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Schumer-Manchin reconciliation bill includes corporate minimum tax, carried interest changes, green energy incentives

The path forward for budget reconciliation legislation in the Senate took an unexpected turn this week when Majority Leader Charles Schumer, D-N.Y., and Sen. Charles Manchin, D-W.Va., unveiled the Inflation Reduction Act of 2022—a $739 billion tax-and-spending package that includes some targeted corporate and individual tax increases, a large increase in funding for the Internal Revenue Service, incentives to promote climate change mitigation and clean energy, and provisions to promote health care affordability.
URL: https://www.democrats.senate.gov/imo/media/doc/inflation_reduction_act_of_2022.pdf

A reconciliation on reconciliation

Schumer and Manchin unveiled the text of their proposal on July 27, just hours after announcing that they had agreed on a plan to replace the Build Back Better legislation that has been stalled in the Senate since last December. That announcement came nearly two weeks after Manchin appeared to walk away from behind-the-scenes negotiations and Senate Democratic leaders seemed resigned to moving a considerably narrower reconciliation measure focused chiefly on health care and lacking a significant tax title. (For prior coverage, see *Tax News & Views*, Vol. 23, No. 23, July 15, 2022.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220715_1.html

Explaining his thinking and the negotiations with Schumer in recent days, Manchin told reporters July 28 that, contrary to the conventional belief, "I never walked away. I've never walked away from anything." He said that his concern with the broader bill being discussed in recent months—which called for significantly more tax hikes than the measure he has put forward with Schumer—was the potential that it could exacerbate the recent spike in inflation.

"The bottom line was inflation scared the bejesus out of me at 9.1 [percent]," Manchin told *Punchbowl News*, referring to the recent report that inflation increased by 9.1 percent in June compared to the same period last year. Manchin added that he and his staff "scrubbed everything" and deleted any provisions they thought could be inflationary from agreement that had been under discussion.

At a high level, the new agreement between Schumer and Manchin includes revenue-raising provisions that would impose a 15 percent book minimum tax on certain large corporations, modify the tax treatment of income from carried interests, and provide a special allocation of $80 billion (over 10 years) to fund IRS compliance and enforcement efforts. A one-page summary from Schumer and Manchin notes that "[t]here are no new taxes on families making $400,000 or less and no new taxes on small businesses."
URL: https://www.democrats.senate.gov/imo/media/doc/inflation_reduction_act_one_page_summary.pdf

Some of the revenue from those provisions—and from nontax provisions to modify the Medicare prescription drug pricing rules—would offset the cost of several investment and production tax incentives for clean energy (from certain fossil fuels as well as alternative sources) and an extension (through 2025) of enhanced premium subsidies for certain individuals who purchase health insurance through one of the Affordable Care Act exchanges.

A portion of the revenue raised under the measure would be allocated to deficit reduction—something that has been a key priority for Sen. Manchin.

With an agreement in place the focus for Democratic leaders now turns to the process of ensuring they have sufficient support among their members in both chambers of Congress and that the bill can pass muster with the Senate parliamentarian.

This edition of *Tax News & Views* provides details on the major tax provisions in the legislation and discusses the plans to move it through Congress as well as some of the potential obstacles ahead.

Corporate minimum tax

The Inflation Reduction Act does not propose to increase the top corporate income tax rate; however, it would impose a 15 percent minimum tax on adjusted financial statement income for corporations with profits in excess of $1 billion. Corporations generally would be eligible to claim net operating losses and tax credits against the AMT, and would be eligible to claim a tax credit against the regular corporate tax for AMT paid in prior years, to the extent the regular tax liability in any year exceeds 15 percent of the corporation's adjusted financial statement income. The proposed minimum tax would be effective for taxable years beginning after December 31, 2022.

This provision largely mirrors language included in the House-approved version of the Build Back Better Act; however, it does make a few notable changes to the House measure.

First, the Schumer-Manchin bill does not include the provision in Build Back Better legislation that expanded the definition for a single employer under section 52. Second, although the proposed legislation includes a cross reference to section 163(n) for purposes of defining an international financial reporting group, section 163(n) is not included in the proposed legislation, and sources on Capitol Hill expect that reference to 163(n) to be removed in subsequent drafts of the proposal. Finally, a new provision is included for purposes of calculating adjusted financial statement income that makes adjustments for income, cost, or expense related to defined benefit pensions. (A detailed discussion of the House-approved Build Back Better bill, including a description of the prior version, of the corporate minimum tax, is available from Deloitte Tax LLP.)
URL: https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-provisions-in-the-build-back-better-act.pdf

Increased holding period for carried interests

The Inflation Reduction Act proposes several changes to the carried interest rules, most notably by requiring generally that net capital gain attributable an applicable partnership interest be held for more than five years to qualify for long-term capital gain treatment. The three-year holding period under current law would remain in effect for real property trades or businesses and for taxpayers with adjusted gross income of less than $400,000.

Additional proposed changes would, among other things:

1. Reform the holding period rules for purposes of measuring the three- or five-year holding period (including in the context of tiered partnerships),
2. Modify the rules so that they apply to all transfers and not just to certain related persons, and
3. Extend regulatory authority under the provision to address carry waivers.

These changes, which are substantially similar to those in a version of Build Back Better legislation approved by the House Ways and Means Committee last September, would be effective for taxable years beginning after December 31, 2022.

IRS funding boost to improve taxpayer compliance

The Schumer-Manchin bill would provide the Internal Revenue Service approximately $80 billion in additional appropriations (available over 10 years) to enhance its tax enforcement and compliance efforts. According to Schumer and Manchin (who cited estimates from the nonpartisan Congressional Budget Office), the more robust compliance and enforcement regime that would be made possible by the funding boost would generate an additional $203 billion of tax revenue that was owed to the government but not paid.

This additional funding includes:

- $3.1 billion for *taxpayer services* (for example, pre-filing assistance and education, filing and account services, taxpayer advocacy services, and other authorized services);
- $45.6 billion for tax *enforcement activities* (such as determining and collecting owed taxes, providing legal and litigation support, conducting criminal investigations and using investigative technology in the investigations, providing digital asset monitoring and compliance activities, enforcing criminal statutes related to violations of internal revenue laws and other financial crimes, purchasing and hiring passenger motor vehicles, and providing other authorized other services);
- $25.3 billion for *operations support* (for example, rent payments; facilities services; printing; postage; physical security; headquarters and other IRS-wide administration activities; research and 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
- $4.7 billion for *business systems modernization* (such as development of callback technology and other technology to enhance customer service but not including the operation and maintenance of legacy systems).

The proposal expressly states that the additional funds are not intended to increase taxes on any taxpayer with a taxable income below $400,000.

These appropriated funds would remain available until September 30, 2031. If the proposal is enacted, the IRS would be required to provide a report to Congress detailing how the funds will be spent. After the initial report, the IRS must provide Congress quarterly reports regarding the implementation of its plan.

The proposal also would provide $15 million of funds for the IRS to prepare and deliver a report to Congress within nine months of enactment on the cost of developing and running a free direct e-file tax return system. Moreover, the proposal would allow the IRS to exercise greater flexibility with respect to personnel, including certain “direct hire” authority.

IRS officials have told House and Senate taxwriters at several hearings this year that having direct-hire authority would give the Service greater flexibility in attracting experienced tax professionals as well as support personnel since it allows the agency to onboard new hires in as few as 30 to 45 days (compared to the six to eight months under normal government hiring procedures).

Superfund excise tax

The measure would reinstate and increase the hazardous substance Superfund financing rate on crude oil and imported petroleum products, indexed to inflation, effective after December 31, 2022, and until January 1, 2033. (The Infrastructure Innovation and Jobs Act that was signed into law last year reinstated and modified other Superfund excise taxes on the production of certain chemicals through December 31, 2031.)

Excise tax on certain pharmaceutical manufacturers

The Schumer-Manchin bill also includes an excise tax of up to 95 percent that would be imposed on pharmaceutical manufacturers that do not participate in proposed mandatory negotiations with the government on Medicare prescription drug pricing.

Clean-energy tax incentives

On the incentive side, the Inflation Reduction Act includes a number of tax and nontax provisions that, according to Schumer and Manchin, "will bring down consumer energy costs [and] increase American energy security, while substantially reducing greenhouse gas emissions." The impact of those investments, Manchin and Schumer contend, "will put the US on a path to roughly 40 percent emissions reduction by 2030."

Certain tax credits proposed in the legislation include a direct-pay option as well as transferability provisions.

Some of the more notable tax-focused provisions are briefly highlighted here. A more detailed discussion will be published by Deloitte Tax LLP's Periods, Methods and Credits Group in the coming days.

Reducing consumer energy costs: The bill would extend a number of tax credits aimed at bringing down the cost of residential energy-efficiency improvements such as heat pumps, rooftop solar systems, and electric HVAC systems and water heaters.

The measure also calls for a $4,000 credit to make it more affordable for certain lower- and middle-income individuals to purchase used clean-energy vehicles. A credit of up to $7,500 would be available for the purchase of new clean-energy vehicles. (Sen. Manchin had contended that similar incentives in earlier iterations of the Build Back Better legislation were focused on more expensive vehicles that were intended to appeal primarily to affluent taxpayers.)

Promoting American energy security and domestic manufacturing: The measure includes tax and nontax provisions intended to improve reliability of the US energy grid and promote domestic clean-energy manufacturing.

Among the tax-focused provisions are production tax credits to accelerate US manufacturing of solar panels, wind turbines, and critical minerals processing. Also included is an investment tax credit to build clean technology manufacturing facilities that produce electric vehicles, wind turbines, solar panels, and similar clean-energy property.

Decarbonizing the economy: The bill calls for an array of tax and nontax provisions aimed at reducing emissions from energy production, transportation, industrial manufacturing, buildings, and agriculture.

Specifically, it includes tax credits for clean sources of energy and energy storage, tax credits for clean fuels and clean commercial vehicles to reduce emissions within the transportation sector, and tax credits to reduce emissions from industrial manufacturing processes.

Supporting farmers, forestland owners, and rural communities: The bill proposes investments in clean-energy development in rural communities, including through tax credits to support the domestic production of biofuels and to build the infrastructure needed for sustainable aviation fuel and other biofuels.

Promoting environmental justice: To support the goal of expanding environmental justice efforts, many of the clean-energy tax credits in the bill include either a bonus rate or set-aside for investments in economically distressed communities.

Affordable Care Act premium enhancements

The bill would extend through 2025 temporary provisions that reduce an individual's or family's share of premiums used in determining the amount of the premium-assistance credit under the Patient Protection and Affordable Care Act and make the credit available to taxpayers with incomes above 400 percent of the federal poverty line for the applicable family size.

These premium-assistance enhancements were enacted in 2021 as part of the American Rescue Plan and are scheduled to expire at the end of this year.

A sprint towards summer break

President Joe Biden, who Sens. Schumer and Manchin briefed on their new agreement July 27 before they announced it publicly, urged the Senate and the House to move the bill as quickly as possible. Emerging from a meeting of the full Democratic caucus the morning of July 28, senators said Schumer told them he expects the work to clear the provisions with the parliamentarian will be completed "in the coming days" and that the Senate will vote on the legislation the week of August 1. The chamber is scheduled for a four-week recess beginning August 5 and running through Labor Day, but senators could remain in town into the weekend of August 6 if necessary to complete passage.

The Senate parliamentarian's review of the provisions in the bill—a process known colloquially as a "Byrd bath"—is necessary to ensure that each provision adheres to the strict Byrd Rules that govern the budget reconciliation process. For example, to be Byrd Rule-compliant, provisions must have a budgetary effect (not merely an "incidental" effect), cannot increase the deficit outside the 10-year budget window, and cannot be related to Social Security.

As part of the budget reconciliation process, the Senate will also have to go through what is known as a vote-a-rama, a process that allows for an unlimited number of amendments that are briefly debated before being voted on. These amendments—specific to budget-related measures—are often used for political messaging rather than to modify the underlying bill, and the process can take many hours. The upcoming vote-a-rama, which will be preceded by up to 30 hours of debate on the underlying reconciliation bill, is not expected to begin until at least August 3. A final vote on passage will follow the vote-a-rama.

"It will require us to stick together and work long days and nights for the next 10 days," Schumer told his members, according to senators in the July 28 meeting. "We will need to be disciplined in our messaging and focus. It will be hard. But I believe we can get this done."

The House begins its own recess July 29 and is not scheduled to return until September 13, but Democratic leaders are already planning to bring the chamber back to Washington briefly in August if the Senate passes a reconciliation bill while the House is out of session. Majority Leader Steny Hoyer of Maryland told his members on July 28 that the target return date for the House is August 8 but that it will remain fluid based on the Senate's work.

Obstacles ahead

Scheduling considerations aside, getting a bill through Congress and to President Biden's desk will require lawmakers in both chambers to navigate a series of political obstacles and work around several assorted health concerns.

Still no GOP support expected: Successfully sidestepping a filibuster and passing the proposed bill in the Senate will require the support of all 50 Democrats in that chamber plus the tie-breaking vote of Vice President Kamala Harris, as Republicans have made clear that they remain opposed to reconciliation legislation in any form. After the Bureau of Economic Analysis announced July 28 that US gross domestic product fell 0.9 percent in the second quarter—its second consecutive quarterly decline—GOP leaders pointed to the data as further argument against the Democrats' tax increase and spending plans. Republicans have also cited worsening inflation data throughout last fall and the first half of this year as another reason to shun an expansive reconciliation package.

"This [Inflation Reduction Act] is the nonsense that Democrats are focused on . . . not helping you put gas in your car, not helping you afford groceries, . . ." Senate Republican Leader Mitch McConnell of Kentucky said on the Senate floor July 28 after the BEA announcement, adding, "Democrats say the response to Democrat inflation is Democrat tax hikes. It wasn't enough that Democrats have already destroyed your family's purchasing power. Now they want to kill your job and tax your electricity, too."

For his part, Sen. Manchin, speaking on a popular West Virginia news radio program July 28, said he welcomes attacks on him for backing a 15 percent corporate minimum tax.

“I’m anxious to get hit hard on that,” he said, adding, “Why is . . . any corpora[tion] upset by . . . paying 15 [percent]? So yes, I’m anxious to find out who they are. Come forward.”

Manchin said he does not believe that it will be inflationary to raise taxes on companies as large as those that will be impacted by the minimum tax.

The West Virginian also argued that Republicans should support the reconciliation bill because it is tied to a separate nontax deal calling for changes to permitting for energy pipelines and exports, which the GOP advocates. (The permitting reform has to be structured as a side deal to the Inflation Reduction Act because it does not meet the requirements for inclusion in a reconciliation bill under the Byrd Rule, but Manchin has said he would not support reconciliation without it.)

“Without permitting reforms, without the ability of America to do what it does best—produce—there is no bill,” Manchin told radio host Hoppy Kercheval. “And that is totally agreed upon and understood.”

Despite Manchin’s argument, no Republicans are expected to support the revised reconciliation package. It is also worth noting that while Manchin said he secured an agreement with Biden, Schumer, and House Speaker Nancy Pelosi, D-Calif., on an upcoming measure to ease permitting restrictions, this deal is not in any way actually bound to the Inflation Reduction Act and is not guaranteed to move.

Getting all Democrats to ‘yes’: It’s also possible that Republicans will not be the only roadblock to the new bill. Manchin has received most of the attention as a potential “decider” in the evenly divided Senate, but every Democrat essentially holds a veto on the reconciliation package. (As Sen. Bob Menendez, D-N.J., told reporters July 28: “Anybody can be Joe Manchin. I can be Joe Manchin right now.”)

With that in mind, many are now waiting for word from Sen. Kyrsten Sinema, D-Ariz., who was not part of this week’s negotiations or the resulting legislative package but has previously been a holdout on some of her party’s tax-and-spending plans.

Last fall, after the House Ways and Means Committee passed its version of the Build Back Better Act with long-anticipated increases in the corporate tax rate, top individual rate, and capital gains rate, Sinema surprised her colleagues by saying she would not support any rate hikes. Her position led taxwriters to develop the corporate book minimum tax proposal now in the Inflation Reduction Act, as well as other provisions aimed at generating revenue from large corporations and high-income earners *without* raising tax rates.

Something else that fell out of the earlier bill, reportedly at Sinema’s insistence, was a proposal to modify the tax treatment of carried interests. Ways and Means Democrats included a longer required holding period for gain attributable to applicable partnership interests in the bill they marked up last September, but it was omitted from the version the House approved last November. It is not clear that Sinema will agree to the provision that has now reappeared in the Inflation Reduction Act, but Manchin told reporters July 28 that he is "not prepared" to drop it from the new bill, calling it "the only thing I was adamant about."

Manchin said he had not spoken to Sinema about the agreement he reached with Schumer, adding only, "I would hope that she would be receptive."

Sinema has not made any comment on the bill—yet—and reportedly did not attend the caucus meeting July 28 where Schumer discussed it. Her office has indicated Democrats will have to hold their breath for a while as she studies it.

"We aren't going to have comment because [Sen. Sinema] is reviewing the text, and she'll need to review what comes out of the parliamentarian process," a spokesperson told one reporter.

Could SALT lick the Dems?: Aside from Sinema, some questions remain about Democrats in both chambers who have insisted over the past year-and-a-half that any vehicle with tax changes must either repeal or relax the $10,000 cap on state and local tax (SALT) deductions—something that is not in the Inflation Reduction Act. The group that has been dubbed the "SALT Caucus" comprises more than 30 members, including some Republicans from high-tax states, but the focus is on the handful including Rep. Tom Suozzi of New York and Reps. Josh Gottheimer and Mikie Sherrill of New Jersey, who have consistently declared "No SALT-No Deal" as a bedrock position.

Suozzi seemed to provide breathing room for Democrats July 28 when he told reporters that he did not object to the Schumer-Manchin deal, despite its lack of SALT cap relief. He said he is studying the bill but that as long as there were no changes to the personal income tax rules, he was fine with it not including a SALT provision. Likewise, Gottheimer did not immediately shoot down the deal.

"I've got to understand the impact it has on families in my district," Gottheimer said. "Until I see specifics it's hard to know."

The potential loss of even a few Democratic votes in the House could present challenges for Speaker Pelosi, as the voting math in that chamber is already tricky and is about to get trickier. Democrats currently hold 220 seats in the House compared to 211 for Republicans, while 4 seats remain vacant. Thus, at the moment, Pelosi can afford to lose no more than four of her members if she hopes to get a measure through her chamber along strict party lines. But mounting a majority may become slightly more difficult after August 9 if Republicans win a special election in Minnesota—as is currently expected—and shrink the size of Democrats' vote cushion to just three.

Across the Capitol, a spokesperson for New Jersey Democrat Bob Menendez—a supporter of SALT relief—said shortly after the new deal was announced that there were "issues . . . that should be addressed, namely lifting the SALT cap." However, when asked by reporters July 28 if he would vote against the reconciliation bill because there was no SALT provision, Menendez said, "I don't make decisions like that. . . . I look at the totality of [the legislation]."

Senate plays whack-a-mole with COVID: The other challenge Democrats face as they race to approve the legislation before the summer break is the continuing threat to lawmakers posed by COVID. The current uptick in virus cases has included in its numbers not just the president but also several senators, who are unable to vote while they are isolating. (Unlike in the House, the Senate does not allow for remote or proxy voting.) Democratic Sens. Manchin, Tom Carper of Delaware, and Tina Smith of Minnesota, as well as Republican Lisa Murkowski of Alaska, have all been temporarily out of action in the past week or so. Senate Majority Whip Dick Durbin, D-Ill., was the latest to test positive for COVID on July 28, making him unavailable to vote for at least five days.

Sen. Pat Leahy, D-Vt., meanwhile, has mostly been away from the Senate since the end of June after undergoing two surgeries to repair a broken hip, but is expected to be available to return to the chamber for votes when necessary.

— Storme Sixeas and Michael DeHoff
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Pared-down 'CHIPs' bill with tax break for US semiconductor makers—but no section 174 fix—heads to White House

After months of negotiations, Congress this week passed and will send to President Biden bipartisan legislation designed to boost domestic semiconductor manufacturing and encourage US research activities. However, while the measure includes an investment tax credit intended to promote domestic production of semiconductors, lawmakers did *not* add a provision that would retroactively permit expensing for research expenditures under tax code section 174.

House passage of the CHIPS Act of 2022 (H.R. 4346: text; section-by-section summary) occurred on July 28, by a vote of 243-187. The measure cleared the Senate just one day earlier on a 64-33 vote, which included the backing of 17 Senate Republicans.
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220722_2_suppA.pdf
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220722_2_suppB.pdf

The vote in the House came less than 24 hours after Senate Majority Leader Charles Schumer, D-N.Y., and Sen. Joe Manchin, D-W.Va., announced that they had reached an accord on a tax, climate, health care, and deficit reduction bill dubbed the Inflation Reduction Act of 2022. (See related coverage in this issue for the latest news on Senate Democrats' apparent budget reconciliation deal and its prospects for passage in the coming days.)

Accord over reconciliation leads to friction over CHIPS

After the Senate Democrats announced their reconciliation deal, House Republican leaders began urging a "no" vote on the CHIPS legislation—the same position that Senate Minority Leader Mitch McConnell, R-Ky., had adopted up until the point on July 14 when it appeared Sen. Manchin had entirely broken off talks on a "Build Back Better" package and could only support a narrower bill focused only on health care. (McConnell had vowed that Republicans would not vote for CHIPS legislation if Democrats continued to pursue a broad tax-and-spending bill, but he dropped his opposition to CHIPS once it looked as though an expansive reconciliation package had no chance of becoming law.)

House Minority Leader Kevin McCarthy, R-Calif., suggested Senate Democrats' turnabout on reconciliation amounted to bad faith.

"They lied about reconciliation," McCarthy said. ". . . [Senate Republicans] said they weren't going to [support the CHIPS Act] without making sure reconciliation isn't going. The day they voted for it, [Democrats] said they had a deal on reconciliation."

But in the end, 24 House Republicans still ended up backing the bill. And progressive Democrats—some of whom had earlier viewed the CHIPS legislation as so-called "corporate welfare"—came around in strong enough numbers, buoyed by their renewed hopes of a more robust reconciliation package coming down the pike, to easily send the legislation to President Biden's desk.

25 percent investment tax credit plus funding for domestic chip makers

The CHIPS legislation, which the nonpartisan Congressional Budget Office (CBO) estimates will cost roughly $80 billion over 10 years, leans heavily on direct funding aimed at building, expanding, and modernizing domestic semiconductor facilities, along with boosting funding for research and development programs administered by the Department of Commerce.
URL: https://www.cbo.gov/system/files?file=2022-07/hr4346_chip.pdf

On the tax side, the bill would create a 25 percent investment tax credit (under new tax code section 48D) for "qualified property"—generally, tangible and depreciable or amortizable property—that is constructed or acquired new by the taxpayer and is integral to the operation of a facility for which the primary purpose is the manufacture of semiconductors or equipment used in semiconductor manufacturing. The provision would also allow taxpayers, including partnerships and S corporations, to receive the credit under a direct-pay option (similar to the direct-pay provisions for delivering certain clean energy tax incentives in the House-approved version of the Build Back Better Act and in the Inflation Reduction Act, the budget reconciliation proposal that was recently unveiled in the Senate).

The credit, which carries a 10-year cost of roughly $25 billion according to CBO, generally would be available for property placed in service after December 31, 2022, and for which construction begins before January 1, 2027.

Expensing of research expenditures left out, for now

Though the policy maintains broad bipartisan support, the CHIPS legislation now making its way to the White House does *not* include language aimed at reversing a change within tax code section 174—originally enacted as part of the 2017 Tax Cuts and Jobs Act (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.

As a result, advocates of the section 174 fix likely have to hope that it can be added as an amendment to the emerging Inflation Reduction Act that the Senate may vote on the week of August 1, or else wait until the post-midterm election lame duck session, when that and a number of other potential revenue measures (related to retirement tax policy and certain expired and expiring provisions known as "tax extenders") may be in play as part of a potential year-end tax-and-appropriations package.

— Alex Brosseau
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CBO: Long-term budget outlook remains bleak

The nonpartisan Congressional Budget Office (CBO) on July 27 released its annual Long-Term Budget Outlook, which continues to paint a sobering picture of the nation's projected fiscal condition over the next 30 years.
URL: https://www.cbo.gov/system/files/2022-07/57971-LTBO.pdf

The report, which extrapolates CBO's typical 10-year current-law "baseline" projections through 2052, predicts the federal debt held by the public (that is, debt not held in intragovernmental accounts such as the Social Security trust fund) will reach 185 percent of gross domestic product (GDP) by the end of the 30-year window.

The largest debt-to-GDP level in recorded US history—106 percent—was reached in 1946 in the wake of World War II.

Those increasing debt levels are the product of large and growing annual budget deficits that would consistently rise from about 3.9 percent of GDP in the current fiscal year to more than 11 percent of GDP in 2052. Over the past five decades, budget deficits have averaged 3.5 percent annually.

Revenue and spending mismatch

As it has many times in recent years, CBO once again attributes those large and growing deficits to a fundamental mismatch between revenues and spending driven in part by the continuing retirement of the Baby Boom generation (which is resulting in a greater number of Medicare and Social Security beneficiaries), lower birth rates, and health care cost growth.

Revenues: In CBO's estimation, revenues will rise gradually over the next few decades—from about 18.1 percent of GDP in the most recently completed fiscal year (that is, fiscal year 2021) to 19.1 percent of GDP by 2052—as the economy recovers, temporary tax cuts expire, scheduled tax increases take effect, and more income is taxed at higher rates due to a concept called "bracket creep" (or the tendency of revenues to naturally rise over time as wage growth exceeds the inflation index to which the individual tax brackets are tied). Accelerating distributions from tax-deferred retirement plans by Baby Boomers exiting the workforce also plays a role.

Over the past five decades, revenues have averaged slightly more than 17 percent of the economy.

Spending and debt service: Another notable metric in this week's report—and a large contributor to future deficits, along with growing outlays on Social Security and Medicare due to the aging population and growing health care expenses—relates to the government's projected debt service costs. Though low interest rates—at least up until to the Federal Reserve's recent campaign to raise the Federal Funds Rate—have caused the CBO to significantly write down its estimates of what the government will spend on interest over the medium term, it does not see that trend continuing after 2030. Between 2030 and 2052, the agency projects the government's net interest costs will more than double from 3 percent of GDP to 7.2 percent of GDP.

Current-law caveat

It is important to note that, by law, CBO is generally required to make its projections on the basis of "current law," or laws as they are currently in effect. (One exception is excise taxes dedicated to trust funds—for example, highway taxes—which are assumed to be continued beyond any scheduled expiration).

That means this week's analysis does not account for the potential budget impact of the Inflation Reduction Act of 2022—an unexpected deal struck Senate Majority Leader Charles Schumer, D-N.Y., and Sen. Joe Manchin, D-W.Va., and released late July 27 after months of negotiations—and which, according to a summary, could reduce budget deficits, on net, by roughly $300 billion over the next decade. (See related coverage in this issue for the latest news on Senate Democrats' apparent budget reconciliation deal and its prospects for passage in the coming days.)

On the flip side, also inherent in CBO's projections is an assumption that most expiring tax provisions—including, most notably, nearly all of the individual tax changes in the Tax Cuts and Jobs Act of 2017 (TCJA, P.L. 115-97) as well as the TCJA's passthrough deduction under section 199A, which are scheduled to lapse after 2025—will not be renewed, and revenues will be higher as a result. That assumption similarly applies to current and pending changes affecting bonus depreciation, the interest deduction limitation under section 163(j), the timing of research expenditure deductions, and the minimum tax affecting US multinationals known as the Global Intangible Low-Taxed Income (GILTI) regime that, if left untouched by lawmakers, will have the effect of raising revenue under current law later in the budget window.

Thus, if additional tax cuts or spending increases are enacted into law, or if temporary tax provisions are instead made permanent or otherwise extended beyond their scheduled expiration, future deficits may be higher than this week's CBO projections.

— Alex Brosseau
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JCT projects $1.7 trillion net revenue gain under White House FY 2023 budget proposal

The tax provisions in the fiscal year 2023 budget blueprint that President Biden sent to Congress this past March would, if enacted into law, result in a net increase in federal receipts of just over $1.7 trillion between fiscal years 2023 and 2032, according to a revenue estimate released by the Joint Committee on Taxation (JCT) staff on July 25. Significantly, however, the estimate does not include revenue from the administration's proposed new income tax on certain ultra-wealthy individuals, as the JCT noted that it currently has insufficient details to score that provision.
URL: https://www.jct.gov/publications/2022/jcx-17-22/

The JCT's estimate is substantially below the $2.5 trillion (net) revenue score provided by the Treasury Department in conjunction with its release of the budget blueprint—a disparity attributable in large part to the fact that the administration measured its budget proposals against a baseline that assumes nearly all of the tax provisions in the expansive Build Back Better legislation that cleared the House last November (other than one that would relax the present-law cap on the deduction for certain state and local taxes) are enacted into law. (A detailed discussion of the tax provisions in the House-approved Build Back Better bill is available from Deloitte Tax LLP.)
URL: https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-provisions-in-the-build-back-better-act.pdf

Highlights of notable tax offsets

The president's latest budget release echoes his longstanding calls for significant tax increases targeting multinational entities, large domestic corporations, and high-income individuals to pay for tax relief for low- and middle-income families and new investments in clean energy and economic development. Some of the more notable proposed offsets are highlighted below. (Descriptions of all the administration's tax proposals are available in the "Green Book" released by the Treasury Department along with the budget blueprint. For additional discussion, see *Tax News & Views*, Vol. 23, No. 12, Mar. 29, 2022.)
URL: https://home.treasury.gov/system/files/131/General-Explanations-FY2023.pdf
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220329_1.html

Multinational and corporate provisions: The budget blueprint includes a familiar proposal from the fiscal year 2022 tax-and-spending plan to increase the top income tax rate to 28 percent for corporations, which the JCT estimates would increase revenues by nearly $873.4 billion over the 10-year budget window.

A new proposal the White House put forward this year would repeal the current-law base erosion and anti-abuse tax (BEAT) and replace it with an undertaxed profits rule consistent with one described in the OECD's Pillar Two Model Rules. That provision, if enacted, would raise nearly $318.7 billion over 10 years, according to the JCT.

High-wealth provisions: The budget blueprint also proposes a number of provisions reiterating the president's position that the wealthiest individuals should pay "their fair share" in taxes. A proposal to increase the top individual income tax rate to 39.6 percent—an item carried over from fiscal year 2022—would raise nearly $169.9 billion over 10 years, the JCT says.

New proposals to tax long-term capital gains and qualified dividends of taxpayers with taxable income of more than $1 million ($500,000 for married taxpayers filing separately) at ordinary income tax rates and treat transfers of appreciated property by gift or on death as realization events would generate a combined total of roughly $195.2 billion over the budget window, according to the JCT. The administration would raise an additional $30.9 billion through proposed modifications to the income, estate, and gift tax rules for certain grantor trusts.

The JCT staff was *not* able to provide an estimate for a new budget proposal that would impose a minimum tax of 20 percent on total income, generally inclusive of unrealized capital gains, for all taxpayers with wealth greater than $100 million, however. The JCT notes, without elaborating, that the "proposal requires further specification."

Noncorporate business provisions: The budget includes several proposals intended to tighten the tax rules for noncorporate taxpayers, such as:

1. Preventing basis shifting by related parties through partnerships (10-year revenue gain: $27.4 billion);
2. Repealing deferral of gain from like-kind exchanges (10-year revenue gain: $30.9 billion);
3. Taxing carried interest income as ordinary (10-year revenue gain: $1.7 billion); and
4. Limiting a partner's deduction in certain syndicated conservation easement transactions (10-year revenue gain: $17.1 billion).

The White House's carried interest proposal has a revenue score that's lower than those of other proposals to modify the tax treatment of carried interests because it is stacked with the administration's proposal to impose higher rates on certain capital gain income. As a result, the incremental income picked up by the proposed carried interest change is substantially smaller than it would be if it were enacted in isolation.

Fossil fuel taxation: This year's budget blueprint renews proposals from the fiscal 2022 plan that would:

1. Repeal a host of deductions and other incentives that the administration feels unduly benefit the fossil fuel industry,
2. Expand the Superfund excise tax on domestic crude oil and imported petroleum products to apply other crudes, and
3. Eliminate eligibility of the Oil Spill Liability Trust Fund for drawback, for what the JCT estimates to be a combined 10-year revenue gain of $25.1 billion.

Tax rules for digital assets: Building on proposals in its fiscal year 2022 budget blueprint, the administration has called for several additional rules addressing the tax treatment of digital assets. A proposal to amend the mark-to-market rules for dealers and traders to include digital assets would increase revenues by $5.75 billion over 10 years and a proposal to require certain taxpayers to report foreign digital asset accounts would generate $2.5 billion over the budget window.

Tax administration and compliance: The administration would raise roughly $6.1 billion (combined) through a series of targeted proposals aimed at expanding information reporting, tightening taxpayer compliance provisions, and expanding the application of certain tax penalties.

A handful of business and individual tax incentives

On the incentive side, the budget blueprint includes business-friendly economic and community development proposals that would provide a basis boost for certain bond-financed low-income housing tax credit projects (estimated 10-year revenue loss: $7.85 billion) and permanently extend the new markets tax credit (estimated 10-year revenue loss: $3.26 billion).

Tax relief proposals for individuals taxpayers would make the adoption tax credit refundable (estimated 10-year revenue loss: $7.7 billion) and provide an income tax exclusion for certain student loan debt forgiveness (estimated 10-year revenue loss: $408 million).

Enactment of sweeping corporate, high-wealth tax hikes unlikely

The revenue-raising provisions in the administration's budget blueprint that are focused on corporations and high-wealth individuals are not expected to be enacted into law in the near term. Congressional Republicans have been adamant that they will not support major tax increases and their position appears unlikely to change. That means the best chance for the White House and congressional Democrats to advance a tax package that includes substantial revenue offsets would be through a party-line budget reconciliation bill that could clear the Senate by a simple majority vote rather than the three-fifths supermajority typically required to overcome procedural obstacles in that chamber.

But as we have seen with efforts to advance another reconciliation package—the Build Back Better Act—through Congress this year, Democrats in the evenly divided Senate have struggled to coalesce around a measure that can win the support of all 50 of their members (plus the tie-breaking vote of Vice President Harris) and they now appear to be on a path to settle for a smaller bill—with a more modest revenue title—

than the roughly $1.75 trillion proposal that was approved in the House last November. (See separate coverage in this issue for the latest developments on Senate efforts to move the narrower reconciliation bill—the Inflation Reduction Act of 2022—that was unveiled this week by Majority Leader Charles Schumer, D-N.Y., and Sen. Joe Manchin, D-W.Va.)

The legislative calendar also weighs against near-term passage of another reconciliation bill. The fiscal year 2022 budget resolution that includes the reconciliation instructions that Democrats have relied on to move the Build Back Better legislation (and now its replacement, the Inflation Reduction Act) expires on September 30. Democrats could, in theory, pass a fiscal year 2023 budget resolution during the upcoming fall work period that includes a new set of reconciliation instructions, but that process would be extremely challenging and time-consuming as lawmakers look ahead to the midterm elections, making the chances of success this year highly unlikely.

Democrats would be in a position to advance a reconciliation bill in 2023 if they retain control of the House and Senate in the upcoming midterms, although their chances for getting a bill to the president's desk might be in doubt unless they also expand their majority in the Senate, which would reduce the risk that a single member of their caucus could stall their legislative agenda. The prospects for those outcomes currently appear uncertain, however.

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