Build Back Better Act

November 19, 2021

Highlights

- ✔ $1.75 Trillion Bill Solely Supported by Democrats
- ✔ Significant Reduction in Scope from Previous Proposal
- ✔ Return of Corporate AMT
- ✔ SALT Cap Increase
- ✔ Extension of Many Popular ARPA Tax Credits
- ✔ Changes to Taxation of Foreign Corporations
- ✔ Massive Expansion and Extension of Green Energy Incentives

Inside

House Passes Massive Spending Bill

On November 19, 2021, the House of Representatives passed the Build Back Better Act, by a vote of 220 to 213. The bill includes new social spending programs, like universal preschool, as well as expanded programs related to health care and housing. The bill also includes a massive expansion of green energy incentives, extensions of popular expansions of tax credits meant to help middle and lower-income taxpayers, and an increase in the limitation of the state and local tax deduction. All of this is paid for with tax increases on high-income taxpayers, as well as changes to corporate and international taxation.

Biden's Build Back Better Plan has gone through many iterations since initially proposed earlier in 2021. The plan was originally estimated to cost up to $6 trillion dollars and include a massive investment in what Biden called "human infrastructure."

On September 25, 2021, two House committees approved legislative text for the Build Back Better Act. That $3.5 trillion proposal included robust expansion of social programs and was paid for through increases in income and capital gains taxes for individuals, as well as a corporate tax increase.

During the negotiations in the following weeks, in an effort to get more Democratic support, the size of the proposal was reduced. On October 28, a framework of a deal was released, setting the size of the bill at its current $1.75 trillion price tag, with many of the social spending initiatives trimmed or eliminated altogether. Gone with those programs were the more broadly applicable tax increases. However, the green energy incentives remain in the bill, as do the reforms to the taxation of foreign activities and businesses.

Earlier in November, Congress passed the Infrastructure Investment and Jobs Act. With that hurdle out of the way, the House turned its attention to the Build Back Better Act. On November 18, the Congressional Budget Office released its score of the bill, paving the way for approval in the House almost entirely along party lines.

It is not clear at this point how the bill will be received in the Senate, where an even 50-50 split means that Democrats will have to use the budget reconciliation process to pass the bill, given the promise of unified GOP opposition to the proposal. On December 3, temporary funding for the government expires, with estimates showing that the debt ceiling will also be breached by mid-December. Therefore, some action, whether it is another short-term extension of everything or a final negotiated agreement, should be expected by early December.

COMMENT. *While this proposal is likely closer to what will ultimately be approved by Congress, it would not be surprising to see additional changes in the Senate. This Briefing will attempt to cover the highlights of the proposal as it currently stands.*

BUSINESS PROVISIONS

Very few of the proposals from the original Build Back Better Act impacting non-foreign businesses survived to the latest version of the bill. In their place are some new proposals, included both for purposes of raising revenue for the legislative package, as well as ensuring large corporations are not able to avoid paying any tax at all.

Corporate Alternative Minimum Tax

The Build Back Better Act resurrects the corporate alternative minimum tax (AMT) which was eliminated by the Tax Cuts and Jobs Act, although it returns in a slightly altered form. Proposed to be effective for tax years beginning after 2022, the new corporate AMT would equal 15 percent of the corporation's "adjusted financial statement income" for the tax year, reduced by a corporate AMT foreign tax credit. The tax would only apply to corporations with average annual adjusted financial statement income in excess of $1 billion for the three prior tax years. This threshold is reduced to $100 million in the case of certain foreign-parented corporations. Certain exceptions also apply to the determination of an applicable corporation where there is a change in ownership or a consistent reduction in income.

A corporation's adjusted financial statement income is the amount of net income or loss the corporation reports on its applicable financial statement, for purposes of determining when to include income for tax purposes. That amount is adjusted for various purposes, including certain adjustments in the case of consolidated returns or for certain foreign income.

Stock Repurchases

The proposal also includes a one percent excise tax on stock repurchases by domestic corporations whose stock trades on an established securities market. A repurchase is a redemption, or any transaction determined to be economically similar to a redemption. The tax also applies to the purchase of the stock of a specified affiliate corporation, which is a corporation more than 50 percent owned (by vote or value) by the purchasing corporation, or a partnership in which the purchasing corporation holds more than 50 percent of the capital or profits interest. Separate rules also apply the tax to certain purchases of the stock of a foreign affiliate. The tax would apply to repurchases after 2021.

Business Interest Expense

The bill proposes a limitation on the net interest expense that is allowed as a deduction by a specified domestic corporation. A specified domestic corporation is a domestic corporation that is part of a multinational group that prepares consolidated financial statements and has average interest expense of $12 million annually over the prior three years. The deduction for such a corporation's net interest expense (or the excess of interest expense over interest income) is limited to 110 percent of the group's net interest expense. The limitation would apply to tax years beginning after 2022.

Additional Changes for Businesses

The proposed legislation makes several other changes to business-related provisions of the Code. The below changes are proposed to take effect for tax years beginning after 2021, unless otherwise noted:

- Modifications to the requirements of the orphan drug tax credit;
- Treatment of losses as capital losses in the case of worthless securities or partnership interests;
- Modifications to the calculation of gain and basis in the case of a divisive corporate reorganization (effective upon enactment);
- Exclusion of rents from prison facilities in the calculation of REIT qualified income;
- Acceleration of the expansion to the top eight highest paid employees for the limitation on excessive employee remuneration under ARPA, initially set to take effect after 2026, to tax years beginning after 2021;
- Application of the constructive sales rules to appreciated digital assets;
- Modifications to the wash sales rules; and
- Delay of the requirement to amortize research and development expenses under the Tax Cuts and Jobs Act to 2026.

INTERNATIONAL PROVISIONS

For the most part, the provisions providing changes to foreign-related and international taxation remained intact under the latest proposed bill.

FDII and GILTI Deductions

Under current law, a domestic corporation receives a deduction of 37.5% of its foreign-derived intangible income (FDII) and a 50% deduction for its global intangible low-taxed income. These are scheduled to be reduced to 21.875% and 37.5%, respectively, for tax years beginning after 2025. Under the bill, these reductions would be accelerated to apply to tax years beginning after 2021, and reduced instead to 24.8% and 28.5%, respectively.

Additionally, under current law, if the sum of the FDII and GILTI deductions exceeds the corporation's taxable income, then the deduction for the total is reduced by the amount of the excess, and the reduction is not included in the calculation of the corporation's net operating loss (NOL). The bill eliminates the limitation and allows for the deduction to be used in calculating NOLs.

CFC One-Month Deferral

The bill eliminates the election available to controlled foreign corporations (CFCs) to use a tax year beginning one month before the tax year of its majority U.S. shareholder, effective for the tax years of corporations which would otherwise begin after November 30, 2022.

Foreign Tax Credit

The bill codifies the safe harbor under Reg. §1.901-2 that a domestic company can use to determine the proper amount of foreign tax credit where the company pays an amount to a foreign government that is at least partially in exchange for an economic benefit provided by the foreign government.

The bill also applies the limitation on the foreign tax credit on a country-by-country basis, rather than on an aggregate basis. This would stop domestic corporations from using excess taxes paid to high-tax countries to reduce U.S. tax liability on income earned in lower tax countries. The change would apply not only to regular taxes, but also oil and gas taxes.

For purposes of the foreign tax credit, the bill also replaces the 20 percent "haircut" on tested foreign income taxes paid with a five percent "haircut."

GILTI Inclusion Modification

The bill requires the inclusion of GILTI in the income of a shareholder of a CFC on a country-by-country basis (in a method similar to that proposed to apply to the calculation of the foreign tax credit). The modification is effective for tax years beginning after 2022.

Deduction for Foreign-Source Dividends

The current rule under Code Sec. 245A allowing for a deduction equal to the amount of the foreign-sourced portion of a dividend received from a 10-percent owned foreign corporation is modified to only allow the dividend if the foreign corporation is a CFC. However, the shareholder and the foreign corporation can elect to treat the foreign corporation as a CFC if it is not in fact a CFC. The provision is effective upon the enactment of the bill.

Foreign Base Company Income

For purposes of calculating income under Subpart F, foreign base company sales income and foreign base company services income are proposed to be included in the income of CFC shareholders only if the shareholder is a taxable unit that is a tax resident of the U.S.

BEAT Modification

The bill eliminates the current rule that limits the application of the BEAT to taxpayers for which base erosion tax benefits from base erosion payments exceed three percent of total deductions for tax years beginning after 2023. As a result, any corporate taxpayer with gross receipts in excess of $500 million would be subject to the BEAT. Regulated investment companies, real estate investment trusts, and S corporations would continue to be excepted from the application of BEAT. The bill also progressively increases the current 10-percent BEAT rate to 18 percent for tax years beginning after 2024 (12.5 percent for 2023; 14 percent for 2024).

Additional International Changes

The bill makes several other changes to international and foreign-related provisions of the Code, including:

- Modification of the definition of a 10-percent shareholder for purposes of the exemption of portfolio interest (effective upon enactment);
- Modification of the treatment of notional principal contract income calculated by reference to U.S. source income or gain of all publicly traded partnerships (effective for payments made after 2022); and
- Modification of the calculation of the earnings and profits of a CFC (effective for dividends paid after the date of enactment).

INDIVIDUAL PROVISIONS

The original proposal of the Build Back Better Act included an increase of the top individual income tax rate as well as an increase in the top capital gain tax rate, both targeted to individual taxpayers with adjusted gross income in excess of $400,000. Those provisions are eliminated in the latest proposal.

Income Tax Surcharge

In lieu of income tax rate increases on the top tax bracket, the bill includes a new, two-stage surcharge on the modified adjusted gross income of individuals, estates and trusts. An additional tax of five percent applies to the modified adjusted gross income of a joint filer, single filer, or head of household in excess of $10 million ($5 million for a married taxpayer filing separately, $200,000 for an estate and trust). An additional three percent tax applies to the modified adjusted gross income of a joint filer, single filer, or head of household in excess of $25 million ($12.5 million for a married taxpayer filing separately, $500,000 for an estate and trust). The surcharge would apply in tax years beginning after 2021.

Net Investment Income Tax

The bill expands the scope of taxpayers subject to the net investment income (NII) tax. Effectively, taxpayers who are S corporation shareholders, limited partners, and LLC members not currently subject to the NII tax on income received from these entities because they materially participate in the trade or business would no longer be exempt from the 3.8 percent tax. This change only applies to joint filers with income in excess of $500,000 ($400,000 for heads of households and single filers; $250,000 for married taxpayers filing separate returns). The provision is effective for tax years beginning after 2021.

Excess Business Losses

Under the bill, the prohibition on the excess business losses of a noncorporate taxpayer, currently applicable through 2026, would be permanent.

INDIVIDUAL CREDITS

A significant focus of the Build Back Better Act is the expansion of the social safety net. While this takes the form of many non-tax programs expanding health and education resources, there are tax-related programs as well. For the most part, these are in the form of expansion, extension, and modification of the credits expanded by ARPA earlier in 2021.

SALT Deduction

The deduction for state and local taxes was capped at $10,000 ($5,000 for married taxpayers filing separately) through 2025 by the Tax Cuts and Jobs Act. The bill increases the cap to $80,000 ($40,000 for married taxpayers filing separately). The newly increased cap would be extended through 2030, with a return to the $10,000 cap in 2031.

Child Tax Credit

ARPA significantly modified the child tax credit in several ways, but only for 2021. The bill extends many of those modifications to 2022, including:

- Full refundability of the credit;
- Advance payment of the credit (for the full year instead of six months);
- Increase in the age limit of a qualifying child;
- Increase in the amount of the credit to $3,000 ($3,600 for children under six);
- Two-stage phaseout of the credit amount and the increased credit amount; and
- Allowance of the credit to U.S. possessions.

The bill also extends the full refundability of the credit to tax years after 2022, but does not provide for any monthly or advance payment of the credit, nor an extension of the increased credit amount.

Earned Income Tax Credit

ARPA also significantly expanded the scope of the earned income tax credit (EITC). While some of the EITC provisions of the legislation were permanent, those that increased the amount of the credit for taxpayers without children were for 2021 only. The bill would extend the increased EITC for childless taxpayers to 2022.

Health Care Credits

ARPA reduced the share of premiums that individuals or households must contribute towards the cost of health insurance in calculating the amount of their premium assistance credit. It also generally expanded eligibility for the premium assistance credit to individuals and families with household incomes above 400 percent of the federal poverty level for a family of the size involved. These provisions in ARPA were for 2021 only, but the bill extends the changes through 2025. Other changes to the premium assistance credit are also included in the bill.

The health coverage tax credit, set to expire for months beginning on or after January 1, 2022, is also made permanent under the bill. The amount of the credit is also increased to 80 percent of qualified health insurance premiums from the current 72.5 percent.

IRA Prohibited Transactions

The bill makes the receipt of any commission or other payment from an entity, any stock or interest in which is owned by the individual for whose benefit the IRA is maintained by an account that holds a DISC or FSC, a prohibited transaction, effective for stock and other interests acquired or held on or after December 31, 2021.

COMPLIANCE AND IRS ENFORCEMENT

A significant strategy in coming up with ways to pay for a large legislative package is by improving IRS service to close the so-called "tax gap." The tax gap is the difference between what ***should*** be collected by the IRS and what is ***actually*** collected by the IRS. In many cases, the lack of resources by the IRS to enforce the nation's tax laws can be leveraged by taxpayers to lower their tax bills, and it is believed that a small investment in IRS resources can lead to an outsized increase in revenue.

The bill looks to close the tax gap by allocating an increased amount to the IRS to improve enforcement. The bill also would apply backup withholding rules to third party settlements. Finally, the bill proposes to allow the IRS more freedom in assessing certain penalties.

GREEN ENERGY

The largest part of the Build Back Better Act to survive to the latest iteration is the incentives for green energy. The bill provides more than a half trillion dollars in green energy incentives and investments, with $320 billion of that devoted to tax credits.

Electricity Produced from Renewable Resources

The bill extends the credit for electricity produced from certain renewable resources through 2033 and includes solar facilities which produce less than one megawatt of electricity, which had expired after 2005. The credit phases down in years 2032 and 2033. An increased credit may be claimed if the entity meets certain workforce and wage requirements in construction or operation of the facility.

Energy Investment Credit

The energy investment credit is also extended through 2033, with phasedowns in the last two years and workforce/wage credit enhancements like the renewable electricity credit. An enhancement of the credit is also available through 2031 for solar facilities placed in service in connection with low-income communities.

> *"The bill ... includes a massive expansion of green energy incentives and extensions of popular expansions of tax credits meant to help middle and lower-income taxpayers."*

Elective Direct Payment

In lieu of a tax credit, entities can elect to claim a direct payment for certain energy projects. The credits for which a direct payment can be claimed include the alternative fuel refueling property credit, the renewable electricity production credit, the carbon oxide sequestration credit, the energy investment tax credit, and the qualifying advanced energy project credit. A penalty will apply if the taxpayer receives a larger direct payment than the credit to which it is entitled.

Electric Transmission Property

A new credit would provide a six percent investment credit for investments in qualifying electric transmission property. This is tangible depreciable property such as electric transmission lines or related property. The credit is increased to 24 percent where wage and workforce requirements are met.

Zero Emissions Facility

A new credit provides a 30 percent investment tax credit for qualified investments in qualified property that is part of a zero emissions facility (a facility that produces electricity, does not generate greenhouse gasses, and is not eligible for another credit). The credit only applies if wage and workforce requirements are met.

Residential Energy Incentives

The credit for nonbusiness energy property is modified and extended through 2031 by the proposal. This credit applies to energy efficient windows and doors, and the lifetime maximum for the credit is replaced with an annual limit of $1,200. The residential energy efficient property credit is also extended through 2033.

Plug-in Electric Vehicles

The credit for the purchase of plug-in electric vehicles is extended through 2031, and enhanced, under the bill. The bill eliminates the current credit's limitation on the number of vehicles produced by a specific manufacturer. The base amount of the credit
is also increased, with further increases for vehicles and batteries produced at certain U.S. facilities such that the maximum amount of the credit is $12,500.

A new credit of up to $2,500 is also provided for the purchase of a previously-owned plug-in electric vehicle, as well as a new credit for up to 30 percent of the basis of a qualified commercial electric vehicle placed in service after 2021 and before 2032

Other New Green Energy Credits

Additional new credits to encourage the growth of the green energy industry in the Build Back Better Act include the following:

- A credit of .3 cents per kilowatt-hour for energy produced from a zero-emission nuclear power facility, through 2026;
- A credit for sustainable aviation fuel sold or used after 2022;
- A credit for the production of clean hydrogen after 2021; and
- A credit for qualified electric bicycle purchases, effective after the date of enactment through 2031.

Other Extended and Modified Green Energy Credits

The Build Back Better Act also proposes modifications to other existing energy credits while also extending them. The bill's changes include:

- The carbon oxide sequestration credit is modified and extended through 2031;
- Incentives for biodiesel, renewable diesel, alternative fuel, and alternative fuel mixtures are extended through 2031;
- The credit for second generation biofuels is extended through 2031;
- The energy efficient commercial buildings deduction is modified for tax years beginning after 2021 and before 2032;
- The new energy efficient home credit is modified and extended through 2031;
- The credit for qualified fuel cell vehicles is extended through 2031;
- The alternative fuel refueling property credit is increased and extended through 2031; and
- The exclusion of employer-reimbursed bicycle commuting expenses, eliminated by TCJA, is reinstated for tax years beginning after 2021.