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Bipartisan group mulls tax provisions for potential climate change bill

In the face of skepticism from many outside observers, a bipartisan group of senators met twice this week to discuss a possible bill to address climate change and energy security. The small group, which kicked off April 25, was convened by Energy and Natural Resources Committee Chairman Joe Manchin, D-W.Va., and Sen. Lisa Murkowski, R-Alaska, and has some Democrats concerned that this new endeavor will further subvert their stalled effort to pass a broader tax-and-spending bill (with clean energy title) under the fast-track budget reconciliation process.

Manchin has been a key stumbling block to advancing what's known as the Build Back Better agenda, which will need all 50 Democratic senators plus the tie-breaking vote of Vice President Kamala Harris to pass. (For prior coverage on the status of efforts to move Build Back Better legislation, see *Tax News & Views*, Vol. 23, No. 16, Apr. 29, 2022.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220429_1.html

Carbon border-adjusted tax and other energy provisions

Following a meeting of the bipartisan group on May 2, participants said they had discussed the concept of a carbon border-adjusted tax—essentially levying tariffs on certain fossil fuels and other carbon-intensive imports coming from countries with weaker climate policies than the US. The idea, which is also being advanced by the European Union, would be to put pressure on countries that are not moving quickly enough to cut their greenhouse gas emissions.

Senate Finance Committee member Bill Cassidy, R-La., was quick to clarify to reporters following the meeting that he does not view the concept as a carbon tax, adding, "I've spoken to Republicans who are very interested in this."

Specific language has not been released, but as currently understood, the border adjustment tax is not expected to directly affect domestic manufacturers but could fall on imported components.

Cassidy said domestic manufacturers that use natural gas instead of more carbon-intensive sources of energy would have a big competitive advantage under the tariff system, because the US policies are more stringent than those in most other countries. Manchin said he is promoting a North American zone that would include Canada and Mexico.

Democratic Finance Committee member Mark Warner of Virginia, who is also participating in the bipartisan group, said he is working to understand exactly how the carbon adjustment would operate.

"I've always thought a price on carbon, a market mechanism, is where I think the world ought to be headed, and it also puts a penalty in place for those countries like China," Warner said.

Energy tax incentives: The group held an additional meeting this week, on May 4, during which, according to *E&E News*, they discussed a wide range of energy-related tax incentives, including those in the Build Back Better legislation that cleared the House this past November as well as those in a freestanding clean energy package that was approved by the Senate Finance Committee in May of last year. (A detailed summary of the tax provisions in the House-passed legislation is available from Deloitte Tax LLP. For details on the Finance Committee energy package, see *Tax News & Views*, Vol. 22, No. 27, May 28, 2021.)
URL: https://www2.deloitte.com/us/en/pages/tax/articles/build-back-better-tax-legislation.html?id=us:2em:3na:tnv:awa:tax:050622&sfid=7015Y000003WdCFQA0
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210528_2.html

Senators who spoke to reporters after the meeting did not indicate that there was consensus on a possible tax credits package, although taxwriter Tom Carper, D-Del., commented that “I think some progress was made in better understanding what the Finance Committee voted on in the energy tax package that was debated and voted on months ago.”

EV or not EV?: One energy provision that appears to have no support from Sen. Manchin is an expansion of the current-law tax credit for electric vehicles (EVs) that is included in the House-passed Build Back Better legislation.

During a recent Senate Appropriations Committee hearing with Transportation Secretary Pete Buttigieg, Manchin questioned the merits of providing a tax credit for buyers of EVs at a time when demand for EVs exceeds the supply.

“There’s a waiting list for EVs right now,” Manchin said, “[b]ut they still want us to throw $5,000 or $7,000 or a $12,000 credit to buy an electric vehicle. It makes no sense to me whatsoever, when . . . we can’t produce the product for the people who want it, and we’re still going to pay them to take it? It’s absolutely ludicrous in my mind.”

Buttigieg responded that the EV credit in the Build Back Better legislation reflects the need for the US to act on climate change in “months rather than years.”

There is currently a federal tax credit of up to $7,500 for EV purchases depending on the make and model of the vehicle. The Build Back Better bill as approved by the House proposed an expanded credit of up to $12,500. (The maximum credit amount would apply to EVs that meet certain battery capacity, domestic assembly, domestic content, and collective bargaining standards.)

Are there really 60 votes?

Democratic climate hawks have been skeptical that enough Republicans would sign on to a bill that has what they consider strong enough measures to address climate change. Legislation done outside of the reconciliation process would need 60 votes in the Senate to avoid a filibuster, meaning at least 10 Republicans would have to vote in favor if all 50 Democrats support it.

After the bipartisan group’s kick-off meeting late last month, Democratic Sen. Sheldon Whitehouse of Rhode Island scoffed at the idea that anything would come of the new effort with the GOP.

“They’re just not capable of that,” Whitehouse said. “There’s literally nothing happening in the bipartisan effort. One Republican senator showed up at one meeting.”

Rep. Sean Casten, D-Ill., was similarly pessimistic about the prospects for a bipartisan deal. “I don’t know how you can be in Congress for any significant period of time and come to the conclusion [that] there is a significant bloc of Republicans who are going to take climate change seriously,” he said in a May 2 interview.

Some Republicans who are not participating in the discussions have also expressed their doubts that the bipartisan effort will go anywhere. Sen. Mike Braun, R-Ind., recently commented that he thought the meetings were simply “for show” and that there is little chance 10 Republicans will support legislation.

Running out the clock on Build Back Better?

Another Senate Republican, granted anonymity to speak candidly, told *Politico* this week that the bipartisan effort appeared to be aimed at derailing Democrats’ budget reconciliation agenda by consuming time and sapping momentum for negotiating a revised tax-and-spending deal that could win support from all 50 Senate Democrats.

For his part, Sen. Kevin Cramer of North Dakota, a Republican participating in the bipartisan talks, told reporters the GOP isn’t explicitly trying to kill Democrats’ party-line bill by working across the aisle on the climate change agenda; but he commented if that if ending Build Back Better happened to be a byproduct of the bipartisan climate change negotiations, then “hallelujah.”

Given the limited time remaining on the legislative calendar before the budget reconciliation instructions authorizing the Build Back Better legislation expire at the end of the fiscal year on September 30 and the lack of progress that has been made on hammering out a compromise measure, many are pessimistic that the party will succeed in finalizing even a narrow version of their proposal to raise taxes on businesses and high-income individuals and provide targeted spending for certain Democratic priorities.

“There are varying levels of optimism” among Democrats about the prospects for a party-line bill, Senate Majority Whip Dick Durbin, D-Ill., recently told reporters. “I am the most skeptical.”

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Senate-approved ‘motion to instruct’ China competitiveness conferees calls for preserving expensing of research costs

A nonbinding measure calling on conferees to a recently convened House-Senate conference committee on China competitiveness legislation to include language in any conference agreement preserving full and immediate expensing of research and experimentation costs was approved by the Senate May 4 on a bipartisan 90-5 vote.

28 ‘motions to instruct’

The research expensing measure was offered by Senate Finance Committee member Maggie Hassan, D-N.H., as part of a broader package of 28 so-called “motions to instruct” the House and Senate conferees to H.R.

4521, which is variously referred to as the United States Innovation and Competition Act of 2021 (USICA), the America COMPETES Act, or the "CHIPs" bill (as in, microchips and/or semiconductors, the domestic production of which would be bolstered under the legislation). Twenty of the motions came from the GOP side of the aisle and eight came from Democrats.
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220506_2_suppA.pdf

The conference committee, which was formally established on April 28, is comprised of a massive group of 107 House and Senate members, largely due to the fact that the sweeping legislation touches the jurisdiction of many different congressional committees.

The Hassan motion which, again, is not binding on the conference committee, is aimed at reversing a change under section 174—originally enacted as part of the Tax Cuts and Jobs Act of 2017 (P.L. 115-97)—that, as of January 1 of this year, requires certain research expenditures to be amortized over a number of years rather than deducted currently.

The motion, which is comprised of nothing more than a single sentence of text, encourages to the conferees to "insist that the final conference report include provisions that expand the research and development tax credit for small businesses and preserve full and immediate expensing for research and development investments."

In a related development this week, a group of almost 70 House lawmakers—led by taxwriters John Larson, D-Conn., and Ron Estes, R-Kan.—sent a letter to party leaders calling for "immediate action" to reverse research expense amortization.

"As each month passes, failure to act yields proportionately more harm to innovation and competitiveness," the letter said.

Handful of other tax-related motions to instruct also get votes: In addition to the section 174 measure, the Senate also voted this week on a handful of other motions to instruct that had possible implications for the tax code.

Motions that were approved include calls to:

- Provide incentives to support domestic semiconductor manufacturing and innovation (offered by Sen. Mark Kelly, D-Ariz., and approved by a voice vote). Senate Finance Committee Chairman Ron Wyden, D-Ore., told Bloomberg Government that he and ranking member Mike Crapo, R-Idaho, "feel strongly" about providing an investment tax credit for semiconductors and will push to ensure that such a provision is included in the final legislation.
- Require that any taxpayer funds spent in the bill, including those provided to universities and private corporations, be subject to a "return on investment analysis" and potential claw-back (offered by Sen. Rick Scott, R-Fla., and approved by voice vote).

- Prohibit any renewable energy projects from receiving assistance—whether by grant or tax incentive—under the final bill from procuring materials, technology, or critical minerals from China (offered by Sen. Dan Sullivan, R-Alaska, and approved by voice vote).

The Senate defeated motions to:

- Prohibit recipients of incentives for domestic semiconductor manufacturing from buying back their own stock, outsourcing jobs, or weakening union agreements (offered by Sen. Bernie Sanders, I-Vt., and rejected by a 6-87 vote) and
- Prohibit the enactment of new mandates on greenhouse gas emissions unless China enacts similar mandates (offered by Senate Finance Committee member Tim Scott, R-S.C., and rejected by a 47-49 vote).

Kildee: Attaching tax title to China bill may be 'difficult'

Although the motion to instruct conferees to include a fix for research and experimentation costs under section 174 garnered widespread support from both Senate Democrats and Republicans, many observers—and some lawmakers—remain dubious that any conference agreement on China competitiveness legislation (which may take weeks, if not months, to negotiate) will carry a tax title, and believe that the provisions included in the various motions to instruct instead may have to wait for another legislative vehicle such as a post-election lame duck tax-and-spending bill that has been customary in recent years.

House Democratic taxwriter Dan Kildee of Michigan, for example, told Politico this week that opening up the bill to tax changes could complicate its path to enactment, in large part because so many members have varying tax priorities that they would like to have sent to President Biden's desk.

"I think we recognize that, at the appropriate time, we'll need to take up tax legislation," Kildee said. ". . . In order to keep the momentum for [the China legislation], it's more difficult to open up the door to a specific tax title, and then allow that to be another reason to delay and delay. . . . So I think it's really more a tactical question, less so a substantive one . . . about how much we can do with each particular vehicle. It was a source of some discussion, but I think it's fairly clear there won't be a specific tax title in this bill."

— Alex Brosseau
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Bipartisan Ways and Means contingent tells Yellen of taxpayer concerns about foreign tax credit regs

A bipartisan group of House taxwriters wrote a letter to Treasury Secretary Janet Yellen on April 29 asking her to work with companies and other stakeholders to provide further guidance and safe harbors for recently finalized regulations on foreign tax credits (FTCs) and to extend the March 7, 2022, deadline for implementing the new rules.
URL: https://hern.house.gov/uploadedfiles/schneider-hern_ftc_letter_to_treasury_final_4.29.22.pdf
URL: https://www.federalregister.gov/documents/2022/01/04/2021-27887/guidance-related-to-the-foreign-tax-credit-clarification-of-foreign-derived-intangible-income

The letter, led by House Ways and Means Committee members Brad Schneider, D-Ill., and Kevin Hern, R-Okla., urged Treasury to continue discussions with multinational businesses to develop a "productive outcome" on issues such as:

- "[T]he potential impact these new regulations will have on US companies operating in foreign countries with no US tax treaty in place";
- [T] he development of safe harbors "to make clear the regulations do not disallow credits for taxes that are clearly imposed on net income attributable to the taxing country"; and
- [T]he timely development of guidance.

The letter was also signed by Reps. Jodey Arrington, R-Texas; Ron Estes, R-Kan.; Drew Ferguson, R-Ga.; Ron Kind, D-Wis.; Stephanie Murphy, D-Fla.; Jimmy Panetta, D-Calif.; Stacey Plaskett, D-USVI; and Jackie Walorski R-Ind.

The FTC regulations, filed December 28, 2021, affect taxpayers that claim credits or deductions for foreign income taxes, or that claim a deduction for foreign-derived intangible income (FDII). (A summary of the regulations is available from Deloitte Tax LLP.) Numerous trade associations have argued that the final regulations included new and dramatically different provisions from earlier draft regulations released in November 2020 but the government did not provide an opportunity for stakeholders to comment. Industry groups also say the regulations serve to deny FTCs for foreign taxes that have long been creditable and will lead to double taxation and a competitive disadvantage for US groups.
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220506_3_suppA.pdf

Some practitioners have also questioned whether the new regulations are compatible with the global tax reform plan being developed through the OECD that the US and nearly 140 other countries signed on to last October.

Noting the complexity involved in coordinating all the moving pieces related to international taxation, the House members wrote in their letter that "[a]s the Biden administration develops tax policy impacting US-based multinational corporations, it is crucial for Treasury to keep our global competitiveness at the top of its considerations while we work together to put our economy on the road towards long-term growth and recovery."

"FTCs play a critical role in the international tax system by preventing double taxation of income that is properly subject to tax in another jurisdiction. Denying credits for foreign taxes that were previously creditable may lead to unintended consequences with compounding effects for US businesses, such as double-taxation or US firms making decisions to offshore intellectual property. While we appreciate Treasury's role in issuing these final regulations, misaligned US policy could also dissuade investment by US companies in emerging markets where we need to stay competitive with China," the letter said.

At a Federal Bar Association tax law conference on March 3, several senior staff members to the congressional taxwriting committees addressed the FTC regulations and the concerns they have heard from industry, saying they too are working to understand the implications and believe Treasury is cooperating with both Congress and the business community on implementation.

"None of this is happening in isolation," said Derek Theurer, chief tax counsel for House Ways and Means Republicans, referring to the global negotiations taking place though the OECD. "Our members are very concerned about where that stands. How these foreign tax credit regs fit into Treasury's negotiations there, and what they want to be the final result, I think, is pretty important and not clear at this stage, so we're still kind of in information-gathering territory."

Andrew Grossman, chief tax counsel for the Ways and Means Democrats, also said Treasury was engaged in discussions with the committee's members about industry concerns but added some criticism of companies weighing in this year.

"If the new regs caused alarm in their final form, I think the business community would have been a little bit wiser to have reacted with a bit more alarm in their draft form," Grossman said.

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Finance Committee Democrats back tighter rules to curb excessive political activity by nonprofits

Senate Democratic taxwriters this week called for legislative and regulatory changes that they argued would help ensure that tax-exempt entities—particularly social welfare groups organized under section 501(c)(4)—are not engaging in impermissible levels of political activity and urged the Internal Revenue Service to make better use of the enforcement tools it already has at its disposal to combat potential abuses.

The discussion arose during a May 4 hearing convened by the Subcommittee on Taxation and IRS Oversight to examine laws and enforcement mechanisms related to political activity of exempt organizations. (A background report on current law governing tax-exempt organizations and their political activity was released by the Joint Committee on Taxation staff in conjunction with the hearing.)
URL: https://www.jct.gov/publications/2022/jcx-7-22/

Promoting transparency

Subcommittee Chairman Sheldon Whitehouse, D-R.I., explained in his opening statement that "the statute governing section 501(c)(4) organizations states they must be 'operated exclusively for social welfare'"; but he noted that "the IRS muddied the waters with a regulation that allowed social welfare organizations to devote up to 49.9 percent of their spending to political activities and still qualify for [tax-exempt] status."

Section 501(c)(4) organizations, which are not required to disclose the names of their donors, began to proliferate in the wake of the Supreme Court's decision in *Citizens United v. Federal Elections Commission*, Whitehouse said, and political expenditures among these organizations jumped accordingly—from $103 million in the decade before the decision to more than $1 billion in the decade after the ruling. According to Whitehouse, evidence of election-related irregularities among this fast-growing segment of the nonprofit sector began to emerge as early as 2012 when "a ProPublica investigation found that roughly three in ten of the 501(c)(4) organizations surveyed reported to the [Federal Elections Commission (FEC)] that they had spent money on electioneering, but reported to the IRS they spent no money to influence elections directly or indirectly."

Donor disclosure: Addressing the perceived lack of transparency among some tax-exempt groups regarding their political activity, Whitehouse asked witness Philip Hackney of the University of Pittsburgh School of Law about the impact of final regulations issued by the Treasury Department in 2020 rescinding a rule that had required tax-exempt entities—other than those organized under section 501(c)(3) or section 527—to disclose to the IRS on their annual Form 990 the names and addresses of donors who contribute $5,000 or more.
URL: https://s3.amazonaws.com/public-inspection.federalregister.gov/2020-11465.pdf

Hackney, who worked in the IRS Office of Chief Counsel on issues related to tax-exempt sector from 2006-2011, replied that the IRS had required disclosure of information about large donors for as long as Form 990 has been in existence and that the decision to roll back that requirement was "of significant concern." According to Hackney, "the IRS knows information reporting matters" and dropping the donor-disclosure requirement was "problematic for revenue collection, enforcement of laws, and the perception of equal enforcement."

Another witness, former FEC Chair Ann Ravel, agreed that eliminating the requirement "impairs an already somewhat dysfunctional process" at the IRS for identifying potential violations of laws limiting political activity by tax-exempts and will "increase [the agency's] inability to enforce the law."

Addressing a separate disclosure issue, Democratic subcommittee member Debbie Stabenow of Michigan called for passage of the Disclose Act (S. 443), a measure sponsored by Whitehouse that, among other things,

would require 501(c)(4) groups and other organizations to disclose to the Federal Elections Commission the names of donors who have given $10,000 or more during an election cycle. A House companion measure (H.R. 1334) is sponsored by Rep. David Cicilline, D-R.I.
URL: https://www.congress.gov/bill/117th-congress/senate-bill/443/text
URL: https://www.congress.gov/bill/117th-congress/house-bill/1334/text

Enforcement issues: Whitehouse contended that the problem of impermissible political activity on the part of nonprofits has been exacerbated by the fact that the IRS appears to be doing little to enforce existing rules. According to Whitehouse, a 2018 report from the Treasury Inspector General for Tax Administration estimated that over 1,000 cases of impermissible political activity among 501(c)(4) groups were not referred to an IRS committee tasked with recommending audits, and a 2020 Government Accountability Office report found that the Service conducted only 14 audits of 501(c)(4) groups between 2010 and 2017.
URL: https://www.treasury.gov/tigta/auditreports/2019reports/201910006fr.pdf
URL: https://www.gao.gov/assets/710/705927.pdf

Witness Philip Hackney told the panel in his opening statement that the lackluster enforcement effort by the IRS is due in part to resource constraints. He noted that between 2010 and 2018, as applications for 501(c)(4) status were skyrocketing, the agency's budget declined by 20 percent, and that between 2010 and 2019 the Exempt Organizations division shrank from 889 employees to 559. The recently enacted IRS budget bump for fiscal year 2022 is an improvement, he said, but still does not leave the agency in a position to vigorously enforce the nation's tax laws.

In exchanges with Whitehouse and subcommittee member Elizabeth Warren, D-Mass., however, Hackney also faulted the IRS for not taking basic enforcement actions within its purview, such as coordinating with the FEC to ensure that organizations are consistently reporting their political activity to the government agencies that oversee them. (Ann Ravel, the former FEC chair, likewise told the panel in her opening statement that the IRS, the FEC, and the Justice Department do not routinely engage in the kind of rigorous information sharing that could help the government identify potential election-related violations on the part of nonprofit groups.)

Hackney also told Warren that reinstating the requirement for exempt organizations to disclose significant donors on their Form 990 filings is an immediate action the Treasury Department and IRS could take to strengthen the government's hand in enforcing prohibitions against improper political activities.

Protecting privacy

For his part, subcommittee ranking member John Thune of South Dakota argued that some of the changes sought by Democrats—particularly, requiring 501(c)(4) to disclose names and addresses of their larger donors—could raise free-speech and right-to-privacy concerns.

"[A]llowing Americans to privately give to causes that they care about is a fundamental component of protecting free speech and the First Amendment," Thune said in his opening statement. "Partisan legislation to force tax-exempt groups to choose between spreading their message and protecting donors' privacy runs a real, and potentially corrosive, risk of chilling free speech."

One of the GOP's invited witnesses, Scott Walter of the Capital Research Center, agreed with Thune about potential privacy implications of increased disclosure and said that concerns among exempt organizations about protecting the identity of donors cut across ideological lines.

According to Walter, left-leaning organizations as well as right-leaning organizations "believe their donors' privacy needs to be respected. We've had anonymous speech since the beginning of the Republic. . . . This position is "not unreasonable."

Another GOP witness, Bradley Smith of the Institute for Free Speech, told the panel in response to a question from Thune about the Disclose Act that the "tendency for *ad hominem* attacks on individuals is a problem in US politics and that emphasizing donor disclosure as a policy matter would be "poisonous" to the political system.

"Once money is given as a donation the individual donor no longer has any control over it," he said, adding that "the focus on who is speaking is quite wrong and one of the reasons the Supreme Court has protected individuals' rights to free speech and association."

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