently, section 245A provides a 100% dividends received deduction for the foreign-source portions of any dividends received from a specified 10% owned foreign corporations, even in cases where the foreign corporation is not a CFC (and therefore not subject to the subpart F and GILTI regimes). This provision would amend section 245A so that the dividends received deduction applies to the foreign-source portions of dividends received only from CFCs. This change would apply to distributions made after the House bill's enactment.

Changes to rules for "dual capacity" taxpayers: The House bill would implement stricter rules for so-called "dual capacity" taxpayers—that is, taxpayers that are both subject to tax or levy in, and receive certain benefits from (for example, extraction rights on government land), a foreign country. In particular, the bill would provide that, with respect to amounts paid or accrued after December 31, 2021, an amount paid by a dual capacity taxpayer to a foreign country will not be considered a tax for US tax purposes to the extent either: (1) the foreign country or possession does not impose a generally applicable income tax, or (2) to the extent the amount paid or accrued exceeds the amount that would be paid by such taxpayer under the generally applicable income tax law of that country.

Foreign oil – related income: The House bill expands the definition of foreign oil – related income in section 907(c)(2)(A) to include oil shale or tar sands in addition to oil and gas wells. This amendment would apply to taxable years beginning after December 31, 2021.

Modification to section 312(n): The House bill would modify section 312(n) to provide that in the case of a CFC, earnings and profits are determined without regard to sections 312(n)(4), (5), or (6), which provide rules related to LIFO inventory accounting, the installment method of accounting, and the completed contract method of accounting.

These changes would apply to taxable years of foreign corporations ending after the date of the enactment of these provisions and to taxable years of US shareholders in which or with which such taxable years ends.

Modification to section 1059: The House bill would modify section 1059 to treat any "disqualified CFC dividend" as an extraordinary dividend to which section 1059 applies. A disqualified CFC dividend is any dividend paid by a CFC to the extent such dividend is attributable to earnings and profits that were: (1) earned during a period that such corporation was not a CFC, or (2) attributable to a disqualified CFC dividend received from another CFC. In addition, to the extent that not all of the stock of the CFC is owned directly or indirectly by a US shareholder during the period when any earnings and profits were earned, a portion of such earnings attributable to stock not owned by the US shareholder shall be treated as earned while the corporation was not a CFC. Finally, for purposes of this provision, a CFC is not treated as a CFC if it was only so treated because of the repeal of section 958(b)(4).

These changes would apply to dividends paid (or amounts treated as a dividend taken into account) after the date the House bill is enacted.

Modification to exemption for portfolio interest: The House bill would modify the portfolio interest exception to provide that such exemption does not apply if the interest is paid by a corporation to any person who owns 10% or more of the vote or 10% or more of the value of the stock of such corporation. The change would apply to obligations issued after the House bill is enacted.

Other business-focused tax provisions

Research and experimental expenditures

With respect to taxable years beginning before January 1, 2022, taxpayers may currently elect to deduct the amount of research or experimental expenditures paid or incurred in connection with a trade or business. Alternatively, taxpayers may elect to defer the deduction such that it is recovered ratably over a period of not less than 60 months. Amounts defined as research or experimental expenditures under section 174 and the regulations generally include all costs incurred in the experimental or laboratory sense related to the development or improvement of a product. Moreover, under long-standing administrative guidance issued by the IRS, the costs of developing computer software have been accorded tax accounting treatment similar to research and experimental expenditures, which generally are defined broadly in Treasury Reg. section 1.174-2.

Under current law, as a result of modifications made to section 174 by the TCJA, for taxable years beginning after December 31, 2021, research or experimental expenditures incurred in connection with a trade or business are required to be capitalized and amortized ratably over a five-year period for domestic research or a 15-year period for research conducted outside of the United States. Amortization begins at the midpoint of the taxable year in which such expenditures were paid or incurred. Research or experimental expenditures subject to capitalization and amortization specifically include any amount paid or incurred in connection with the development of computer software. In the case of retired, abandoned, or disposed property with respect to which specified research or experimental expenditures had been paid or incurred, any remaining basis may not be recovered in the year of retirement, abandonment, or disposal, but instead must continue to be amortized over the required amortization period.

The House bill would delay the effective date for the modifications made to section 174 by the TCJA for four more taxable years, such that mandatory capitalization and amortization of research and experimental expenditures (and software development costs) will be scheduled to become effective for amounts paid or incurred in taxable years beginning after December 31, 2025.

OBSERVATIONS:

The requirement for taxpayers to capitalize and amortize research and experimental expenditures (including software development costs) was a significant taxpayer-unfavorable aspect of the TCJA, and its delay for four more years will simplify the tax accounting treatment of such expenditures during the interim period.

Credit for clinical testing of orphan drugs limited to first use or indication

The Orphan Drug Act of 1983 (P.L. 97-414) added to the code a tax credit for taxpayers incurring qualified clinical testing expenses for certain rare diseases or conditions. As originally enacted, the so-called "orphan drug credit"—now codified in section 45C—allowed taxpayers to claim a credit equal to 50% of their qualified clinical testing expenses incurred during the tax year. As part of the Tax Cuts and Jobs Act of 2017, the section 45C credit percentage was reduced to 25%, effective for taxable years beginning after December 31, 2017. For purposes of this credit, the term "qualified clinical testing expenses" is defined as amounts paid or incurred to test an orphan drug to cure or treat a rare disease or condition, but only after the drug has been approved for such human testing by the Food and Drug Administration (FDA) and before the drug has been approved for sale by the FDA.

Such testing is allowed to be conducted outside of the United States if there is an insufficient testing population in the United States. A "rare disease or condition" is defined as one that (1) affects fewer than 200,000 persons in the United States, or (2) affects more than 200,000 persons, but for which the FDA determines there is no reasonable expectation that the costs of developing and making available a drug for such disease or condition will be recovered from sales of the drug in the United States. Amounts taken into account when computing the section 45C credit are excluded from the computation of the research credit determined under section 41; and the deduction otherwise allowed for qualified clinical testing expenses must be reduced to reflect the section 45C credit determined for the taxable year.

The House bill would amend section 45C(b)(2)(B) so that human clinical testing may be taken into account for purposes of the orphan drug credit only to the extent such testing is related to the first use or indication with respect to which a drug for a rare disease or condition is designated under section 526 of the Federal Food, Drug, and Cosmetic Act. Additionally, the legislation clarifies that any human clinical testing for any drug after the first date on which the drug receives marketing approval under section 505 of such Act for any use or indication (either for use in rare disease or condition or non-rare disease or condition) does not qualify for the credit. A similar rule applies to so-called "biological products," such that credit-eligible testing must occur before the first date on which a license for any use or indication of the product for any disease or condition is issued under section 351(a) of the Public Health Service Act. These amendments would apply to taxable years beginning after December 31, 2021.

OBSERVATIONS:

The limitation of the section 45C credit for human clinical testing of orphan drugs or biological products to their first use or indication for a rare condition or disease (or before the drug or product receives marketing approval for any non-rare disease or condition) will preclude taxpayers from claiming the credit for human clinical testing of the same drugs or biological products (often tested in combination with other drugs and products) for other rare diseases or conditions and multiple rare subtypes of diseases or conditions. However, clinical testing expenses not eligible for the section 45C credit as a result of the House bill amendments may nevertheless be eligible for the section 41 research credit under certain circumstances.

Modifications to treatment of certain losses

The House bill would make a number of changes to current law related to the treatment of losses from worthless securities and the deferral of losses on certain liquidations.

Section 165 changes: The bill would modify the rules related to certain partnership losses. Most of the modifications, except as noted below, were originally included in the Ways and Means Committee – approved tax title to the Build Back Better Act.

Specifically, the legislation would:

- Amend section 165 to provide that a loss on a worthless partnership interest is subject to the same rules as a loss from the sale or exchange of a partnership interest;

- Amend section 165(g) to provide that losses with respect to securities are treated as realized on the day that the identifiable event establishes worthlessness;
- Provide that partnership indebtedness is treated in the same manner as corporate indebtedness under section 165(g)(2)(C); and
- Amend section 165(g) to provide that abandoned securities are treated as worthless at the time of abandonment. (This provision was not included in the Ways and Means – approved legislation.)

These proposed changes would be effective for losses arising in taxable years beginning after December 31, 2021.

OBSERVATIONS:

If these changes are enacted, the character of the loss with respect to a worthless partnership interest would generally be treated as capital, subject to the exception under section 751 (relating to unrealized receivables and inventory items). According to a Joint Committee on Taxation summary of the Ways and Means – approved legislation, the "presence or absence of partnership liabilities is not determinative."

Deferral of losses on certain liquidations: Under current law, the rules under section 267 that govern losses from transactions involving related parties do not apply to either disallow or defer stock losses recognized under section 331 (resulting from the complete liquidation of a corporation) or worthless stock deductions under section 165(g). As a result, corporate shareholders can recognize losses in stock of a subsidiary pursuant to so-called Granite Trust transactions (i.e., transfer subsidiary stock to a nonconsolidated affiliate to create a section 331 taxable liquidation), or claim a worthless stock deduction in connection with the liquidation or deemed liquidation (pursuant to an entity classification election) of an insolvent subsidiary without a requirement that the subsidiary's assets be sold to an unrelated third party.

The House bill would defer these stock losses and worthless stock deductions by introducing new section 267(h). Under proposed section 267(h), a corporation that is a member of a controlled group (within the meaning of section 267(f)) would no longer be able to currently recognize losses or claim worthless stock deductions with respect to stock of a liquidating subsidiary where the loss or deduction results from a "specified controlled group liquidation." For this purpose, a "specified controlled group liquidation" would mean, with respect to any corporation that is a member of a controlled group, (1) one or more distributions in complete liquidation (within the meaning of section 346, which would include section 331 liquidations) of such corporation, (2) any other transfer (including any series of transfers) of property of such corporation if any stock or security of such corporation becomes worthless in connection with such transfer, or (3) any issuance of debt by such corporation to one or more persons who are related (within the meaning of section 267(b)(3) or section 707(b)(1)) to such corporation if any stock or security of such corporation becomes worthless in connection with such debt issuance.

If section 267(h) applies, the stock loss or worthless stock deduction would be deferred until all members of the controlled group that received property in connection with such liquidation have transferred such property to one or more persons who are not related (within the meaning of section 267(f) or section 707(b)(1)) to the member that received such property. Section 267(h) would apply to liquidations on or after the date of enactment. Note that the prior proposed section 267(h) in the revenue title approved by the House Ways and Means Committee in September would require deferral only for section 331 stock losses.

Adjusted basis limitation for divisive reorganization

The House bill would add a new section 361(d) to impose a basis limitation on the amount of debt securities of a controlled corporation that a distributing corporation can transfer to its creditors in a tax-free manner in connection with a section 355 spin-off transaction. A distributing corporation commonly deleverages by using cash and/or debt securities received from the controlled corporation in a section 368(a)(1)(D) reorganization to repay its creditors (the use of controlled corporation debt securities, a so-called debt-for-debt exchange). Under current law, the distributing corporation is required to recognize gain on assets contributed to the controlled corporation if (and to the extent) the amount of cash or other property received from the controlled corporation and transferred to the distributing corporation creditors exceeds the net basis of the assets (i.e., asset basis reduced by liabilities assumed) contributed by the distributing corporation to the controlled corporation. However, if the controlled corporation issues debt securities in the exchange, the basis limitation described above does not apply.

The House bill would require the distributing corporation to recognize gain where the aggregate amount of the controlled corporation debt securities and cash received by the controlled corporation exceeds the net basis of the assets contributed by the distributing corporation to the controlled corporation. New section 361(d) would apply to divisive section 368(a)(1)(D) reorganizations occurring on or after the date of enactment. A transition rule, however, would provide that new section 361(d) would not apply to any divisive section 368(a)(1)(D) reorganization occurring pursuant to a written agreement that was binding as of the date of enactment and at all times thereafter, described in a ruling request submitted to the Internal Revenue Service on or before such date, or described on or before such date in a public announcement or filing with the Securities and Exchange Commission.

Limitation on certain special rules for section 1202 gains

The House bill would add new section 1202(a)(5), which imposes a limitation on gain exclusion for certain sales of qualified small business stock. Under current law, in the case of qualified small business stock acquired after February 17, 2009, and on or before September 27, 2010, 75% (instead of 50%) of the gain from the sale or exchange of such stock can be excluded from gross income for taxpayers other than corporations. In addition, for qualified small business stock acquired after September 27, 2010, 100% (instead of 50%) of the gain can be excluded. Under new section 1202(a)(5), these 75% and 100% exclusions would not be available to taxpayers that have an adjusted gross income that is equal to or exceeds $400,000, or to taxpayers that are trusts or estates. However, the baseline 50% gain exclusion pursuant to section 1202(a)(1) would remain in effect and would be unmodified by the legislation. The section 1202(a)(5) limitation would be applicable to sales and exchanges occurring after September 13, 2021, but there would be an exception for any sale or exchange made pursuant to a written binding contract that was in effect on September 13, 2021 and is not materially modified thereafter. (See additional discussion in the section on "Individual tax provisions" elsewhere in this publication.)

Rules relating to common control

Section 52(b) provides for a so-called "aggregation rule" under which, pursuant to Treasury Department regulations, "all employees of trades or business [whether or not each trade or business is organized as a partnership, proprietorship, or a corporation] which are under common control shall be treated as a single employer." Section 52(a) provides for a similar aggregation rule when all members of a controlled group (generally determined by reference to section 1563(a)) are corporations. The long-standing regulations that implement the section 52(b) aggregation rule to identify the members of a group of trades or businesses under common control are contained in Treasury Reg. section 1.52-1(b)-(g). These groups of trades or businesses under common control generally fall into one of three categories: (1) parent-subsidiary groups, (2) brother-sister groups, and (3) combined groups (where each organization is a member of either a parent-subsidiary group or a brother-sister group and other requirements are satisfied). Numerous provisions of the code are applied on an aggregate "controlled group" basis, by cross-referencing section 52(b) for a variety of tax-related purposes.

The House bill would amend section 52(b) to expressly provide that the term "trade or business" includes any activity treated as a trade or business under sections 469(c)(5) or (6). Accordingly, for purposes of section 52(b), the term "trade or business" includes any activity involving research or experimentation (within the meaning of section 174) as provided under section 469(c)(5), as well as any other activities undertaken in connection with a trade or business (even if still in a start-up phase), or activities undertaken for the production of income and for which expenses are deductible under section 212, as provided under section 469(c)(6). This amendment is effective for taxable years beginning after December 31, 2021.

The House bill also would modify section 52(a) to clarify that the aggregation rule applies to all corporations that are "component members" of the same controlled group of corporations, which is determined by reference to section 1563(b) but without regard to the excluded member definition under section 1563(b)(2). To be a component member, a corporation must be a member of a controlled group of corporations on December 31 of the taxable year or, if not a member of the group on December 31, a member for one-half or more of the number of days in the taxable year preceding December 31.

OBSERVATIONS:

The amendments made by the House bill, if enacted, will increase the number of business entities treated as being under common control for purposes of section 52, which in turn will impact the application of many other provisions of the code that cross-reference sections 52(a) and (b). The statutory changes made to section 52(a) are generally clarifications of current-law interpretations. The statutory changes made with respect to section 52(b), however, are more substantive. For example, lower-tier operating companies that are majority-owned by a private equity fund may be deemed to be under common control for purposes of section 52(b), which could have a far-reaching impact on these companies' treatment for different US federal income tax purposes (e.g., applying certain gross-receipts tests and related-party rules, applying the newly proposed corporate AMT regime to "applicable taxpayers," and when calculating certain tax credits on an aggregate basis, such as the section 41 research credit).

Wash sales

The House bill would expand the wash sale rule in section 1091(a) to disallow loss recognized on any sale or disposition (including any termination) of commodities, foreign currencies, and digital assets if the taxpayer or a related party acquires substantially identical assets or enters into a contract or option to acquire, or a long notional principal contract with respect to, substantially identical assets, within the period beginning 30 days before and ending 30 days after such sale, disposition, or termination. The wash sale rule is currently limited to losses recognized on sales or dispositions of stock or securities (including for this purpose contracts or options to acquire or sell stock or securities) when the taxpayer itself acquires substantially identical stock or securities. Furthermore, the legislation would also expand the definition of security for this purpose, provide an exception to the wash sale rule for losses recognized on certain foreign currency and commodity transactions entered into as hedges or otherwise directly related to the needs of the taxpayer's trade or business, provide a new basis-adjustment rule for the taxpayer or a spouse to add the disallowed loss to the basis of a substantially identical asset acquired prior to the end of the taxable year following the year in which the disallowed loss was recognized, and expand the circumstances in which a taxpayer's loss on a short position may be disallowed by the wash sale rule. The amended wash sale rule would apply to sales, dispositions, and terminations after December 31, 2021.

Constructive sales

The House bill would amend section 1259 to include digital assets in the constructive sale rules. The constructive sale rules are currently limited to stock, debt instruments, and partnership interests. The constructive sale rules in section 1259 require the taxpayer to recognize gain on an appreciated financial position if the taxpayer enters into certain offsetting positions. These rules prevent taxpayers from locking in investment gains without recognizing taxable gain. The amended constructive sale rules would apply to constructive sales after the date of enactment.

Partnership considerations related to corporate minimum tax

Taxpayers will need to consider how the provisions related to the proposed corporate minimum tax (discussed elsewhere in this publication) include or exclude the share of earnings from partnerships. It is also important to note that whether an applicable corporation is subject to these rules will depend on the broad aggregation rules under sections 52(a) and (b), which, as noted elsewhere, are also amended in this legislation to expand the definition of trades or businesses (see rules relating to common control). Additionally, how entities in tiered structures, that are or are not members of a group, are reported for financial statement purposes will be important for how these rules may operate.

Application of limitation on business interest to partnerships and S corporations

The proposed limitation on the deduction for business interest (discussed elsewhere in this publication) also would amend section 163(j)(4) to provide that the business interest limitation rules generally would apply at the ultimate partner or shareholder level, rather than at the partnership or S corporation level. Aggregate treatment for partnerships and S corporations is subject to an exception in the case of small businesses as defined in section 163(j)(3). This exception was not included in the tax title for the Build

Back Better Act that the House Ways and Means Committee approved in September. Specifically, the proposal would amend the small business exemption to provide an exception for partnerships and S corporations. To the extent any partnership or S corporation does not meet the gross receipts test under section 448(c), section 163(j)(3) would not apply with respect to any share of items (including income and business interest) from the partnership or S corporation to its partners or shareholders. Broad regulatory authority would be provided to Treasury in the case of reporting, addressing tiered structures or trades or businesses, and allocating business interest and other items from a partnership or S corporation.

The provision would be effective for taxable years beginning after December 31, 2022. To the extent a partner had been allocated excess business interest expense from a partnership and had a carryforward of that amount, any such carryforward would be treated as business interest paid or accrued in the first taxable year that begins after December 31, 2022. A similar transition rule would apply for S corporations and their shareholders.

OBSERVATIONS:

Unlike the passthrough reform discussion draft released by Senate Finance Committee Chairman Ron Wyden, D-Ore., which took a pure entity approach to applying the business interest limitation to partnerships and S corporations, the House proposal generally provides aggregate treatment. This approach is expected to simplify the calculation and rules for partnerships and S corporations.

Rents from prison facilities not treated as qualified income for purposes of REIT income tests

The House bill would amend section 856(d)(2) to provide that any amount received or accrued, directly or indirectly, with respect to any real or personal property primarily used in connection with any correctional, detention, or penal facility does not qualify as rents from real property. The provision would be effective for taxable years beginning after December 31, 2021.

OBSERVATIONS:

This proposal is unchanged from the Ways and Means Committee – approved legislation. A provision in the Ways and Means package that would have eliminated "double down" attribution under the constructive ownership rules applicable to the REIT income tests was not included in the House bill.

Treatment of certain partnership interest derivatives

House legislation would amend section 871(m), which treats "dividend equivalent" payments to nonresident alien individuals and foreign corporations on certain derivative contracts as US-source dividends, to provide that any payment made pursuant to a "specified notional principal contract" that (directly or indirectly) is contingent upon, or is determined by reference to, income or gain with respect to an interest in a specified partnership (generally any publicly traded partnership) would be treated as a dividend equivalent. Income or gain with respect to an interest in a specified partnership would include any income or gain from the deemed disposition of an interest in a specified partnership as a result of the termination of, or payment with respect to, the contract (determined in the same manner as under section 864(c)(8), without regard to US real property interests) and any income or gain under section 881(a)(1). Under such regulations as Treasury shall prescribe, payments determined by reference to such income or gain, that would be exempt from US tax or treated as foreign-source income or gain that is not effectively connected with a US trade or business if earned by a nonresident alien individual, would not be treated as dividend equivalents. Payments treated as dividend equivalents generally are subject to 30% US withholding tax (which may be reduced by an applicable income tax treaty).

Treasury would have broad authority to exempt any payment it determines does not have the potential for tax avoidance, as well as to determine the contracts identified as specified notional principal contracts or to apply the provision to other derivative transactions. Additionally, Treasury may provide regulations similar to those promulgated under section 1446 in determining the amount of payment, which is a dividend equivalent.

The provision would be effective for payments made after December 31, 2022.

OBSERVATIONS:

According to the Joint Committee on Taxation's summary of the Ways and Means – approved tax title to the Build Back Better Act, in order to "determine the portion of the notional principal contract income that is attributable to the income or gain of a publicly traded partnership that is subject to the new sourcing rule, the publicly traded partnerships themselves must provide relevant information in notices to the relevant withholding agents." Reporting considerations will be important in order for specified partnerships to comply with these rules.

DISCS and FSCs held in IRAs

The House bill would make certain modifications to the DISC and FSC provision under section 996(g), as well as a modification to section 4975(c)(1) related to the treatment of DISCs and FSCs.

With respect to section 996, the legislation would modify the provisions addressing the treatment of income arising from distributions and deemed distributions from DISCs and FSCs. With respect to section 4975, the provision provides that holding an interest in a DISC or FSC that receives any commission or other payment from an entity owned by the individual for whose benefit the IRA is established is a prohibited transaction for purposes of section 4975. The provision also applies if the DISC or FSC is held indirectly through one or more corporations. For purposes of determining ownership of the entity that makes the payments, the constructive ownership rules in section 318 apply, substituting 10% for 25%. The tax imposed by section 4975 applies even if the account ceases to be treated as an IRA.

In general, these modifications would be effective for gains, distributions, and stock or other interests acquired or held, respectively, after December 31, 2021.

Treatment of financial guaranty insurance companies as qualifying insurance corporations under passive foreign investment company rules.

The House bill would provide that a financial guarantee insurance company that satisfies certain conditions may include unearned premium reserves in its applicable insurance liability for purposes of determining whether it is a passive foreign investment company. The provision clarifies that certain items on a financial statement shall be reported separately, and provides regulatory authority to impose additional tax reporting requirements on financial guarantee insurance companies. This provision is effective as if included in the TCJA, for taxable years beginning after December 31, 2017, except for reporting provisions, which are effective for reports made after the date of enactment.

Expenses in contingency fee cases

Section 162(a) generally allows for the deduction of ordinary and necessary expenses paid or incurred in carrying on a taxpayer's trade or business. However, no deduction generally is allowed to the extent the taxpayer reasonably expects to be reimbursed for an expenditure made in an agency-type capacity. An attorney representing clients on a contingent-fee basis generally may not deduct advances to or expenses paid on behalf of the clients because such amounts are expected to be repaid from any recovery and notwithstanding that the attorneys typically do not recover all of their expenditures. Rather, several courts and the IRS treat such advances as nondeductible loans. (See e.g., *Burnett v. Commissioner*, 356 F.2d 755 (5th Cir. 1966)). Thus, attorneys generally must wait until the year in which the matter is closed to recover their unreimbursed expenses.

The House bill would modify section 162 to allow attorneys in contingency fee cases to deduct their out-of-pocket litigation-related costs in the year such expenses are paid or incurred in the ordinary course of the practice of law, rather than waiting for the conclusion of the litigation. Income ultimately recognized by the attorney (e.g., a percentage of a court award or settlement amount owed to the client) is not reduced by any amount deducted by the attorney in a previous tax year. This provision would be effective for amounts paid, incurred, or received in taxable years beginning after the date of enactment.

OBSERVATIONS:

The proposed provision would provide certain attorneys an accelerated section 162 ordinary and necessary business expense deduction for out-of-pocket costs advanced by attorneys in contingent-fee cases. Because many attorneys are cash method taxpayers, this would allow a current deduction in the year the attorney pays the expense rather than waiting until the close of the case. Any reimbursement of such costs would be income in the year the reimbursement is received (or presumably accrued in the case of an accrual method taxpayer).

Research credit against payroll tax for small businesses

A qualified small business may elect under current-law section 41(h) to apply up to $250,000 of its research credit computed under section 41 against the employer portion of its FICA payroll tax liability imposed under section 3111(a) for up to five tax years. A qualified small business is a partnership, corporation, or person with gross receipts of less than $5 million for the current tax year and no gross receipts for any taxable year preceding the five taxable year period ending with the current taxable year.

The House bill would increase the amount of research credit that can be applied against payroll tax liability from $250,000 to $500,000 for years beginning after December 31, 2021. Additionally, the bill provides that the first $250,000 of the credit limitation would be applied against the FICA payroll tax liability and the second $250,000 of the limitation would be applied against the employer portion of Medicare payroll tax liability imposed under section 3111(b).

OBSERVATIONS:

This election has historically been of value to small businesses, such as start-ups, that were unable to utilize their research credits due to net operating losses. The increase to the amount of research credit permitted to be applied against payroll tax liability will be favorable to eligible taxpayers.

Temporary increase in employer-provided child care credit

The House legislation proposes to increase the percentage of the employer-provided child care credit for qualified expenditures in section 45F to 50% (from 25%) and increase the dollar limitation to $500,000 (from $150,000) for taxable years beginning after December 31, 2021 and before January 1, 2026.

Payroll credit for compensation of local news journalists

The legislation proposes a refundable payroll tax credit paid to local news journalists by an eligible local news organization or qualifying broadcasting station for each calendar quarter for 50% of wages paid for the first four calendar quarters and 30% of wages paid thereafter. An employer is limited to claim the credit on $12,500 of wages paid to 1,500 journalists per quarter. The credit applies only to wages paid in calendar quarters beginning after the date of enactment and beginning before the date that is five years after the first day of the first calendar quarter to which the section applies.

Expiration of paid family and medical leave credit

The legislation would accelerate the termination of the employer credit for wages paid to employees during family and medical leave to taxable years beginning after December 31, 2023. Currently, the credit will terminate for wages paid in taxable years beginning after 2025.

Treatment of certain qualified sound recording productions

This House bill would amend section 181 to permit taxpayers to treat expenses incurred in producing qualified sound recording productions not exceeding $150,000 in a taxable year as currently deductible. The bill defines qualified sound recording production as certain sound recordings produced and recorded in the United States. The provision expires on December 31, 2025 (the current section 181 termination date).

Payment to certain individuals who dye fuel

In general, under section 4081, tax is imposed upon the removal of taxable fuel (including diesel fuel and kerosene) from a terminal. Under section 4081(e), if tax is paid and reported to the government on more than one taxable event for a taxable fuel under section 4081, the person paying the "second tax" on such fuel may claim a refund (without interest) of that second tax if certain conditions and reporting requirements are met. However, if the fuel is dyed at removal from the second terminal, there is no second tax paid on the fuel and refund relief is not available under section 4081(e) for the dyed fuel. The House bill would create a new refund mechanism for taxpayers who remove eligible indelibly dyed diesel fuel or kerosene from a terminal for nontaxable use, and establishes to the satisfaction of the Secretary that tax for such fuel under section 4081 has already been paid.

Extension of Black Lung Disability Trust Fund tax

The legislation would extend the tax imposed on the sale of coal that finances the Black Lung Disability Trust Fund through December 31, 2025, effective for sales after December 31, 2021.

Excise tax on prescription drug manufacturers

The House bill would impose an excise tax on prescription drug manufacturers that do not participate in a nontax program to negotiate maximum prices for certain selected prescription drugs with the federal government. The excise tax would be imposed on a manufacturer during periods of noncompliance.

Imposition of tax on nicotine

The House bill would impose a new excise tax on "taxable nicotine," defined as any nicotine (other than nicotine used in currently listed tobacco products or certain products approved by the FDA) that has been extracted, concentrated, or synthesized. The amount of tax is the greater of (1) the dollar amount specified for small cigarettes, or (2) $50.33 per 1,810 milligrams of nicotine (and a proportionate tax on any fractional part thereof).

Taxable nicotine is treated as a tobacco product and general provisions that apply to tobacco products, such as (1) packaging requirements, (2) provisions relating to purchase, receipt, possession, or sale, and (3) provisions relating to civil and criminal penalties, apply to taxable nicotine. Additionally, a manufacturer of taxable nicotine is subject to the occupational tax and other requirements that apply to manufacturers of tobacco products. The Secretary would be required to prescribe regulations or other guidance as necessary or appropriate, including regulations or other guidance for coordinating the taxation of tobacco products and taxable nicotine to protect revenue and prevent double taxation. This provision is effective for articles removed in calendar quarters beginning 180 days after the date of enactment.

Green energy tax provisions

The House bill proposes production and investment tax credits related to renewable and alternative energy property and for production of certain alternative fuels; business- and consumer-focused incentives for energy-efficient buildings; incentives to promote alternative fuel vehicles for consumer and commercial use; and credits to develop a "green" workforce, all as part of the Biden administration's larger effort to mitigate climate change.

Extension and enhancement of tax credits that incentivize the production of renewable energy and reduction in carbon emissions

The legislation would incentivize investments in renewable energy resources through extensions and enhancements (if certain requirements are met) of various tax credits and incentives related to renewable and alternative energy.

Renewable electricity production tax credit (PTC): The proposal would extend the beginning of construction deadline by five years, through December 31, 2026, for wind facilities, closed-loop and open-loop biomass facilities, geothermal facilities, landfill gas facilities, trash facilities, qualified hydropower facilities, and marine and hydrokinetic renewable energy facilities.

The inflation-adjusted credit rate would be reduced to a base credit of 0.5 cents and a bonus credit is available in an amount equal to 2.5 cents if certain wage and apprenticeship requirements are met. A facility would also be deemed to satisfy the wage and apprenticeship requirements if the facility has a maximum net output of less than one megawatt, or *the construction of the facility begins prior to the date that is 60 days after the Secretary publishes guidance with respect to the wage and apprenticeship requirements.*

The proposal would extend the application of the PTC to solar facilities if construction begins before January 1, 2027.

For wind facilities placed in service before January 1, 2022, the current phased-down PTC values would apply for the respective year in which construction began (i.e., 80% value PTC for facilities that began construction in 2017, 60% value PTC in 2018, 2020, and 2021, and 40% value in 2019). For wind facilities placed in service after December 31, 2021, where construction began in 2017, 2018, 2019, 2020, and 2021, the current phased-down PTC values would no longer apply.

For a qualified facility placed in service within an "energy community," the PTC would be increased by 10% of the otherwise determined credit rate, without regard to the increased credit rate determined if certain domestic content requirements are met. An energy community means a census tract or any directly adjoining census tract in which (1) after December 31, 1999, a coal mine has closed, or (2) after December 31, 2009, a coal-fired electric generating unit has been retired.

An elective payment (i.e., a direct-pay election) would be available at 100% of the value of the allowable credit for certain facilities qualifying for the PTC if construction of such facility commences before January 1, 2024 or for facilities that have a net maximum output of less than one megawatt. Domestic content requirements are phased in for purposes of determining the direct-pay percentage for facilities that

have a net maximum output of at least one megawatt and begin construction after December 31, 2023. Facilities that begin construction during calendar year 2024 and fail domestic content requirements are eligible for direct pay at 90% of the "base credit" or bonus credit amount otherwise available. Facilities that begin construction during calendar year 2025 and fail domestic content requirements are eligible for direct pay at 85%. Facilities that begin construction after calendar year 2025 and fail to satisfy domestic content requirements are ineligible for direct pay.

If the qualified facility is financed by tax-exempt bonds, the PTC amount would be reduced by the lesser of 15% or the fraction of the proceeds of the tax-exempt obligation used to finance such project over the aggregate amount of additions to the capital account of such project. This limitation is applicable for facilities the construction of which begins after December 31, 2021.

This provision would similarly extend the deadlines for making an election to claim the section 48 investment tax credit (ITC) in lieu of the PTC by five years.

Energy investment tax credit (ITC): The proposal would extend the section 48 ITC by five years for investments in solar property, qualified fuel cell property, qualified microturbine property, qualified small wind energy property, and qualified investment credit facility property that begin construction before January 1, 2027. Ten-year extensions would be given to waste heat recovery property, geothermal heat pump property, and combined heat and power system property, thereby extending the beginning of construction deadline through December 31, 2033.

The energy credit percentage would be reduced to a base credit of 6% for solar property, qualified fuel cell property, qualified small wind energy property, waste energy recovery property, and qualified investment credit facility property (e.g., wind, open-loop biomass, hydropower facilities).

In addition, the energy credit percentage for combined heat and power system property and geothermal heat pump property (currently 10% ITC) would be modified to a base credit of 6% (with a bonus credit amount of 30%). The energy credit percentage for qualified microturbine property would be a 2% base credit amount. An "increased credit amount for energy projects" (bonus credit) would be available if certain wage and apprenticeship requirements are met, effectively restoring the current statutory energy credit percentages of 30% and 10% (only for microturbine property), respectively.

An energy project is a project consisting of multiple energy properties that are part of a single project and such project would be deemed to satisfy the wage and apprenticeship requirements if the project has a maximum net output of less than one megawatt, or *the construction of the project begins prior to the date that is 60 days after the Secretary publishes guidance with respect to the wage and apprenticeship requirements*.

For solar property, qualified fuel cell property, qualified small wind property, waste energy recovery property, and qualified investment credit facility property placed in service before January 1, 2022, where construction began in calendar year 2020 or 2021, the proposal maintains the current phased-down 26% energy credit percentage. However, the proposal eliminates this phased-down energy credit percentage for such property placed in service after December 31, 2021.

For combined heat and power system property, geothermal heat pump property, and waste heat recovery property placed in service after December 31, 2021, where construction started before January 1, 2032, the full ITC value (6% base credit) would be available. The ITC phases down to 5.2% if construction begins in calendar year 2032, 4.4% in calendar year 2033, and 0% thereafter.

For energy projects placed in service within an "energy community," the ITC base credit amount would be further increased by 2 percentage points or the bonus credit amount would be further increased by 10 percentage points for a project that satisfies the wage and apprenticeship requirements. An energy community has the same meaning as previously defined in the PTC section above. Certain solar energy property would be eligible for an increased ITC of 10 percentage points to 20 percentage points if such property is in connection with a low-income community.

The proposal would expand the ITC for several new technologies, including energy storage, qualified biogas property, and microgrid controllers, that are placed in service after December 31, 2021. The proposal does not apply effective date provisions using language described in former section 48(m) but instead provides that the amendments made to section 45(e), (f), and (g) (i.e., the addition of energy storage, qualified biogas property, and microgrid controllers) apply to any property the construction of which begins prior to January 1, 2022, only to the extent of the basis attributable to the construction, reconstruction, or erection after December 31, 2021. In addition, the eligible basis of energy property may include costs incurred for qualified interconnection property in connection with the installation of energy property that has a maximum net output of not greater than five megawatts to provide for the transmission or distribution of the electricity. The proposal also adds dynamic glass as a type of property eligible for the ITC and expands the definition of fuel cells to include electromechanical processes, among other standard modifications.

A direct-pay election would be available at 100% of the value of the allowable credit for certain property if construction of such property begins before January 1, 2024 or for property that has a net maximum output of less than one megawatt. Domestic content requirements are phased in for purposes of determining the direct-pay percentage for property that has a net maximum output of at least one megawatt and begins construction after December 31, 2023. Property that begins construction during calendar year 2024 and fails domestic content requirements is eligible for direct pay at 90% of the "base credit" or bonus credit amount otherwise available. Property that begins construction during calendar year 2025 and fails domestic content requirements is eligible for direct pay at 85%. Property that begins construction after calendar year 2025 and fails to satisfy domestic content requirements is ineligible for direct pay.

Certain reductions to the eligible basis of the energy property are required for property that uses tax-exempt bonds for project financing.

PREVAILING WAGE AND APPRENTICESHIP REQUIREMENTS FOR ITC AND PTC PURPOSES

Under section 45(b)(7), the wage requirements provide that taxpayers must pay wages at prevailing rates during the construction of a facility and for the alteration or repair of such facility during the 10-year period beginning on the date the facility was originally placed in service. A taxpayer can correct its failure to pay prevailing wages by making payment to such laborer or mechanic in an amount equal to the difference between the amount required to be paid and the amount actually paid plus interest on such true-up and pay a penalty in the amount of $5,000 per laborer or mechanic paid wages below the prevailing rate for any period during such year, assessed in the form of a tax. (The penalty may increase up to $10,000 if there is an intentional disregard of the wage requirements).

During the construction of a facility, apprenticeship requirements—as defined under section 45(b)(8)—apply in order to be eligible for the bonus credit. A taxpayer must ensure that not less than 15% of the total labor hours for projects that begin construction after calendar year 2023 and later (otherwise, 10% for projects the construction of which begins before calendar year 2023 and 12.5% for projects beginning construction in calendar year 2023) for construction, alteration, or repair work on any project are performed by qualified apprentices. In addition, the ratio of apprentice-to-journeyworker must meet the standard set by the Department of Labor. The apprenticeship requirement applies to contractors or subcontractors that employ four or more individuals to perform construction, alteration, or repair work on a qualified facility, and requires the employ of one or more qualified apprentices to perform such work (i.e., minimum 4:1 ratio). If a project fails to satisfy the apprenticeship requirements, the taxpayer must pay the IRS a penalty equal to $50 per hour of apprenticeship requirement that has not been met, unless the taxpayer meets the good-faith effort exception. (The penalty may increase to $500 per hour if there is an intentional disregard of the apprenticeship requirements.)

DOMESTIC CONTENT REQUIREMENTS FOR ITC AND PTC PURPOSES

As defined under proposed section 45(b)(9), facilities or property that meet certain domestic content requirements are eligible for an additional bonus credit in the amount of 10%. The taxpayer must certify (in a time and manner prescribed by the Secretary) with respect to a qualified facility or property that any steel, iron, or manufactured product that are components of such facility or property upon completion of construction were produced in the US.

For purposes of steel and iron, this requirement shall be applied consistently with section 661.5(b) of title 49, Code of Federal Regulations, which stipulates "all steel and iron manufacturing processes must take place in the United States, except metallurgical processes involving refinement of steel additives." Exceptions apply to any steel or iron that is used as a component or subcomponent of a manufactured product that is not primarily made of steel or iron. The manufactured products that are components of a qualified facility upon completion of construction shall be deemed to have been produced in the US if not less than the adjusted percentage of the total costs across all such manufactured products of such facility is attributable to manufactured products (including components) that are mined, produced, or manufactured in the US.

The adjusted percentage for manufactured products is 40% if the facility begins construction before January 1, 2025. The percentage increases to 45% if the facility begins construction in calendar year 2025, 50% if the facility begins construction in calendar year 2026, and 55% if the facility begins construction in year 2027 or thereafter. Special domestic content rules apply for offshore wind facilities. The adjusted percentage for manufactured products is 20% if the facility begins construction before January 1, 2025, 27.5% if the facility begins construction during calendar year 2025, 35% if the facility begins construction during calendar year 2026, 45% if the facility begins construction during calendar year 2027 (applicable under section 45BB), and 55% if the facility begins construction after calendar year 2027 (also applicable under section 45BB).

Elective payment for energy property and electricity produced from certain renewable resources: The legislation would add new section 6417, which allows taxpayers to elect to be treated as having made a payment of tax equal to the value of the applicable credit for which such taxpayer would have otherwise been eligible. This provision would apply to the following tax credits:

- Section 48 ITC;
- Section 45 PTC;
- Section 45Q credit for carbon capture and sequestration;
- Section 30C alternative fuel vehicle refueling property credit;
- Section 48C advanced energy project credit;
- Section 48D investment credit for transmission property;
- Section 45W zero-emission nuclear power production credit;
- Section 45X clean hydrogen production credit;
- Section 48E advanced manufacturing investment credit;
- Section 45AA advanced manufacturing production credit;
- Section 45BB clean electricity production credit;
- Section 48F clean electricity investment credit; and
- Section 45CC clean fuel production credit.

The applicable credit means (1) so much of the PTC under section 45 as is attributable to qualified facilities that are originally placed in service after December 31, 2021, (2) the ITC determined under section 48, (3) so much of the 45Q credit as is attributable to carbon capture equipment that is originally placed in service after December 31, 2021, the 30C credit, and the 48C credit. Certain tax-exempt organizations and governmental entities may make a direct-pay election and any credit shall be determined without regard to sections 50(b)(3) and (4)(A)(i), and by treating any property with respect to such credit determined as used in a trade or business of the taxpayer. For partnerships and S corporations, the election is made and payments are received at the entity level. Payments to partnerships or S corporations will be treated as tax-exempt income for purposes of sections 705 and 1366. A partner's distributive share of such tax-exempt income shall be based on such partner's distributive share of the otherwise applicable credit for each taxable year (i.e., the allocation of the tax-exempt income reflects the way that the ITC or PTC would have been allocated but for the direct-pay election).

Any election under this subsection shall be made not later than the due date (including extensions of time) for the return of tax for the taxable year for which the election is made, but in no event earlier than 270 days after the date of the enactment of this section. Any such election, once made, shall be irrevocable. For the PTC, 45Q credit, section 45X credit, and 45BB credit, a one-time, irrevocable election must be made for the taxable year in which the facility is placed into service, and such election shall apply for all subsequent taxable years.

Investment credit for electric transmission property: The proposal would add a new section 48D ITC for electric transmission property equal to a 6% base credit amount (or a 30% bonus credit amount if certain wage and apprenticeship requirements are met) of the basis of qualifying electric transmission property for such property placed in service before January 1, 2032. Qualifying electric transmission property includes qualifying electric transmission lines capable of transmitting electricity at a voltage of not less than 275 kilovolts or is a superconducting line, and has a transmission capacity of 500 megawatts and certain related transmission property. Upgrades to existing property may qualify, but only to the extent such upgrade increases the capacity of the existing transmission property and existing transmission property would not be included in the basis.

The proposal precludes a credit for any property that is selected in a regional transmission plan approved by a transmission planning region that was approved by the Federal Energy Regulatory Commission prior to January 1, 2022, or any property if construction of such property begins before January 1, 2022 or the construction of any portion of the qualifying electric transmission line to which such property relates begins before such date.

For purposes of the new section 48D, construction of property begins when the taxpayer has begun on-site physical work of a significant nature to such property. Certain wage and apprenticeship requirements and domestic content requirements apply. The direct-pay election is also included applying rules similar to the phase-out for the ITC direct-pay election where domestic content requirements are not satisfied.

Expand and enhance the carbon oxide sequestration credit (45Q credit): This proposal would extend the deadline to begin construction by five years (through December 31, 2031) and amend the 45Q credit for certain facilities or carbon capture equipment that begin construction after December 31, 2021.

The proposal would provide base credit amounts of $12 per metric ton and $17 per metric ton for qualified carbon oxide captured by a taxpayer and utilized (in a commercial market or used as a tertiary injectant) or sequestered (in secure geological storage) by taxpayer, respectively, or $60 per metric ton and $85 per metric ton bonus credit amounts if certain wage and apprenticeship requirements are met. Similarly, the base credit amount for direct air capture facilities would be $36 per metric ton, with a bonus credit amount of $180 per metric ton if certain wage and apprenticeship requirements are met. A facility or carbon capture equipment would be deemed to satisfy the wage and apprenticeship requirements if construction of the carbon capture equipment begins prior to the date that is 60 days after the Secretary publishes guidance with respect to the wage and apprenticeship requirements at a qualified facility the construction of which begins prior to such date.

The proposal modifies the definition of a qualified facility by lowering the qualified carbon oxide capture thresholds. Specifically, a qualified facility would mean a facility that captures:

- In the case of a direct air capture facility, not less than 1,000 metric tons of qualified carbon oxide during the taxable year;
- In the case of an electricity generating facility, not less than 18,750 metric tons of qualified carbon oxide during the taxable year and not less than 75% by mass of carbon oxide that would otherwise be released into the atmosphere by such facility during such taxable year; and
- In the case of any other facility, not less than 12,500 metric tons of qualified carbon oxide during the taxable year.

For any carbon capture equipment placed in service before the date of enactment of the Bipartisan Budget Act of 2018, no credit shall apply with respect to carbon oxide captured after the earlier of December 31, 2022, or the end of the calendar year in which the Secretary certifies that a total of 75 million metric tons of qualified carbon oxide have been taken into account.

In the case of facilities placed into service on or after the date of enactment of the Bipartisan Budget Act of 2018, the taxpayer may elect to have the 12-year credit period begin on the first day of the first taxable year in which a credit under this section is claimed for carbon capture equipment originally placed in service on or after that legislation's enactment date. A taxpayer may only make such an election if (1) no taxpayer claimed a credit under this section with respect to such carbon capture equipment for any prior taxable year, (2) the qualified facility at which such carbon capture equipment is placed in service is located in an area affected by a federally declared disaster (as defined by section 165(i)(5)(A)) after the carbon capture equipment is originally placed in service, and (3) such federally declared disaster resulted in a cessation of the operations of the qualified facility after the carbon capture equipment was originally placed in service.

For qualified facilities, the construction of which began before January 1, 2022, any additional carbon capture equipment installed at such facility or construction of such equipment after December 31, 2021, would be eligible for an incremental credit amount for the qualified carbon oxide captured at such facility in excess of the original capacity of such equipment in service on February 9, 2018.

If the qualified facility is financed by tax-exempt bonds, the 45Q credit amount would be reduced by the lesser of 15% or the fraction of the proceeds of the tax-exempt obligation used to finance such project over the aggregate amount of additions to the capital account of such project, applicable for facilities the construction of which begins after December 31, 2021.

Green energy publicly traded partnerships: The proposal would allow publicly traded partnerships to own interests in green and renewable energy resources by expanding the definition of qualified income. These additions include income from certain activities related to energy production eligible for the PTC, property eligible for the ITC, renewable fuels, and energy and fuel from carbon sequestration projects eligible for the section 45Q credit.

Zero-emission nuclear power production credit: The proposal would create a new credit under section 45W equal to a base credit of 0.3 cents per kilowatt-hour produced by the taxpayer at a qualified nuclear power facility and provides a bonus credit in an amount equal to 1.5 cents if certain wage and apprenticeship requirements are met. The electricity must be sold by the taxpayer to an unrelated person during the taxable year. The credit amount is reduced as the sale price of such electricity increases, and would be reduced by 16% of the excess of the gross receipts (excluding certain state and local zero-emissions grants) from any electricity produced and sold by such facility over the product of 2.5 cents multiplied by the amount of electricity sold during the taxable year. A qualified nuclear power facility means any nuclear facility that is (1) owned by the taxpayer and which uses nuclear energy to produce electricity, (2) has not received an allocation under section 45J, and (3) is placed in service before the date the legislation is enacted. The direct-pay option would be available (see discussion of the direct-pay election for more information). The proposal would apply to electricity produced and sold after December 31, 2021, in taxable years beginning after such date and terminate in taxable years beginning after December 31, 2027.

Extension and enhancement of renewable fuels tax credits

Renewable fuels credits and second-generation biofuel incentives: The proposal would extend incentives for biodiesel, renewable diesel, and alternative fuels through December 31, 2026 for sections 40A(g), 6426(c)(6), 6427(e)(6)(B), 6426(d)(5), 6426(e)(3), and 6427(e)(6)(C), and extend section 40(b)(6)(J)(i) through December 31, 2027. The proposal would apply to fuel sold or used after December 31, 2021.

Sustainable aviation fuel credit: The proposal would provide a new sustainable aviation fuel credit under section 40B, which would be added as a general business credit under section 38. The credit amount for the taxable year would be, with respect to any sale or use of a qualified mixture that occurs during such taxable year, an amount equal to the product of the number of gallons of sustainable aviation fuel in such mixture multiplied by (1) a base credit amount of $1.25, plus (2) the applicable supplementary credit amount (i.e., an amount equal to 1 cent for each percentage point by which the lifecycle greenhouse gas emissions reduction percentage with respect to such fuel exceeds 50%; however, in no event shall the applicable supplementary amount exceed 50 cents). The proposal would apply to any sale or use of sustainable aviation fuel after December 31, 2022 and before January 1, 2027.

The proposal would also modify sections 6426 and 6427(e) to include the sustainable aviation fuel credit, which includes the same definitions as section 40B. Any amount of the credit allowed under section 40B would be reduced to take into account any benefit provided with respect to sustainable aviation fuel (as defined in section 40B) by reason of the application of section 6426 or section 6427(e).

Credit for production of clean hydrogen: The proposal would create a new tax credit under section 45X for the production of clean hydrogen produced by a taxpayer after December 31, 2021, at a qualified clean hydrogen facility during the 10-year period beginning on the date the facility is originally placed in service. Construction of a qualified clean hydrogen facility must commence before January 1, 2029.

The credit is equal to the applicable percentage (the percentage varies based on the greenhouse gas emissions rate of carbon dioxide per kilogram of hydrogen) of the base credit amount of 60 cents per kilogram of qualified clean hydrogen produced by the taxpayer during such taxable year at a qualified clean hydrogen production facility during the 10-year period beginning on the date the facility was placed in service. A bonus credit amount of $3 per kilogram of qualified clean hydrogen produced would apply if certain wage and apprenticeship requirements are met. A qualified facility may also qualify for a bonus credit amount if the construction of such facility begins prior to 60 days after the Secretary publishes guidance with respect to the requirements of meeting the wage and apprenticeship rules, and the facility complies with the wage requirements after that date.

The proposal precludes a taxpayer from claiming a credit with respect to qualified clean hydrogen produced at a facility that includes property for which a credit is allowed under section 45Q for the taxable year or any prior taxable year. The proposal permits a taxpayer to receive both the section 45 credit for electricity produced from renewable resources during the 10-year period after such facility is placed in service and the section 45X credit for production of clean hydrogen. The electricity will be treated as sold to an unrelated person if such electricity is used at a qualified clean hydrogen production facility to produce clean hydrogen. Taxpayers are provided the ability to elect direct payment of the section 45X credit in a similar manner to other provisions.

In lieu of the clean hydrogen production credit under section 45X, the proposal permits a taxpayer to make an irrevocable election to treat specified clean hydrogen production facilities (or any portion of such facility) as energy property. The ITC energy percentage with respect to such property would be a base credit amount up to 6% (the base credit amount varies based on the greenhouse gas emissions rate of carbon dioxide per kilogram of hydrogen produced at the facility) with a bonus credit amount of up to 30% if certain wage and apprenticeship requirements are met. A specified clean hydrogen production facility means any facility as defined in section 45X(c)(3) or any portion of such facility that is placed in service after December 31, 2021, to which no credit has been allowed under sections 45Q or 45X, and the taxpayer makes an irrevocable election to treat such facility as energy property. For any property the construction of which begins prior to January 1, 2022, only the basis attributable to the construction, reconstruction, or erection after December 31, 2021 may be included.

The proposal would also terminate the excise tax credit for hydrogen fuel sold or used after December 31, 2021, and the available credit amount will be reduced for facilities financed by tax-exempt bonds. This provision would be effective for facilities the construction of which begins after December 31, 2021.

Green energy and energy-efficiency incentives for individuals

Extension, increase, and modifications of nonbusiness energy property credit: The proposal would extend the section 25C credit for nonbusiness energy property for 10 years (through December 31, 2031) at an increased credit amount of 30% for qualified energy-efficiency improvements and residential energy property expenditures. The proposal applies an annual limitation, in lieu of the previously imposed lifetime limitation of the credit, in an amount equal to $1,200. Certain energy property would have a lower annual limitation whereas other property (e.g., energy-efficient building envelope components) is excluded from such annual limitation. The proposal modifies certain definitions and would be applicable to property placed in service after December 31, 2021.

Residential energy-efficient property: The proposal would extend the section 25D credit for residential energy-efficient property expenditures through December 31, 2033 and add qualified battery storage technology as eligible property. The applicable percentage would be:

- 30% (full value) for property placed in service after December 31, 2021, and before January 1, 2032;
- 26% for property placed in service in calendar year 2032; and
- 22% for property placed in service in calendar year 2033.

For calendar years after 2023, no credit shall be allowed with respect to any property placed in service unless the property is installed by a qualified installer, and the taxpayer includes the qualified installation identification number (i.e., a unique identification number with respect to the expenditures in connection with a residence of a taxpayer that is installed by a qualified installer). The Secretary may require certain information or registration of a qualified installer as the Secretary deems necessary or appropriate to prevent duplication, fraud, or improper claims with respect to such property installed by a qualified installer.

Effective for calendar year 2023, the proposal would disallow the carryforward of any unused tax credits (excluding any credit carried forward from a previous taxable year) and it would make the credit refundable starting in 2024.

Energy-efficient commercial buildings deduction: The proposal would enhance the section 179D deduction for taxable years beginning after December 31, 2021 and before January 1, 2032. The proposal would allow taxpayers to elect to take an alternative, parallel deduction for energy-efficient lighting, HVAC, and building envelope costs placed into service in connection with a qualified retrofit plan. In order to qualify for the alternative deduction, a building retrofit project must reduce a building's energy usage intensity by no less than 25%.

The proposal increases the maximum deduction to an amount equal to 50 cents per square foot (or $2.50 bonus credit amount) increased (but not above $1 (or $5 bonus credit amount)) by 2 cents (or 10-cent bonus credit amount) for each percentage point by which the total annual energy and power costs for the building are certified to be reduced by a percentage greater than 25% (modifying the current section 179D statutory efficiency standard from 50% to 25%). The proposal provides a bonus credit amount for certain property that satisfies wage and apprenticeship requirements during the construction, alteration, or repair of any property or building modifications.

A project satisfies the bonus credit requirements if it meets one of the following conditions: (1) a building or qualified retrofit plan, the construction of which begins prior to 60 days after the Secretary publishes guidance with respect to the requirements of meeting the wage and apprenticeship rules, or (2) a building or qualified retrofit plan the construction of which satisfies the wage and apprenticeship requirements. The proposal would change the maximum amount of deduction with respect to any building from a lifetime cap to a three-year cap. Furthermore, the proposal would allow tax-exempt entities to allocate the deduction to the designer of the building or qualified retrofit plan and in the case of a corporation that is a real estate investment trust, any amount deductible under section 179D shall be allowed in the year in which the property giving rise to the deduction is placed in service.

Extension, increase, and modifications of energy-efficient new home credit: This provision would extend the section 45L credit for 10 years (through December 31, 2031) and increase the existing credit amounts to $2,500 for new homes that meet certain energy-efficiency standards and $5,000 for new homes that are certified as zero energy ready homes. The credit for multifamily dwelling units is reduced to 20% of the otherwise applicable amount ($500 and a bonus credit amount of $2,500). The proposal provides a higher-tier base credit amount of $1,000 (or a bonus credit amount of $5,000) for eligible multifamily units certified as zero energy ready under the Department of Energy's Zero Energy Ready Home Program. The bonus credit amount is available with respect to multifamily housing where certain wage requirements are met during the construction of such housing. The proposal would be effective for dwelling units acquired after December 31, 2021.

Modifications to income exclusion for conservation subsidies: Section 136(a) provides that gross income shall not include the value of any subsidy provided (directly or indirectly) by a public utility to a customer for the purchase or installation of any energy conservation measure. Section 136(c)(1) defines the term "energy conservation measure" as any installation or modification primarily designed to reduce consumption of electricity or natural gas or to improve the management of energy demand with respect to a dwelling unit. Section 136(c)(2)(B) defines "public utility" as any person engaged in the sale of electricity or natural gas to residential, commercial, or industrial customers for use by such customers.

The House bill would amend section 136(a) to exclude from the recipient's gross income any subsidy provided, directly or indirectly, by: (1) a public utility to a customer, or by a state or local government to a resident of such state or locality, for the purchase or installation of any water conservation or efficiency measure; (2) a storm water management provider to a customer, or by a state or local government to a resident of such state or locality, for the purchase or installation of any storm water management measure; or, (3) a state or local government to a resident of such state or locality for the purchase or installation of any wastewater management measure. Additionally, the House bill provides conforming amendments to section 136(c) to define "water conservation or efficiency measure," "storm water management measure," "wastewater management measure," and "storm water management provider," and modify the definition of "public utility" to mean a person engaged in the sale of electricity, natural gas, or water to residential, commercial, or industrial customers for use by such customers.

This amendment is effective for water conservation, storm water management, and wastewater management subsidies received after December 31, 2018. The bill provides that nothing in the Build Back Better legislation shall be construed to create any inferences with respect to the proper tax treatment of such subsidies received before January 1, 2019.

OBSERVATIONS:

The expansion of the section 136 exclusion from a recipient's gross income to include water conservation subsidies, storm water management subsidies, and wastewater management subsidies may encourage a customer of a public utility or storm water management provider, or a resident of a state or local government, to purchase or install a water conservation or efficiency measure, storm water management measure, or wastewater management measure. Furthermore, the expansion of section 136 may encourage water utilities and storm water management providers to offer subsidies or extend current programs related to the additional measures now addressed by section 136.

Greening the fleet and alternative vehicles

Refundable new qualified plug-in electric drive motor vehicle credit for individuals: The proposal would add three new electric vehicle credits for individual and commercial use, repealing section 30D.

The new qualified plug-in electric drive motor vehicle tax credit under section 36C would eliminate the existing section 30D tax credit's limitation on the number of credit-eligible electric vehicles each manufacturer can sell.

The proposal applies to vehicles acquired after December 31, 2021 and before January 1, 2032. A taxpayer would be limited to one vehicle per taxable year. The proposal provides a maximum credit of $12,500 for a new qualified plug-in electric drive motor vehicle purchased and placed in service by an individual that meets the battery capacity, domestic assembly, domestic content, and collective bargaining standards outlined below:

- ***For vehicles acquired before January 1, 2027***, the base credit amount would be $4,000 and a supplemental credit of $3,500 would be available for vehicles with a battery capacity of not less than 40 kilowatt hours and such vehicle has a gasoline tank capacity not greater than 2.5 gallons.
- ***For vehicles acquired after December 31, 2026***, the base credit amount would be $4,000 and a supplemental credit of $3,500 would be available for vehicles with a battery capacity of not less than 50 kilowatt hours and such vehicle has a gasoline tank capacity not greater than 2.5 gallons.
- The base credit amount would be increased by an additional $4,500 for new qualified plug-in electric drive motor vehicles for which the final assembly is at a facility located in the US and such facility is operating under a collective bargaining agreement negotiated by an employee organization.
- The base credit amount would be further increased by $500 for new qualified plug-in electric drive motor vehicles with battery cells manufactured in the US.

The proposal precludes the credit from exceeding 50% of the purchase price of the vehicle and the credit would be reduced to $0 if the manufacturer's suggested retail price exceeds $80,000 in the case of a pickup truck, sport utility vehicle, or van, and $55,000 in the case of any other vehicle. The credit would be reduced further if a taxpayer's modified adjusted gross income exceeds certain thresholds (i.e., $500,000 in the case of a joint return or surviving spouse; $375,000 in the case of a head of household; and $250,000 in any other case). The proposal permits limited transferability of the credit between dealers and buyers as well.

The proposal includes a credit under section 36C for certain two- and three-wheeled plug-in electric drive vehicles in an amount equal to the lesser of 30% of the cost of the two- or three-wheeled plug-in electric vehicle, or $7,500.

Credit for previously owned qualified plug-in electric drive motor vehicles: The proposal would create a new credit for previously owned qualified plug-in electric drive motor vehicles under section 36D in an amount equal to $2,000 plus a supplemental credit amount of $2,000 if the vehicle is placed in service before 2027, and such vehicle draws propulsion energy from a battery with not less than 40 kilowatt hours of capacity and has a gasoline tank capacity not greater than 2.5 gallons. If such vehicle is placed in service after 2026, then the supplemental credit amount would be $2,000, so long as the vehicle draws propulsion energy from a battery with not less than 50 kilowatt hours of capacity and has a gasoline tank capacity not greater than 2.5 gallons. The credit amount cannot exceed 50% of the sale price of the vehicle and would be further reduced if a taxpayer's modified adjusted gross income exceeds certain thresholds. Similar transferability rules apply as provided in section 36C. The proposal would take effect for vehicles acquired after December 31, 2021 and before January 1, 2032.

Credit for qualified commercial electric vehicles: The proposal would create a new tax credit for qualified commercial electric vehicles under section 45Y equal to the lesser of (1) 30% of the basis of such vehicle (or 15% in the case of a hybrid vehicle also powered by a gasoline or diesel internal combustion engine), or (2) the incremental cost of such vehicle. The incremental cost of any qualified commercial electric vehicle is an amount equal to the excess of the purchase price for such vehicle over such price of a comparable vehicle (i.e., comparison of the commercial electric vehicle to any vehicle comparable in size and use to a commercial electric vehicle which is powered solely by a gasoline or diesel internal combustion engine). Taxpayers that acquire a vehicle for lease to individuals may make an election to claim the credit in an amount equal to the credit allowed under the new section 36C (i.e., up to $12,500) contingent upon compliance with certain requirements under section 36C.

A qualified commercial electric vehicle is defined as a vehicle that:

- Meets the requirements of subparagraphs (A) and (C) of section 36C(e)(1) (i.e., the original use of the vehicle commences with the taxpayer and such vehicle is made by a qualified manufacturer) without regard to any gross vehicle weight rating or such taxpayer's modified adjusted gross income (i.e., the requirements of section 36C(d)), and is acquired for use or lease by the taxpayer and not for resale;
- Either meets the requirements of subparagraph (D) of section 36C(e)(1) (i.e., treated as a motor vehicle for purposes of title II of the Clean Air Act) and is manufactured primarily for use on public streets, roads, and highways (not including a vehicle operated exclusively on a rail or rails), or is mobile machinery as defined in section 4053(8) (including vehicles that are not designed to perform a function of transporting a load over the public highways);

- Is either propelled to a significant extent by an electric motor that draws electricity from a battery with a capacity of not less than 15 kilowatt hours and is capable of being recharged from an external source of electricity, or such vehicle is a new qualified fuel cell motor vehicle described in subparagraphs (A) and (B) of section 30B(b)(3); and
- Is of a character subject to the allowance for depreciation.

The proposal includes certain recapture rules applicable to section 45Y. If a taxpayer leases a vehicle to an individual, the taxpayer would be required to ensure the individual's modified adjusted gross income does not exceed certain thresholds as outlined in section 36C. Furthermore, the proposal would require the taxpayer to reduce the basis of the vehicle in an amount equal to the value of the credit. Vehicles placed in service by tax-exempt entities and that are not subject to a lease are provided an exception so that such vehicle is not required to be of a character subject to the allowance for depreciation. The proposal would apply to vehicles acquired after December 31, 2021, and before January 1, 2032.

Qualified fuel cell motor vehicles: The proposal would extend section 30B, the tax credit for qualified fuel cell motor vehicles, by 10 years (through December 31, 2031) and modify the definition of a new qualified fuel cell motor vehicle such that the vehicle is property not of a character subject to an allowance for depreciation. The proposal would be effective for property placed in service after December 31, 2021.

Alternative fuel refueling property credit: The proposal would enhance and extend the alternative fuel refueling property credit under section 30C by 10 years (through December 31, 2031). The proposal expands the credit for zero-emissions charging and refueling infrastructure installed for personal and commercial use.

For depreciable property (for businesses) the proposal would provide a base credit amount of 6% or a bonus credit amount of 30%, if certain wage and labor requirements are met, of any qualified alternative fuel vehicle refueling property placed in service by the taxpayer during the taxable year up to $100,000. A supplemental credit amount of 4% (or a supplemental bonus credit amount of 20%, if certain wage and labor requirements are met) of allowable expenses in excess of the $100,000 limitation would be available if such expenses are attributable to qualified alternative vehicle refueling property that is (1) intended for general public use with no associated fee or payment arrangement, (2) is intended for general public use and accepts payment via credit card reader, including a credit card reader that uses contactless technology, or (3) is intended for use exclusively by commercial or governmental vehicles. The allowable expenses for which the supplemental 4% base credit or 20% bonus credit may be claimed include expenses for certain electric charging property if such property refuels vehicles with only electricity or fuel consisting of at least 85% hydrogen by volume (i.e., such electricity or hydrogen fuel will be treated as a clean-burning fuel for purposes of section 179A(d)).

For nondepreciable property (for individuals), a base credit amount of 30% or $3,333.33 would be available, plus a supplemental credit amount of 4% for allowable expenses in excess of such limitation (i.e., it allows a credit for expenses beyond the limit if certain requirements are met) as outlined above.

The term, "qualified alternative fuel vehicle refueling project", means a project consisting of multiple properties that are part of a single project and meets one of the following requirements:

- The construction of such project begins prior to the date that is 60 days after the Secretary publishes guidance with respect to the wage and apprenticeship requirements, or
- A project that satisfies the wage and apprenticeship requirements. A taxpayer may correct its failure to satisfy the wage requirements and apprenticeship requirements as outlined in section 45(b)(7)(B) and (b)(8).

The proposal clarifies that biodirectional charging equipment would qualify and permits electric charging stations to qualify in limited circumstances for vehicles with two or three wheels.

Taxpayers may elect direct payment of the section 30C credit, in a similar manner to other provisions. The proposal would be effective for property placed in service after December 31, 2021.

Reinstatement and expansion of employer-provided fringe benefits for bicycle commuting: See the separate chapter on employee benefits provisions elsewhere in this publication for details on this provision.

Credit for certain new electric bicycles: The proposal would create a new refundable tax credit under section 36E for electric bicycles placed in service after December 31, 2021 and before December 31, 2025 in an amount equal to 30% (i.e., up to $900) of the cost of each qualified electric bicycle (not to exceed $3,000 per electric bicycle) placed in service by the taxpayer during such taxable year. A taxpayer may claim the credit for one electric bicycle per taxable year (two for joint filers). The aggregate amount paid for the electric bicycle must not exceed $4,000 to be eligible. The credit amount is reduced if the taxpayer's adjusted gross income exceeds certain thresholds (i.e., phase-out begins at $75,000 of modified adjusted gross income ($112,500 for heads of household and $150,000 for married filing jointly)) at a rate of $200 per $1,000 of additional income.

A qualified electric bicycle is defined as a bicycle that is equipped with fully operable pedals, a saddle or seat for the rider, an electric motor of less than 750 watts that is designed to provide assistance in propelling the bicycle, and does not provide assistance if the bicycle is moving in excess of 20 miles per hour or only provides assistance when the rider is pedaling and does not provide assistance if the bicycle is moving in excess of 28 miles per hour.

Taxpayers and manufacturers must comply with certain reporting rules (e.g., the manufacturer must assign each bicycle a unique vehicle identification number (VIN) and report such information to the Treasury in a manner prescribed by the Secretary, and taxpayers must provide such VIN assigned to the electric bicycle by the manufacturer in order to claim the credit).

A taxpayer must reduce the basis of any property for which a credit is allowable by the amount of such credit and must also reduce any deduction or other credit allowable for a qualified electric bicycle by the amount of such credit under section 36E. Recapture applies for any property that ceases to be eligible. In certain circumstances, taxpayers may transfer the credit to an "eligible entity" (i.e., the electric bicycle retailer) and such eligible entity may receive advance payments from the Secretary equal to the cumulative amount of the credits allowed with respect to any qualified bicycles sold by such registered retail entity for which such transfer election was made.

Investment in the green workforce

Extension of the advanced energy project credit (48C credit): The House bill reintroduces the section 48C credit with increased allocation of credits to $5 billion annually for years 2022 through 2023, $1.875 billion for each calendar years 2024 through 2031, and zero thereafter. Any unallocated credit amounts may be allocated in the succeeding calendar years but no later than any calendar year after 2036.

Of the base annual allocations, $800 million for calendar years 2022 and 2023, and $300 million for each calendar year 2024 through 2031 must be allocated to projects in automotive communities. An automotive community is a census tract that has experienced major job losses in the automotive manufacturing sector since January 1, 1994, as determined by the Secretary, or a census tract that is immediately adjacent to one such census tract.

Furthermore, $800 million for calendar years 2022 and 2023, and $300 million for each calendar year 2024 through 2031 would be set aside for projects located in energy communities (as defined in section 45(b)(11)(B)). Each applicant that receives a certification will have two years from the date of issuance of such certification to notify the Secretary that such project has been placed in service and the requirements of the certification have been met.

The proposal provides a base credit rate of 6% of qualified investments in qualified advanced energy projects and a bonus credit rate in an amount equal to 30% if taxpayers satisfy (1) prevailing wage requirements for the establishment, expansion, or re-equipping of a manufacturing facility and for five years after the project is placed into service, and (2) apprenticeship requirements during the construction of the project. Taxpayers may correct a failure to satisfy the wage requirements and apprenticeship requirements as outlined in section 45(b)(7)(B) and (b)(8).

In reviewing applications, the Secretary shall give the highest priority to projects if the manufacturing is not for the assembly of parts or if they have the greatest potential for commercial deployment of new applications.

The selection criteria will include additional factors, such as which projects will provide (1) the greatest net impact in avoiding or reducing anthropogenic emissions of greenhouse gases, (2) the greatest domestic job creation during the credit period, (3) the greatest job creation within the vicinity of the project with respect to low-income communities and dislocated workers who were previously employed in manufacturing, coal power plants, or coal mining, and (4) the greatest job creation in areas with a population that is at risk of experiencing higher or more adverse human health or environmental effects and a significant portion of such population comprises people of color, low-income communities, or individuals formerly employed in the fossil fuel industry. The highest priority would be given to projects that manufacture property described in section 48C(c)(1)(A)(i) and have the greatest potential for commercial deployment of new applications.

The proposal expands the definition of qualifying advanced energy projects to include energy storage systems, electric grid property, electric fuel cell vehicles, electric vehicles and bicycles, property for production of hydrogen, and recycling of advanced energy property, among others. An elective payment (i.e., a direct-pay election) would be available at 100% of the value of the allowable credit for certain projects. Taxpayers claiming the 48C credit would be precluded from claiming a benefit under sections 48B, 48F, 45Q, or 45X. The proposal would be effective beginning on January 1, 2022.

Labor costs of installing mechanical insulation property: The proposal would add a new general business credit under section 45Z in an amount equal to 2% or a bonus credit equal to 10%, if certain wage and apprenticeship requirements are met as defined in section 45(b)(7) and (8), for mechanical insulation labor costs paid or incurred by the taxpayer during a taxable year.

Mechanical insulation labor costs are the labor costs of installing mechanical insulation property with respect to a mechanical system located in the US that was originally placed in service not less than one year before the date on which such mechanical insulation property is installed. Mechanical insulation property is depreciable property consisting of insulation materials, as well as facings and accessory products installed in connection to such insulation materials, placed in service in connection with a mechanical system that meets certain requirements (as outlined in section 10 CFR section 434.403), which results in a reduction in energy loss from the mechanical system that is greater than the expected reduction from the installation of insulation materials meeting the minimum requirements of Reference Standard 90.1 (as defined in section 179D(c)(2)). Taxpayers are not allowed a deduction for the portion of mechanical insulation costs otherwise allowable in a taxable year equal to the credit amount under section 45Z. The proposal would be effective for costs paid or incurred in taxable years ending after December 31, 2021 and before January 1, 2026.

Advanced manufacturing investment credit: The proposal would create a new ITC under section 48E in an amount equal to 5% or a bonus credit amount of 25% if certain wage and apprenticeship requirements are met during the construction of such facility and the five years beginning on the date the facility is placed in service, of the qualified investment for such taxable year with respect to any advanced manufacturing facility. An advanced manufacturing facility means a facility the primary purpose of which is the manufacturing of semiconductors or semiconductor tooling equipment.

A qualified investment with respect to any advanced manufacturing facility for any taxable year is the basis of any qualified property placed in service by the taxpayer during such taxable year that is part of an advanced manufacturing facility. The proposal defines qualified property as property:

- Which is tangible property;
- With respect to which depreciation (or amortization in lieu of depreciation) is allowable;
- Which is (1) constructed, reconstructed, or erected by the taxpayer, or (2) acquired by the taxpayer if the original use of such property commences with the taxpayer; and
- Which is integral to the operation of the advanced manufacturing facility.

It may also include any building or its structural components that otherwise satisfy the aforementioned requirements except with respect to a building or portion of a building used for offices, administrative services, or other functions unrelated to manufacturing. An elective payment (i.e., a direct-pay election) would be available at 100% of the value of the allowable credit for certain facilities.

The proposal would apply to facilities or property the construction of which begins before January 1, 2026 and such facilities or property are placed in service after December 31, 2021. For any property the construction of which begins prior to January 1, 2022, the proposal would apply only to the extent of the basis attributable to the construction, reconstruction, or erection after December 31, 2021.

Advanced manufacturing production credit: The proposal would create a new production credit under section 45AA in an amount equal to the sum of the credit amounts for each eligible component (i.e., solar energy component and wind energy component) produced by the taxpayer and sold to an unrelated person after December 31, 2021. A solar energy component means solar modules, photovoltaic cells, photovoltaic wafers, and solar grade polysilicon. Wind energy component means blades, nacelles, towers, and offshore wind foundations.

The credit amount with respect to any eligible component, including any eligible component it incorporates, shall be:

- In the case of a thin photovoltaic cell or crystalline photovoltaic cell, an amount equal to the product of (1) 4 cents, multiplied by (2) the capacity of such cell (expressed on a per direct current watt basis);
- In the case of a photovoltaic wafer, $12 per square meter;
- In the case of solar grade polysilicon, $3 per kilogram;
- In the case of a solar module, an amount equal to the product of (1) 7 cents, multiplied by (2) the capacity of such module (expressed on a per direct current watt basis); and
- In the case of a wind energy component, an amount equal to the product of (1) the applicable amount with respect to such component, multiplied by (2) the total rated capacity (expressed on a per watt basis) of the completed wind turbine for which such component is designed.

The applicable amount with respect to any wind energy component shall be:

- In the case of a blade, 2 cents;
- In the case of a nacelle, 5 cents;
- In the case of a tower, 3 cents; and
- In the case of an offshore wind foundation (1) that uses a fixed platform, 2 cents, or (2) that uses a floating platform, 4 cents.

Under the proposed bill, a person shall be treated as having sold an eligible component if such component is integrated, incorporated, or assembled into another eligible component that is sold to an unrelated person.

The manufacturing production credit will begin to phase down in the case of any eligible component sold after December 31, 2026 as follows:

- In the case of an eligible component sold during calendar year 2027, 75%;
- In the case of an eligible component sold during calendar year 2028, 50%;
- In the case of an eligible component sold during calendar year 2029, 25%; and
- In the case of an eligible component sold after calendar year 2029, 0%.

The term "eligible component" shall not include any property that is produced at a facility if the basis of any property that is part of such facility is taken into account for purposes of sections 48C or 48E after the date of the enactment of section 45AA. The credit amount allowed for eligible components is increased by 10% if the final assembly of such components is at a facility in the United States that operates under a union-negotiated collective bargaining agreement. An elective payment (i.e., a direct-pay election) would be available at 100% of the value of the allowable credit.

Incentives for clean electricity and transportation

Clean electricity production credit: The legislation would add a new section 45BB clean electricity production credit in an amount equal to the product of (1) the kilowatt hours of electricity produced by the taxpayer at a qualified facility placed in service after December 31, 2022 and sold by the taxpayer to an unrelated person during the taxable year, or, in the case of a qualified facility, which is equipped with a metering device which is owned and operated by an unrelated person, sold, consumed, or stored by the taxpayer during the taxable year, multiplied by (2) the applicable amount with respect to such qualified facility. The applicable amount is equal to a base credit of 0.3 cents per kilowatt-hour produced and provides a bonus credit in an amount equal to 1.5 cents if certain wage and apprenticeship requirements are met. Base and bonus credits are indexed to inflation.

For a qualified facility placed in service within an “energy community” (as defined in section 45(b)(11)(B)) the base credit would be further increased by 10%. If a qualified facility meets certain domestic content requirements, as outlined in section 45(b)(9), the credit amount will be increased by an additional 10%. The proposal incorporates similar rules under section 45(b)(7) and (8), the wage and apprenticeship requirements, and the domestic content requirement for elective payment under section 45(b)(10).

The term “qualified facility” means a facility owned by the taxpayer that (1) is used for the generation of electricity, (2) the construction of which begins after December 31, 2026, and (3) for which the greenhouse gas emissions rate is not greater than zero. (The Secretary shall annually publish a table that sets forth the greenhouse gas emissions rates for types or categories of facilities, which a taxpayer shall use for purposes of section 45BB). The term "qualified facility" may also include an expansion of facility, but only to the extent of the increased amount of electricity produced at the facility by reason of (1) a new unit the construction of which begins after December 31, 2026, or (2) any additions of capacity the construction of which begins after December 31, 2026. A facility may be treated as a qualified facility during the 10-year credit period on the date the facility was originally placed in service. A facility may not be treated as a qualified facility for section 45BB purposes if such facility claimed a credit in the taxable year or any prior taxable year under sections 45, 45J, 45Q, 48, 48A, or 48F.

The amount of the clean electricity production credit under subsection (a) for any qualified facility the construction of which begins during an "applicable year" (i.e., the calendar year in which the Secretary determines that the annual greenhouse gas emissions from the production of electricity in the United States are equal to or less than 25% of the annual greenhouse gas emissions from the production of electricity in the United States for calendar year 2021, or 2031) shall be equal to the product of the amount of the credit multiplied by an applicable phase-out percentage as listed below:

- For a facility the construction of which begins during the first calendar year following the applicable year, 100%;
- For a facility the construction of which begins during the second calendar year following the applicable year, 75%;
- For a facility the construction of which begins during the third calendar year following the applicable year, 50%; and
- For a facility the construction of which begins during any calendar year subsequent to the third calendar year following the applicable year, 0%.

If the qualified facility is financed by tax-exempt bonds, the amount would be reduced by the lesser of 15% or the fraction of the proceeds of the tax-exempt obligations used to finance such project over the aggregate amount of additions to the capital account of such project.

Clean electricity investment credit: The proposal would add a new section 48F clean electricity investment credit in an amount equal to the applicable percentage of the qualified investment for such taxable year with respect to any qualified facility. The term "qualified facility" means a facility owned by the taxpayer that (1) is used for the generation of electricity, (2) the construction of which begins after December 31, 2026, and (3) for which the greenhouse gas emissions rate is not greater than zero), and any grid improvement property. A qualified facility may also include expansion of a facility or incremental production as defined in section 45BB(b)(1)(C).

The applicable percentage is 6%, and a bonus rate of 30% is available for a qualified facility (1) with a maximum net output of less than one megawatt, or (2) which satisfies certain wage and apprenticeship requirements as defined in sections 48(a)(10) and 45(b)(8), respectively. The amount of the credit phases out as outlined in section 45BB above.

The applicable percentage for grid improvement property (i.e., energy storage property) is similarly 6%, and a bonus rate of 30% is available in which the grid improvement property is (1) energy storage property with a capacity of less than 1 megawatt, or (2) which satisfies certain wage and apprenticeship requirements as defined in sections 48(a)(10) and 45(b)(8), respectively. For a qualified facility or grid improvement property that is placed in service within an "energy community," the base credit would be further increased by 10%. If a qualified facility meets certain domestic content requirements, as outlined in section 48(a)(12), the credit amount will be increased by an additional 2 percentage points or by 10 percentage points for a project that satisfies the wage and apprenticeship requirements, and the domestic content requirement for elective payment under section 45(b)(10). The maximum allowed ITC is limited to 50%.

A qualified investment with respect to any qualified facility for any taxable year is the sum of the basis of any qualified property placed in service by the taxpayer during such taxable year that is part of a qualified facility, plus the amount of any expenditures that are:

- Paid or incurred by the taxpayer for qualified interconnection property (as defined in section 48(a)(8)(B)), (1) in connection with a qualified facility that has a maximum net output of not greater than five megawatts, and (2) placed in service during the taxable year of the taxpayer, and
- Properly chargeable to capital account of the taxpayer.

"Qualified property" means property that is (1) tangible personal property, or (2) other tangible property (not including a building or its structural components), but only if such property is used as an integral part of the qualified facility, with respect to which depreciation (or amortization in lieu of depreciation) is allowable, and the construction, reconstruction, or erection of which is completed by the taxpayer or which is acquired by the taxpayer if the original use of such property commences with the taxpayer.

The proposal would apply to property placed in service after December 31, 2026, and, for any property the construction of which begins prior to January 1, 2027, only to the extent of the basis attributable to the construction, reconstruction, or erection after December 31, 2026.

Increase in clean electricity investment credit for facilities placed in service in connection with low-income communities: The proposal would increase the clean electricity investment credit for facilities placed in service in connection with low-income communities. It provides for an enhanced incentive for facilities qualifying for the section 48F ITC (not including certain facilities that produce electricity through combustion or gasification) with respect to which the Secretary makes an allocation of environmental justice capacity limitation. This is similar to the enhanced incentive under the section 48 ITC for certain solar and wind facilities placed in service in connection with low-income communities.

The annual capacity limitation is 1.8 gigawatts for each calendar year 2027 through 2031 and zero for calendar years thereafter. The annual capacity limitation shall be increased by the amount of any unused allocations from the preceding calendar year, including any unused amount from section 48 after 2026. No unused amount may be carried forward to any calendar year after 2033. Such projects receiving an allocation of environmental justice capacity limitation receive an additional 10% credit if located in a low-income community (as defined within the new markets tax credit program under section 45D) or on Indian tribal land or an additional 20% credit if such project is a qualifying low-income residential building project or a low-income economic benefit project. The proposal would take effect on January 1, 2027.

Cost recovery for qualified facilities, qualified property, and grid improvement property: The House bill would add new section 45BB to provide a credit for clean energy produced by a taxpayer at a "qualified facility" as defined under new section 45BB(b)(1), and new section 48F to provide a clean electricity investment credit for a taxpayer's investment in any "qualified facility" as defined under new section 48F(b)(3) and any "grid improvement property" as defined under new section 48F(c)(1)(B). New section 48F(b)(1) provides that a taxpayer's qualified investment with respect to any qualified facility for any taxable year is the sum of:

- The basis of any qualified property, as defined under new section 48F(b)(2), placed in service by the taxpayer during such taxable year that is part of a qualified facility, and
- The amount of any expenditures that are (1) paid or incurred by the taxpayer for qualified interconnection property, and (2) properly chargeable to a capital account of the taxpayer.

The House bill would amend section 168(e)(3)(B) to classify any qualified facility as defined under new section 45BB(b)(1), qualified property that is a qualified investment as defined under new sections 48F(b)(1) and (2), and grid improvement property as defined under section 48F(c)(1)(B) as five-year property. This amendment is effective for qualified facility, qualified property that is a qualified investment, and grid improvement property placed in service after December 31, 2026.

OBSERVATIONS:

The classification of a qualified facility, qualified property that is a qualified investment, or grid improvement property as five-year property permits a taxpayer to depreciate the property over a five-year recovery period, using the 200% declining balance method and half-year convention. Additionally, a taxpayer, other than one conducting certain regulated utility trades or businesses, may claim the additional first-year depreciation deduction under section 168(k) for such property if the taxpayer acquires the property or begins manufacturing, constructing, or producing the self-constructed property before January 1, 2027, and places the property into service before January 1, 2028, unless the property is primarily used in a trade or business described in section 163(j)(7)(A)(iv), including an excepted regulated utility trade or business. Until this provision becomes effective, there will continue to be uncertainty regarding the cost recovery of energy storage property and the need to determine how such property is primarily used.

Clean fuel production tax credit: This proposal would create a new technology-neutral incentive under section 45CC for the domestic production of clean fuels. The base incentive amounts are increased to the extent a fuel's lifecycle emissions are below zero and reduced to the extent they are above zero, phasing out ratably between zero and the baseline emissions rate. The clean fuels must be at a minimum transportation grade (i.e., suitable for use in a highway vehicle or aircraft, is not hydrogen fuel, and in the case of fuel that is not aviation fuel, is not derived from coprocessing biomass with a feedstock that is not biomass) but may be used for any business purpose, including as transportation fuel, industrial fuel, or for residential or commercial heat. All taxpayers are eligible for credits of up to 20 cents per gallon (35 cents in the case of aviation fuel). Taxpayers who pay wages at not less than local prevailing rates and utilize registered apprenticeship programs are eligible for elevated credit rates of $1 per gallon ($1.75 in the case of aviation fuel). Taxpayers may elect direct payment of the credits, in a similar manner to other provisions.

Economic and community development tax provisions

The House bill would expand certain current-law credits—and create a new one—that are aimed at revitalizing economically distressed communities.

Low-income housing tax credit

The legislation proposes several enhancements to the current-law low-income housing tax credit (LIHTC).

Increase in low-income housing state allocations: The House legislation would increase the state allocations of the 9% LIHTC and small state minimum for calendar years 2022 through 2025 as follows:

- Calendar Year 2022 — $3.14 (9% credit) and $3,629,096 (small state minimum);
- Calendar Year 2023 — $3.54 (9% credit) and $4,081,825 (small state minimum);
- Calendar Year 2024 — $3.97 (9% credit) and $4,582,053 (small state minimum);
- Calendar Year 2025 — $2.65 (9% credit) and $3,120,000 (small state minimum);
- After Calendar Year 2025 — Amounts are pegged to calendar year 2025 and adjusted for inflation.

Reduction in the tax-exempt bond financing requirement: The House bill would temporarily establish a 25% threshold (reduced from 50%) to enable more LIHTC projects to qualify for the 4% credits when such projects are also financed by the proceeds of tax-exempt bonds. This reduction applies beginning in calendar 2022 through calendar 2026. The threshold would return to 50% after calendar 2026.

Buildings designated to serve extremely low-income households: The House bill would provide a 50% basis boost for LIHTC buildings that designate at least 20% of their occupied units for extremely low-income tenants and limit rent to no more than 30% of the greater of (1) 30% of area median income, or (2) the federal poverty line.

To be eligible for the basis boost, buildings may not use the average income test to qualify as a qualified low-income housing project. Under the provision, 8% of a state's housing credit allocation must go to buildings designated to serve extremely low-income households. For purposes of the 9% credit, a housing credit agency may not allocate more than 13% of the portion of the state's housing credit ceiling amount to such buildings. Furthermore, for purposes of the 4% credit, a state may not issue more than 8% of its private activity bond volume cap to such buildings.

The provision is effective for allocations of housing credit dollar amount after December 31, 2021 and to obligations of 4% credit that are part of an issue after December 31, 2021.

Repeal of qualified contract option and modification and clarification of rights relating to building purchases: The House bill generally would eliminate the qualified contract exception for buildings receiving allocations after January 1, 2022 and make certain additional minor changes to rights related to building purchases.

Neighborhood Homes Credit

The House bill would establish a new Neighborhood Homes Credit in section 42A to encourage the rehabilitation of deteriorated homes in distressed neighborhoods. Under the proposal, states would receive Neighborhood Homes Investment Act (NHIA) tax credit authority and administer and allocate credits on a competitive basis similar to the manner that states allocate low-income housing credits.

The NHIA tax credits would be used to cover the gap between development costs and sales prices after applying certain limits, including a cap of up to 35% of eligible development costs. Rehabilitated homes must be owner-occupied for investors to receive the credits and homeowners must be below certain income limitations; sales prices are capped; and qualifying neighborhoods must have elevated poverty rates, lower incomes, and modest home values. Special rules apply to rehabilitations that occur when homes are already owner-occupied prior to and during such rehabilitation.

The credit for each qualified residence sold is equal to the lesser of:

- The excess (if any) of the reasonable development costs paid or incurred by the taxpayer with respect to such qualified residence, over the sale price of such qualified residence (reduced by any reasonable expenses paid or incurred by the taxpayer in connection with such sale), or
- 35% of the lesser of the eligible development costs paid or incurred by the taxpayer with respect to such qualified residence or 80% of the national median sale price for new homes (as determined pursuant to the most recent census data available as of the date on which the neighborhood homes credit agency makes an allocation for the qualified project).

This provision applies to taxable years beginning after December 31, 2021, and tax credits are provided to states through calendar year 2025. In general, the tax credit ceiling for a state for each calendar year is the greater of:

- The product of $3 ($6 in the case of calendar year 2025) multiplied by the state population (determined in accordance with section 146(j)), or
- $4 million ($8 million in the case of calendar year 2025).

Investments in tribes and territories

The House legislation includes provisions to promote infrastructure development among US Indian tribes and economic development among US territories.

Tribal governments treated as states with respect to bond issuance: This provision generally would allow Indian tribal governments to issue governmental bonds and private activity bonds on a basis similar to state and local governments, but with certain location and gambling facility restrictions applicable to private activity bonds. It would be effective for obligations issued in calendar years beginning after the date of enactment.

New markets tax credit for tribal statistical areas: The legislation would add $700 million of new markets tax credit allocation for calendar years 2022 through 2025 ($175 million per year) for low-income communities in certain tribal areas ("tribal statistical areas") and for projects that serve or employ tribe members.

Inclusion of Indian tribal areas as difficult development areas for purposes of certain buildings: The legislation would modify the definition of Difficult Development Area (DDA) to automatically include certain projects located in a tribal area, making these projects eligible for the 30% basis boost under the low-income housing credit program. This provision would allow these projects to receive more housing credit equity than would otherwise be available and applies to buildings placed in service after December 31, 2021.

Possessions economic activity credit: The legislation would add a new economic activity credit related to active businesses conducted in a US territory or possession under section 45V. The new credit is a general business credit equal to 20% of the sum of the qualified possession wages and allocable employee fringe benefit expenses paid or incurred by a qualified corporation (QC) for the taxable year up to $50,000 with respect to each full-time employee. A corporation is a QC if 80% or more of the gross income of the corporation for the three-year period immediately preceding the close of the taxable year was derived from sources within a possession of the United States and has a trade or business with 75% or more of the gross income of the corporation for such period or such part thereof derived from the active conduct of a trade or business within a possession of the United States.

In the case of a Qualified Small Domestic Corporation (QSDC), the credit increases to 50% of the sum of the qualified wages and fringe benefit expenses paid up to $142,800 for each full-time employee. To be a QSDC, a qualified domestic corporation must have at least five full-time employees in a possession, no more than a total of 30 employees, and no more than $50 million in annual gross receipts. For purposes of the credit, "possessions" include the territories of American Samoa, Guam, Commonwealth of Northern Marianas, Commonwealth of Puerto Rico, and the U.S. Virgin Islands.

Notable infrastructure financing and community development provisions left out

Proposals for permanent extension of the new markets tax credit (section 45D), modifications to the rehabilitation credit (section 47), enhancements to the work opportunity tax credit (section 51), and the establishment of additional infrastructure tax credit bonds, all of which were included in the previously approved Ways and Means tax title for the Build Back Better Act, are not included in the legislation headed to the House floor.

Other provisions

The House bill includes provisions addressing the tax treatment of certain economic assistance payments to farmers, as well as disaster mitigation payments to individuals and businesses.

Income exclusion for certain assistance to farmers: The House bill generally would provide that certain payments to farmers and ranchers authorized in sections 1005(b) and 1006(e) of the American Rescue Plan Act of 2021 will not be included in the gross income of the payee, and any otherwise-allowable deductions continue to be deductible notwithstanding the tax-free treatment of the payment.

In the case of a partnership or S corporation on whose behalf, or to whom, such payment is made, any amount excluded from income shall be treated as tax-exempt income for purposes of sections 705 and 1366, and, except as provided by the Secretary (or the Secretary's delegate), any increase in the adjusted basis of a partner's interest in a partnership under section 705 with respect to any amount described above shall equal the partner's distributive share of deductions resulting from interest that is part of such payment and the partner's share, as determined under section 752, of principal that is part of such payment.

Exclusion of amounts received from state-based catastrophe loss mitigation programs: The legislation would exclude from gross income any amount received by an individual as a qualified catastrophe mitigation payment under a program established by (1) a state or political subdivision or instrumentality thereof, (2) a joint powers authority, or (3) an entity created under state law to ensure the availability of an adequate market of last resort for essential property insurance, over which a state agency or state department of insurance has regulatory oversight. A qualified catastrophe mitigation payment means any amount that is received by an individual to make improvements to such individual's residence for the sole purpose of reducing the damage that would be done to such residence by a windstorm, earthquake, or wildfire.

Credit for qualified wildfire mitigation expenditures: The legislation would create a tax credit equal to 30% of qualified expenditures for individuals and businesses who participate in a qualified state-based wildfire resiliency program under section 28. The provision applies to expenditures paid or incurred after the date of enactment.

Individual tax provisions

The House bill does not include proposals to increase the top rate on ordinary income and long-term capital gain or dividend income, nor does it propose to modify the tax treatment of carried interest income. Rather, it would raise revenue from certain upper-income individuals through several base-broadening provisions such as a new surtax on certain upper-income individuals, estates, and trusts and restrictions on certain large retirement account balances.

A notable tax relief provision in the legislation would significantly increase the current-law cap on the deduction for state and local taxes that was enacted in the TCJA.

Expanded application of net investment income (NII) tax

Under this proposal, for taxable years beginning after December 31, 2021, the 3.8% NII tax base of individuals would be expanded to include, together with all investment income, all trade or business income (including gain on dispositions of business assets) for individuals with more than $500,000 in modified adjusted gross income or MAGI (for joint filers), $250,000 (married filing separately), or $400,000 (all other individual taxpayers). No provision is made for indexing these high-income thresholds for inflation. A modest phase-in rule applies to individuals whose MAGI does not exceed the applicable threshold by more than $100,000 ($50,000 for those married filing separately). The current-law limitation of the NII tax base to the lesser of net investment income or the excess of MAGI over the threshold ($250,000 for those married filing jointly or surviving spouses, half that for those married filing separately and $200,000 for all other individuals) continues.

The proposal also includes in NII any recognized income under sections 951 (subpart F and section 956), 951A (GILTI) and 1293 (passive foreign investment company treated as a qualified electing fund). Under current law, such income generally would be included in NII only by election.

The proposal clarifies that NII tax would not apply to wages on which FICA tax or Railroad Retirement Act tax is already imposed, including amounts taken into account under a recognized nonqualified deferred compensation plan. Wages received from the performance of services earned outside the United States for a foreign employer are also excluded from NII under the proposal. As under current law, trade or business income subject to self-employment tax is excluded from NII.

OBSERVATIONS:

The mechanics of the self-employment tax produce a 3.8% tax rate equivalent to the NII tax rate. Although the deduction in calculating adjusted gross income for one-half of the self-employment tax implies a benefit to having income be subject to self-employment tax rather than the NII tax, modeling is necessary because there can be ancillary computational effects.

The proposed NII regime applied to estates and trusts is the same as for individuals except no high-income threshold (and therefore no phase-in) is provided. Thus, as a general rule, since trusts and estates are not subject to self-employment tax or FICA, all trade or business income will be included in the NII tax base of an estate or trust. The proposal clarifies that the NII tax base of a trust or estate is reduced by that portion of the NII tax base that is distributed to beneficiaries. The current-law limitation of the NII tax base to the lesser of undistributed NII or the excess of AGI (as defined under section 67(e)) over the amount at which the highest marginal income tax bracket of estates and trusts begins ($13,050 for 2021) continues (a case that may arise if the trust or estate has a significant charitable income tax deduction that reduces undistributed NII but not AGI).

Limitations on excess business losses of noncorporate taxpayers (section 461(l))

Under current law, section 461(l) limits the recognition of aggregate trade or business deductions and losses for noncorporate taxpayers to an amount equal to aggregate trade or business gross income and gain plus a threshold amount of generally $250,000 ($500,000 for married taxpayers filing jointly), indexed for inflation. The disallowed excess business loss (EBL) is carried forward to the next taxable year and treated as a net operating loss (NOL) governed by section 172. Current law allows an NOL carryover to offset income from any source, not just trade or business income, subject to the regular tax and AMT limitations imposed on NOL use. Thus, for taxpayers who consistently have sufficient nontrade or business income, such as wages or investment income, the current law acts essentially as a one-year deferral of taking the tax benefit of an EBL. Special limitations apply where business capital losses and business capital gains arise, along with applying these rules to partnerships and S corporations. Under current law, these rules are scheduled to expire for any taxable year beginning after January 1, 2027.

First, if enacted, this proposal would amend section 461(l) to permanently disallow EBLs for noncorporate taxpayers. Additionally, as proposed, for years beginning after December 31, 2020 (meaning that the new rules would be effective for calendar year 2021 taxpayers), section 461(l)(2) is amended to provide that any EBL is to be carried over to the next taxable year and treated as part of the EBL calculation in that taxable year. Thus, it requires the carried over EBL to be "retested" and only allowed to the extent of a subsequent year's aggregate trade or business income plus the threshold amount. By carrying over EBLs within the section 461(l) computations, as opposed to converting them to an NOL, a taxpayer experiencing trade or business losses over time would generally recognize such loss only to the extent of the threshold amount until their trades or businesses become profitable. Similarly, a post-enactment NOL would result only if the allowed threshold amount exceeded all other income in a given year, thus significantly increasing the likelihood of future income tax liability for taxpayers having wage and investment income greater than the threshold amount.

Further compounding this effect, under current law, a passive loss generally allowed upon the full disposition of a passive activity is then subject to the EBL computation; and section 461(l), as proposed, does not include similar rules allowing an EBL to be recognized upon the disposition of the trade or business, or to be recognized, in whole or in part, upon the taxpayer's death. While the proposal does not address the treatment of EBLs upon disposition of a trade or business or upon death of a taxpayer, it does provide a rule governing the treatment of an EBL upon termination of a trust or estate. If a trust or estate terminates with an unused EBL, it is allowed as a deduction to the beneficiaries succeeding to the property. The proposal does not explain in what manner the beneficiary would be allowed the deduction. Instead the proposal directs the Secretary to draft regulations to address the issue.

Given the more expansive treatment of trade or business losses generally, the House legislation also proposes to remove section 461(j), which imposes limitations on certain farm losses. Pre-2021 NOLs would retain their character and be subject to the rules under section 172.

It should be noted that very little guidance has been released to date on these rules since their original enactment in TCJA. Currently, Treasury does not have these rules on its 2021 priority guidance list. That may change if this proposal is enacted.

Limitation on certain special rules for section 1202 gains

For sales and exchanges of qualified small business stock (QSBS) after September 13, 2021 (excluding any sale or exchange made pursuant to a written binding contract in effect as of September 13, 2021), the House proposal would amend section 1202(a) to limit the 100% or 75% exclusion on the gain realized from the sale of QSBS to only individuals with adjusted gross income less than $400,000. Consequently, for QSBS acquired after February 17, 2009, individuals with adjusted gross income of $400,000 or more, as well as trusts and estates, may only exclude 50% of the gain realized from the sale of QSBS. Note that the exclusion amount computed under the 75% and 50% exclusion rules is subject to an AMT adjustment equal to 7% of the exclusion amount pursuant to section 57(a)(7). In addition, note that the percentage of excluded realized gain depends upon the date the applicable taxpayer acquired the QSBS. (See additional discussion of this proposal in the section on "Other business tax provisions" elsewhere in this publication.)

Surcharge on high-income individuals, estates, and trusts

The House bill does ***not*** include Biden administration budget proposals that would raise the top marginal rate on ordinary income from the current law level of 37% to 39.6% and treat transfers by gift or at death as deemed sales for certain higher-income individuals, nor does it include a provision in the Ways and Means Committee – approved tax title to the Build Back Better Act that would restore the lifetime exclusion amount for gifts and bequests (which was temporarily increased to $10 million under the TCJA) to its post-2010 level of $5 million (indexed for inflation since 2012).

The House bill does, however, include a proposed new section 1A, which, for years beginning after December 31, 2021, would impose an additional tax on individuals equal to 5% of modified adjusted gross income in excess of $10 million ($5 million for a married individual filing separately), and an additional tax of 3% of a taxpayer's MAGI in excess of $25 million ($12.5 million for a married individual filing separately). As the surcharge is based solely on the amount of MAGI, it reaches all sources of income, including capital gains and qualified dividend income. For estates and nongrantor trusts, the 5% surcharge applies to MAGI in excess of $200,000 and the additional 3% surcharge applies to MAGI in excess of $500,000. As currently proposed, these thresholds are not indexed for inflation.

MAGI is adjusted gross income reduced by section 163(d) investment interest expense and 163(j) business interest. In the case of an estate or nongrantor trust, adjusted gross income shall be determined as provided in section 67(e), (which, among other adjustments, allows a deduction for distributed income) reduced by the charitable deduction allowed under section 642(c). As currently drafted, section 1A does not apply to trusts all the unexpired interests of which are dedicated to causes identified under section

170(c)(2)(B). All portions of any electing small business trust shall be treated as a single trust for purposes of the surcharge computation. Special rules apply to nonresident aliens, citizens, and residents living abroad, and expatriating citizens and resident aliens. Additionally, the provision specifies the surcharge has no relevance in calculations for AMT or the AMT credit. Various other provisions in the tax code, however, are modified to treat the surcharges as the equivalent of additional tax rate brackets including, among others, computing section 453A interest on certain installment obligation deferred tax liabilities, computing certain elements of the foreign tax credit limitation, determining section 1291 interest on certain tax deferrals, and determining section 1446 withholding for foreign partners.

OBSERVATIONS:

Since MAGI is calculated without regard to most itemized deductions (including charitable contributions by individuals), for affected taxpayers, the proposal would impose a surcharge, when MAGI exceeds the applicable threshold amounts, even if taxable income is below the threshold amounts. As an observation, the surcharge will affect a higher percentage of nongrantor trusts and estates than it will individuals due to the lower MAGI thresholds. However, trusts and estates may find it advantageous to distribute their income to individual beneficiaries (if permitted) since individuals have higher surcharge thresholds and the MAGI of the distributing trust or estate is thereby reduced. For that same reason, a grantor trust may prove advantageous since a grantor trust's income tax attributes are reported by the grantor and are not attributed to the trust, assuming the grantor's MAGI is beneath the individual thresholds.

Restrictions on retirement accounts

The proposal would raise revenue through required distributions of certain high-balance retirement accounts—so-called "mega IRAs"—and other restrictions intended to limit the ability of wealthy taxpayers to use IRAs and other qualified plans as tax planning tools rather than traditional retirement savings vehicles.

Restrictions on new contributions: The proposal generally would prohibit new contributions to a Roth or traditional IRA for a taxable year if the total value of an affected individual's IRA and defined contribution retirement accounts (Total Value) exceeds $10 million as of the end of the prior taxable year (indexed for inflation after 2029). A new annual IRS information reporting requirement would be imposed on employer defined contribution plan accounts with aggregate account balances exceeding $2.5 million (indexed for inflation after 2029). New contributions would not include rollover contributions, inherited IRAs, or IRAs acquired under a divorce or separation agreement. Excess contributions would be subject to an excise tax.

The limit on new contributions would apply to single taxpayers (or taxpayers married filing separately) with MAGI greater than $400,000, married taxpayers filing jointly with MAGI greater than $450,000, and heads of households with MAGI greater than $425,000 (all indexed for inflation after 2029).

These provisions would be effective for taxable years beginning after December 31, 2028.

Mandatory distributions: Under the proposal, as a general rule, an affected individual whose Total Value exceeded $10 million at the end of a taxable year (indexed for inflation after 2029) would be required to take a minimum distribution for the following year. This requirement would apply only to taxpayers whose MAGI exceeds the thresholds described above. The minimum distribution generally would be 50% of the amount by which the individual's prior-year Total Value exceeded the $10 million limit. These required distributions would not be subject to the 10% early withdrawal penalty.

In addition, to the extent that the Total Value exceeds $20 million (indexed for inflation), that excess would be required to be distributed from Roth IRAs and Roth-designated accounts in defined contribution plans up to the lesser of (1) the amount needed to bring the Total Value down to $20 million, or (2) the aggregate balance in the Roth IRAs and designated Roth accounts in defined contribution plans. Once the individual distributes the amount of any excess required under this 100% distribution rule, then the individual would be permitted to determine the accounts from which to distribute to satisfy the 50% distribution rule above. This provision would be effective for taxable years beginning after December 31, 2028.

Tax treatment of rollovers to Roth IRAs and accounts: Under current law, taxpayers with adjusted gross income above certain levels are prohibited from making annual contributions to Roth IRAs. The taxpayer's ability to make an annual Roth IRA contribution is phased out once the AGI hits certain levels. For 2021, the phase-out range is $125,000 to $140,000 (for single taxpayers) and $198,000 to $208,000 (for married taxpayers filing jointly), meaning taxpayers with AGI in excess of the phase-out maximum cannot contribute to a Roth IRA. The rules also permit a taxpayer to convert balances in traditional IRAs to Roth IRAs (Roth conversions). A taxpayer who converts a balance in a traditional IRA to a Roth IRA is taxable on the amount converted, though any portion attributable to prior "after-tax" contributions is not subject to tax. Current law provides that any amount converted includes a proportional amount of after-tax contributions, and this portion of a conversion is not subject to tax. Unlike regular contributions, there are no AGI restrictions, meaning that any taxpayer may convert all or part of an existing traditional IRA balance to a Roth IRA. The lack of an AGI limitation on Roth conversions gave rise to so-called "backdoor Roth IRA contributions," in which an individual would make a contribution to a traditional IRA on an after-tax basis, then convert the IRA to a Roth IRA, with minimal, if any, tax owed on the conversion. The House bill would eliminate this practice by providing that only pre-tax amounts held in traditional IRAs may be converted to Roth IRAs. This provision applies to distributions, transfers, and contributions made after December 31, 2021.

The bill also proposes to eliminate Roth conversions for both IRA and qualified plans for single taxpayers (or taxpayers married filing separately) with taxable income over $400,000, married taxpayers filing jointly with taxable income over $450,000, and heads of households with taxable income over $425,000 (indexed for inflation). This provision applies to distributions, transfers, and contributions made in taxable years beginning after December 31, 2031.

Statute of limitations with respect to IRA noncompliance: The House bill proposes to expand the statute of limitations from three years to six years for the IRS to collect taxes that result from substantial errors (willful or otherwise) in the reporting on a return of any information related to the valuation of investment assets and that result from the IRA engaging in a prohibited transaction. This provision applies to taxes to which the current three-year period ends after December 31, 2021.

IRA owners treated as disqualified persons for purposes of prohibited transactions rules: The House bill proposes that an IRA owner (including a beneficiary that inherits an IRA upon the death of

the IRA owner) will automatically qualify as a disqualified person for purposes of applying the prohibited transaction rules with respect to an IRA. This provision will apply to transactions occurring after December 31, 2021.

Modification of limitation on deduction for state and local taxes

If enacted, the proposal would extend the limitation on state and local taxes from taxable years beginning before January 1, 2026 to taxable years beginning before January 1, 2032. Additionally, the limitation amount would be increased to $80,000 ($40,000 for estates, trusts, and married individuals filing separate returns) for taxable years beginning after the effective date of this proposal and before January 1, 2031. For taxable years beginning after December 31, 2030 and before January 1, 2032, the limitation is $10,000 ($5,000 for estates, trusts, and married individuals filing separate returns). Lastly, the proposal adds language to section 164(b)(6)(B) to specifically include real estate taxes paid by a tenant-shareholder of a cooperative housing corporation in those taxes subject to the limitation. The proposal further provides that the addition of cooperative housing real estate taxes to section 164((b)(6)(B) does not create any inference to the application of the SALT limitation to cooperative housing real estate taxes for any taxable year before the effective date of the proposal. All amendments included in this proposal apply to taxable years beginning after December 31, 2020.

No carried interest provision

The House legislation deletes a provision included in the Ways and Means Committee – approved tax title to the Build Back Better legislation that called for modifying the rules under section 1061. However, as noted elsewhere in this publication, this version of the House legislation is not final and changes to the carried interest rules—such as extending the holding period (among other modifications) as approved by House taxwriters or introducing a deemed loan concept as proposed by Senate Finance Committee Chairman Ron Wyden could make their way into a subsequent version of the Build Back Better Act as it moves through the legislative process.

Tax relief for individuals and families

The legislation's proposed tax increases on upper-income taxpayers would help offset the cost of several provisions intended to enhance certain family-focused tax credits, ensure access to affordable health care coverage, and make college more affordable for students from lower-income families.

Enhanced child tax credit: The measure generally would extend through 2022 the increased amounts for the child tax credit ($3,000 per qualifying child and $3,600 for children under age 6), but would reduce—relative to the levels enacted in the American Rescue Plan earlier this year—the income levels below which taxpayers are eligible for advance payments of the credit. Thus, in 2022, only taxpayers with income below $150,000 (for joint filers), $112,500 (head of household), and $75,000 (single) would be eligible to receive advance payments. Above these levels the credit would also begin to phase out for all filers, but a new lookback provision would allow taxpayers to use prior-year income for purposes of the phase-out rules.

The legislation also would permanently extend a temporary provision in the American Rescue Plan that made the credit fully refundable.

The safe harbor limiting repayment of excess advance payments for certain taxpayers would be increased to $3,000 ($3,600 for a child under age 6), although the safe harbor would not apply if the overpayment is due to fraud or intentional disregard of rules by the taxpayer. The current-law requirement that a taxpayer provide a Social Security number for a child to receive a credit would be repealed.

Earned income tax credit: The bill would extend for 2022 several temporary provisions in the American Rescue Plan that expanded the earned income tax credit for taxpayers with no qualifying children. It also would extend for 2022 a provision allowing taxpayers to use prior-year income in computing the credit in cases where a taxpayer's earned income in the current taxable year has decreased.

Opportunity for same sex – married couples to amend returns back to date of marriage: Prior to the Supreme Court's 2013 decision in *United States v. Windsor*, section 3 of the Defense of Marriage Act (DOMA) prohibited the IRS from recognizing same-sex marriages. In *Windsor*, the Supreme Court held that section 3 of DOMA was unconstitutional because it violated principles of equal protection. Following the *Windsor* decision, the IRS released guidance allowing taxpayers to amend their returns with respect to their marital status, but only generally back to 2010. Thus, taxpayers lawfully married under state law before 2010 could not claim the benefits of federal recognition of same-sex marriage for pre-2010 years. The House bill would permit lawfully married same-sex couples to file claims for credits and refunds related to a change in marital status back to their year of marriage, which in some cases is as early as 2004. Note that registered domestic partnerships and civil unions are not considered legal marriage by the IRS.

If the provision is enacted in 2021, covered taxpayers will have until the due date (including extensions) of their 2021 return to amend prior returns.

Affordable Care Act premium assistance: The legislation would permanently extend the premium tax credits under the Patient Protection and Affordable Care Act and increase the amount of qualified health insurance premiums covered under the credit to 80% (from 72.5%). It also would extend through 2025 the more generous rules enacted in the American Rescue Plan for determining an individual's eligibility for premium assistance and make other targeted changes intended to make health care coverage more affordable for certain low-income populations.

Treatment of Pell Grants: The legislation would exclude Pell Grants from gross income for federal income tax purposes. It also provides that for purposes of the American Opportunity Tax Credit and Lifetime Learning Credit, qualified tuition and related expenses would not be reduced by amounts received under a Pell Grant. The provision would be effective for taxable years beginning after December 31, 2021 but would expire for amounts received after 2025.

American Opportunity Tax Credit eligibility: The legislation would repeal a current-law provision that makes individuals ineligible for the American Opportunity Tax Credit if they have been convicted of felony drug offenses, effective for taxable years beginning after December 31, 2021.

Tax treatment of union dues: The bill would provide a new above-the-line deduction of up to $250 in dues paid to a labor organization, effective for taxable years beginning after December 31, 2021.

Tax treatment of employee uniforms: The legislation would allow an employee to claim an above-the-line deduction of up to $250 for employee uniforms or work clothing required as a condition of employment and not otherwise suitable for everyday wear. This new deduction would apply to taxable years beginning after December 31, 2021.

IRS enforcement and taxpayer compliance provisions

President Biden and congressional Democrats contend that the government can raise significant revenue without raising taxes by reducing the so-called "tax gap"—the difference between the amount of tax owed to the government and the amount actually collected. To that end, the House bill proposes to beef up the Internal Revenue Service's enforcement and information technology resources so the agency can more effectively identify and address sophisticated tax-avoidance transactions. It also includes changes to procedural requirements for the assessment of penalties and changes to the rules related to backup withholding on payments by third-party settlement organizations. It does not, however, include a much-discussed proposal from the president's fiscal year 2022 budget blueprint to require financial institutions to report to the IRS gross account inflows and outflows from specified customer accounts.

Enhancement of Internal Revenue Service resources

The House bill would provide the IRS approximately $79 billion in additional appropriations for fiscal year 2022, which would remain available for the agency to use for a 10-year window. This amount includes:

- $1,931,500,000 for taxpayer services, including pre-filing assistance and education, filing and account services, taxpayer advocacy services, and other authorized services;
- $44,887,500,000 for tax enforcement activities, including to determine and collect owed taxes; to provide legal and litigation support; to conduct criminal investigations (including investigative technology); to provide cryptocurrency monitoring and compliance activities; to enforce criminal statutes related to violations of internal revenue laws and other financial crimes; to purchase and hire passenger motor vehicles, and to provide other authorized services;
- $27,376,300,000 for operations support, including rent payments; facilities services; printing; postage; physical security; headquarters and other IRS-wide administration activities; research (including on statistics of income); telecommunications; information technology development, enhancement, operations, maintenance, and security; the hire of passenger motor vehicles; the operations of the Internal Revenue Service Oversight Board; and other authorized services; and
- $4,750,700,000 for business systems modernization, including development of callback technology and other technology to provide a more personalized customer service but not including the operation and maintenance of legacy systems.

Not later than six months after enactment of the legislation, the IRS would be required to provide Congress a plan detailing how these appropriated funds will be spent over the 10-year period ending with fiscal year 2031. After submitting the initial plan, the IRS would also be required to provide quarterly reports on any updates to the plan, progress made in implementing the plan, and any changes in circumstances or challenges in implementing the plan. Failure to submit the initial plan or a quarterly report would result in a reduction of $100,000 for each late day. The provision would allow the IRS to utilize direct hire authority to recruit and appoint personnel with such funds. In addition, the proposal expressly provides that no use of the appropriated funds is intended to increase taxes on any taxpayer with a taxable income below $400,000.

Modification of procedural requirements relating to assessment of penalties

Section 6751(b)(1) provides that no penalty under Title 26 shall be assessed unless the initial determination of an assessment is personally approved in writing by the immediate supervisor of the individual making that determination or by a higher-level official as the Secretary of the Treasury or her delegate may designate.

This proposal would repeal the written penalty approval requirement in section 6751(b). Instead, each appropriate supervisor of IRS employees would need to certify quarterly by letter to the IRS Commissioner whether or not the requirements of section 6751(a) have been met. Section 6751(a) requires each notice of penalty to include the name of the penalty, the section of the code under which the penalty is imposed, and a computation of the penalty.

The proposal to repeal section 6751(b) would be retroactive back to the initial enactment of section 6751(b) in section 3306 of the Internal Revenue Service Restructuring and Reform Act of 1998. The quarterly certification proposal would be effective upon enactment.

Backup withholding

The House bill would modify the backup withholding threshold applicable to payments by third-party settlement organizations (TPSOs), which are reportable under section 6050W (Form 1099-K reporting). The amended section 3406(b) would not require TPSOs to apply backup withholding on payees until the aggregate annual payments equal or exceed $600. Additionally, the provisions include a transition rule for 2022, requiring that the aggregate number of annual transactions exceeds 200 before application of withholding.

Higher education tax provisions

The House bill would provide credits for college- and university-sponsored programs for research infrastructure and environmental justice, and for scholarships provided to medical students from certain underserved communities.

Other provisions would offer direct tax benefits to students. These are discussed in the "Individual tax provisions" chapter elsewhere in this report.

Credit for public university research infrastructure

The House bill would add a new credit for public university research infrastructure under section 45AA. The new credit would be a 40% general business credit for qualified cash contributions made by a taxpayer to a certified educational institution in connection with a qualifying research infrastructure program. Taxpayers may elect to claim this credit with respect to a qualifying cash contribution in lieu of treating such contribution as a charitable deduction under section 170(c).

Institutions of higher education may designate such contributions made by a taxpayer as qualified cash contributions only if such institution is certified as having been allocated a credit amount by the Secretary with respect to a qualifying project. The amount of cash contributions a certified educational institution may designate as qualified cash contributions may not exceed 250% of the credit amount allocated to such institution under this provision.

The provision provides $500 million of credits for each of calendar years 2022, 2023, 2024, 2025, and 2026 to be awarded by the Secretary to eligible educational institutions on a project application basis. The Secretary shall award these credits based on the extent of expected expansion of a higher education institution's targeted research within disciplines in science, mathematics, engineering, and technology. The Secretary shall award these credits in a manner that ensures consideration is given to eligible education institutions with full-time student populations of less than 12,000. A certified educational institution's allocation may not exceed $50 million per calendar year.

For purposes of this provision, an eligible educational institution is a public college or university, or a nonprofit organization to which authority has been delegated by a public college or university to apply for administering credit amounts on behalf of such institution.

The provision provides authority for the Secretary to prescribe regulations necessary to carry out this provision and to recapture and reallocate undesignated credit amounts. In the event of noncompliance, contributions made to an institution of higher education under this section shall be treated as unrelated business income and subject to tax.

Qualified environmental justice program credit

The House bill would allow a credit for certain eligible educational institutions in an amount equal to the applicable percentage of the amounts paid or incurred by such taxpayer during such taxable year that are necessary for a qualified environmental justice program.

The qualified environmental justice program credit is a capped refundable competitive credit of $1 billion for each year from 2022 through and including 2031 to institutions of higher education for environmental justice programs. Any unallocated credit amounts may be allocated in the succeeding calendar years but

no later than any calendar year after 2036. The base credit is 20% of costs to be spent within five years by the receiving institution. Programs with material participation from Historically Black Colleges and Universities and Minority Serving Institutions are eligible for a higher credit of 30%. An environmental justice program means a program conducted by one or more eligible educational institutions that is designed to address, or improve data about, qualified environmental stressors for the primary purpose of improving, or facilitating the improvement of, health and economic outcomes of individuals residing in low-income areas or areas that experience, or are at risk of experiencing, multiple exposures to qualified environmental stressors.

Rural and Underserved Pathway to Practice Training Program credit

The House legislation proposes to invest $6 million into implementation of the Pathway to Practice Training Program. The proposal would establish section 1899C of the Social Security Act for the Rural and Underserved Pathway to Practice Training Program for Post-Baccalaureate and Medical Students as one of the Pathway to Practice Training Programs. This would incentivize individuals from rural and underserved communities to become physicians and to practice in those communities through a scholarship and stipend for qualifying medical students to attend medical school or pursue post-baccalaureate and medical school training. Students eligible for this program include first-generation college or professional students, Pell Grant recipients, and those who lived in a medically underserved, rural, or health professional-shortage area for four or more years prior to attending an undergraduate program.

The proposal would have the Secretary, beginning in 2023, award 1,000 scholarship vouchers per year, which includes tuition, academic fees, textbooks, equipment, and a monthly stipend tied to the amount provided by the Armed Forces Health Professions Scholarship Program, which for 2021 is $2,540. The Secretary shall prioritize those students who participated in the Health Careers Opportunity Program, were Area Health Education Scholars, are disadvantaged students as defined by the National Health Service Corps, or attended a Historically Black College or University or Minority Serving Institution. Upon scholarship acceptance, the student agrees to complete medical school (and post-baccalaureate program as applicable), residency, and practice for at least one year per scholarship year in a health professional-shortage area, a medically underserved area, or a rural area. If the student does not comply with the terms of the scholarship, the student must repay the amounts and the Secretary will collect these repayments with interest, except for the case of hardship.

The qualified educational institution would provide the scholarship, textbooks, equipment, and stipend to the recipients at their school and then would be reimbursed through a new tax credit under section 36G in an amount equal to the aggregate amount they paid or incurred during such taxable year pursuant to any Pathway to Practice medical scholarship voucher awarded to a qualifying student with respect to their institution.

No reduction of excise tax on investment income

A proposal in the October 28 version of the Build Back Better legislation that called for reducing the current-law excise tax on investment income of private colleges and universities if they meet certain benchmarks in providing financial aid to first-time, full-time undergraduate students is not included in the version of the bill that is headed to the House floor.

Employee benefits provisions

The House legislation includes provisions that would reinstate and expand the exclusion from gross income for employer-provided bicycle commuting reimbursements, modify the employer-sponsored coverage affordability test for purposes of the health insurance premium tax credit, and make other changes to the credit.

Reinstatement and expansion of employer-provided fringe benefits for bicycle commuting

Section 132 provides that gross income does not include certain types of fringe benefits, including "qualified transportation fringe." Qualified transportation fringe benefits are defined as (1) transportation in a commuter highway vehicle if the transportation is for travel between the employee's residence and place of employment, (2) any transit pass, (3) qualified parking, and (4) any qualified bicycle commuting reimbursement. All qualified transportation fringe benefits are subject to maximum monthly limits. The TCJA temporarily suspended the exclusion for qualified bicycle commuting reimbursements for years beginning after December 31, 2017, and before January 1, 2026.

The House bill would eliminate the temporary suspension of the exclusion for qualified bicycle commuting reimbursements, increase the maximum monthly exclusion amount, and expand the definition of the benefit. Under the proposed legislation, the exclusion would be reinstated for years beginning after December 31, 2021, and the limit on the monthly exclusion would be increased from $20 per month to $81 per month (indexed for inflation).

The proposed legislation would expand the benefit to include not only an employer's reimbursement for reasonable expenses incurred by an employee for the purchase of a bicycle and bicycle improvements, repair, and storage, as provided under current law, but also to include (1) an employer's direct or indirect provision of "qualified commuting property," and (2) an employer's reimbursement of expenses incurred for the purchase, financing, lease, rental (including bikeshare), improvement, and storage of "qualified commuting property." Qualified commuting property includes traditional bicycles, electric bicycles, two- or three-wheeled scooters not propelled by an electric motor, and two- or three-wheeled scooters propelled by an electric motor if the motor does not provide assistance in excess of 20 miles per hour.

Modification of employer-sponsored coverage affordability test in health insurance premium tax credit

Section 36B provides certain individuals with a tax credit if the individual purchases health insurance for the individual, the individual's spouse, or the individual's dependents through a health insurance exchange established pursuant to the Patient Protection and Affordable Care Act. An individual is not eligible for this credit if the individual has health insurance coverage other than through the individual market—e.g., through Medicare, Medicaid, or an employer-sponsored health coverage under a group health plan. In the case of employer-sponsored health coverage under an employer-sponsored group health plan, the coverage must be "affordable," as determined under section 36B(c)(2)(C)(i). The credit is also denied to individuals who have coverage under a qualified small employer health reimbursement arrangement, provided that the coverage is "affordable."

Section 36B(c)(2)(C)(i)(II) provides that an individual is considered to have "affordable" coverage under an employer-sponsored group health plan (and therefore, not eligible for the credit) only if the cost of coverage to the employee does not exceed 9.5% of the employee's household income (the "affordability threshold"). If the cost of coverage exceeds the affordability threshold, the individual is eligible for the tax credit under section 36B. A similar threshold is provided in the case of a qualified small employer health reimbursement arrangement. The 9.5% affordability threshold is subject to annual indexation based on the excess of premium growth in the previous year over income growth. For 2021, the affordability threshold is 9.78% of household income.

The House bill would change the definition of "affordable" to provide that, for years beginning after December 31, 2021 and prior to January 1, 2026, coverage is not considered affordable if the cost of coverage exceeds 8.5% of the employee's household income. After 2025, the affordability threshold would revert to 9.5%. Additionally, annual indexation of the affordability threshold is suspended for plan years beginning after December 31, 2021, and before January 1, 2027.

Additional amendments related to the premium tax credit

Other proposed changes to the premium tax credit would:

- Exclude Social Security benefit lump-sum payments for Americans with disabilities, widows, new retirees, and others from calculation of household income for purposes of 36(B) premium tax credits.
- Modify certain eligibility rules and requirements for 36B premium tax credits through 2025; expand eligibility to taxpayers with household incomes below 100% of the federal poverty level (FPL); specify that taxpayers with household incomes below 138% of the FPL with access to employer-sponsored coverage or a qualified small employer health reimbursement arrangement can still receive credits; reduce the recapture limitation for taxpayers with household incomes below 200% of the FPL; exempt certain taxpayers from having to file a return, reconcile, or repay advance payments of 36B premium tax credits; and modify when applicable large employers make an employer shared responsibility payment with respect to certain low-income taxpayers.
- Extend section 9663 of the American Rescue Plan through 2025 and provide that a taxpayer can receive 36B premium tax credits as if the taxpayer's household income was no higher than 150% of the FPL for individuals receiving unemployment compensation as defined in section 85B of the Internal Revenue Code.
- Make the health coverage tax credit permanent (thus removing the uncertainty of annual extensions) and increase the amount of the qualified health insurance premium covered by the credit from 72.5% to 80%.
- Exclude certain dependent income from the calculation of household income for purposes of determining section 36B premium tax credit amounts.

State tax considerations

Corporate and international tax proposals

The Federal corporate income tax proposals that will have a direct state tax impact will generally be those that change federal taxable income. Accordingly, the following tax proposals in the House bill would be unlikely to have a significant direct impact on the computation of state tax:

- The 15% minimum tax on book earnings of large corporations, and
- The creation of federal tax credits.

However, certain proposals would potentially have a direct impact on the computation of state corporate income tax due, such as:

- Changes to GILTI, including reduction of the GILTI deduction under section 250;
- Limitation of interest expense under section 163(n); and
- Changes in the applicability of the dividends received deductions under section 245A.

Fixed date conformity: Most state income tax regimes are affected by federal tax law changes because, for administrative ease, these state regimes tie to the federal tax code by either incorporating the code in whole or in part, or by using federal taxable income as the starting point. States with automatic or "rolling" conformity generally will adopt such changes unless there is specific state legislation enacted to decouple from federal law. Other states adopt the federal code as of a specific date ("fixed date conformity"), do not adopt the code provisions in totality, or provide modifications or exceptions to certain adopted provisions.

In fixed date conformity states, changes to the federal code would not be effective until the state took steps to adopt them. This could be favorable to taxpayers with respect to some provisions, such as continued allowance of a 50% GILTI and 37.5% FDII deduction, or unfavorable with respect to other provisions.

Changes to calculation and reduction of the GILTI section 250 deduction: Many states currently provide at least a partial subtraction or dividends received deduction for GILTI income, with a number allowing a full subtraction. For those that do not decouple or provide a 100% subtraction, any federal changes that increase the amount of section 951A inclusion and/or the new inclusion under section 951B would correspondingly increase state taxable income.

As of the date of this publication, there are 10 jurisdictions that impose tax on GILTI net of the section 250 deduction without any subtraction: New Jersey, New York City, Rhode Island, New Hampshire, Vermont, Maryland, Nebraska, Alaska, Delaware, and the District of Columbia. A number of other states still generate GILTI liability due to less than 100% subtraction provisions and expense disallowance rules.

Limitation of interest expense based on disproportionate borrowing in the US: Many states do not follow federal consolidated return rules and either tax each entity on a separate company basis, as if no consolidated return were filed, or require combined reporting of unitary affiliates, defined in such a way that combined group composition can differ markedly from the section 1504 consolidated group.

While this results in complexity in terms of the section 163(j) limitation, due to its consolidated group calculation, the section 163(n) limitation as proposed does not appear to mandate a different calculation for consolidated groups. If not later modified by regulation, this would generally mean that a corporation's federal section 163(n) limitation may be the same for state purposes, assuming a state does not decouple. State rules requiring the add back of intercompany interest would continue to apply whether or not a limitation under section 163(n) applied.

Changes to dividends received deductions under section 245A: States generally have their own statutory dividends received deductions and a number of states have decoupled from section 245A. However, in the states that do follow section 245A, to the extent the federal dividends received deduction is no longer available, a state-level dividends received deduction may still apply.

Individual and passthrough tax proposals

The following tax proposals are unlikely to have a material direct impact on the computation of state tax because they do not change federal adjusted gross income or taxable income:

- The surcharge on high-income individuals, estates, and trusts, and
- Application of net investment income tax to trade or business income of certain high-income individuals.

Increasing the SALT deduction cap to $80,000: Many states have enacted passthrough entity taxes (PET) in response to the SALT cap. For owners whose state taxes are below the proposed $80,000 SALT cap in the House legislation, the increase in the SALT cap would reduce the potential tax benefit from a PET election. For owners whose state taxes are above the $80,000 cap, there still may be a potential benefit from a PET election. Some of the state legislation was contingent on the SALT cap remaining in place. However, none of the state legislation was contingent on the SALT cap remaining at $10,000.

Limitation on deduction of business interest expense: Many states have conformed to the business interest expense limitations under section 163(j). However, some states have conformed to the changes enacted in the TCJA, but not those enacted in the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Some states have not conformed to any of the recent changes (i.e., pre-TCJA rules). Applying the business interest expense limitation at the partnership or S corporation level created potential problems in the states, especially for state withholding and composite returns. The proposed change to apply the business interest expense limitation rules at the ultimate partner or shareholder level may solve some of these state issues. However, it could also create new state issues.

Permanent extension of excess business loss limitation of noncorporate taxpayers: Many states have conformed to the excess business loss limitations and will probably conform to making these rules permanent. A few states conform to the excess business loss limitations for certain types of taxpayers, but not for others. For example, Illinois conforms to the excess business loss limitations for individuals, but not for trusts.

Modification of procedural requirements relating to assessment of penalties

The proposed repeal of section 6751(b) with retroactive effect could potentially have a downstream impact in the states. For example, although California does not explicitly conform to section 6751, it incorporates language that is substantially similar to section 6751, including subsection (b). Therefore, California could potentially enact legislation to amend its California provision to effectively follow the federal repeal of section 6751(b), which could remove this important safeguard against unwarranted imposition of penalties.

Financial reporting considerations

Pursuant to US Generally Accepted Accounting Principles, the tax effects of new tax legislation are accounted for in the interim and annual reporting periods in which a tax law is enacted. In the United States, the enactment date generally is the day the President of the United States signs the legislation into law. The Build Back Better Act budget reconciliation bill released on November 3, 2021, does not, in and of itself, equate to enacted tax law. If the provisions contained in the Build Back Better Act bill are enacted, proposed changes to GILTI, interest limitations, and foreign tax credits, as well as the establishment of the corporate alternative minimum tax, could have a significant impact on companies' financial statements, including impacts to effective tax rates, deferred taxes, and valuation allowances.

If the change in tax law is enacted subsequent to the balance sheet date, but prior to issuance of the financial statements, it would be considered a nonrecognized subsequent event and companies would need to discuss the new tax law and, potentially, disclose an estimate of its effect on the entity's financial statements and tax accounts.

To the extent potential income tax changes could materially affect the company or its business, SEC registrants should also consider possible disclosure requirements under Risk Factors and Management's Discussion and Analysis of Financial Condition and Results of Operations.

Next steps

House Democratic leaders plan to bring the Build Back Better Act to the floor for debate and a vote on final passage the week of November 15, although the timing of the final vote could depend on factors beyond leadership's control.

A group of House Democratic moderates who have been concerned about the size and scope of the Build Back Better legislation indicated in a statement released November 5 that they would support the bill "in its current form other than technical changes, as expeditiously as we receive fiscal information from the Congressional Budget Office—but in no event later than the week of November 15 . . . ." They also pledged to work to "resolve any discrepancies" if a preliminary budget analysis released by the White House (based on estimates the CBO provided to congressional committees) is "inconsistent" with the CBO's final report.

Exactly when the CBO will release its official analysis is not clear. House Budget Committee Chairman John Yarmuth, D-KY. said November 1 that it could take at least two weeks for the agency to complete its estimates once the bill text is finalized, and some Democratic congressional leaders have suggested that a final CBO score might not be ready until Thanksgiving week. (A CBO score is required for the Senate to take up reconciliation legislation, but it is not a procedural requirement in the House.)

Changes likely in the Senate

Any Build Back Better legislation that clears the House appears certain to be modified when it reaches the Senate. Majority Leader Charles Schumer has set a goal of taking up the bill the week of November 15, which may be possible if events align in a way that allows the House to advance it early that week. However, some Senate Democrats have differing views about that timeline and have talked about provisions they still hope to add or change. Any revisions made by the Senate would require the bill to be reconsidered in the House.

The House's proposed change to the SALT deduction cap, for example, attracted immediate pushback from Sens. Bernie Sanders, I-VT., and Robert Menendez, D-NJ, who contended that the provision would primarily benefit wealthy taxpayers and said they were crafting their own proposal that would be permanent but is expected to apply only to households earning less than about $550,000 a year.

"We have heard for months and months and months from Democratic colleagues that we are sick and tired of seeing the wealthiest people in this country, including multibillionaires, who some years pay nothing in federal income taxes," Sanders said. ". . . [S]o if somebody comes up with a proposal that says, 'yeah, we're going to give even more tax breaks to these people,' it's not a question of messaging. That is terrible, terrible policy."

Commenting on the bill's environmental provisions, Senate Finance Committee member Sheldon Whitehouse, D-RI, told reporters November 4 there are "areas where it's understood that the Senate is still at work, and while we will check in with the House to make sure that they stay good, we've got projects that are not yet concluded and that are not yet in the House bill."

Similarly, Sen. Jon Tester, D-MT, said he would be "surprised" if the bill doesn't change in the Senate, telling *Politico* November 4, that "[i]f they send over a bill that has some challenges in it for rural America, then they're going to have to take it back and work it over." West Virginia Sen. Joe Manchin, for his part, has expressed trepidation about the paid family and medical leave proposals in the House's bill.

The bill will also be subject to stringent requirements in the Senate that govern the reconciliation process, known as the Byrd Rule, and could face challenges if the Senate parliamentarian deems any of the provisions to be noncompliant. Certain provisions in the House bill related to immigration are thought by many to fall into this category, but there may be others as well. This process may produce some largely cosmetic revisions, but it could also lead to some substantial policy changes.

"I wouldn't be surprised at all if, between the parliamentarian and [Manchin's] concerns . . . whatever the House sends will have to be modified at least a little," said Sen. Brian Schatz, D-HI. "It will not be enacted as is. Everybody needs to sit with that and get comfortable with it."

Little room for error

The Build Back Better legislation is moving through Congress under budget reconciliation procedures, which protect the bill from a Senate filibuster as long as it adheres to certain rules and requirements. As a result, it can pass in the Senate with a simple majority instead of the 60 votes typically needed to break a filibuster, thus eliminating the need for Republican support.

Despite that procedural advantage, Democrats nonetheless will face challenges in advancing the legislation given their narrow majorities on both sides of the Rotunda, and leadership will be under pressure to keep their members absolutely united in the face of what is expected to be unified Republican opposition. Democrats control only 50 seats in the Senate and will need all of those votes, plus the tie-breaking vote of Vice President Kamala Harris, if the reconciliation bill is to succeed in that chamber. There is a similar need for unity in the House, where Democrats hold a single-digit majority and can afford only three defections (assuming all members of both parties are present and voting) to ensure passage there.

Some provisions in the House legislation—such as the modification to the SALT deduction cap, for example—have supporters as well as detractors among various Democratic constituencies, and intra-party disagreements over what provisions to include or what provisions to leave out could prolong the measure's path through Congress and to the president's desk.

Acknowledgments and contacts

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