

Build Back Better Act

September 29, 2021

Highlights

- ✓ \$3.5 Trillion Bill Solely Supported by Democrats
- ✓ Tax Increases on Corporations and High-Income Individuals
- ✓ Extension of Many Popular ARPA Tax Credits
- ✓ Changes to Taxation of Foreign Corporations
- ✓ Modifications of Estate Taxes, Grantor Trust Rules, and Retirement Plans
- ✓ Massive Expansion and Extension of Green Energy Incentives

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House Committee Advances \$3.5T Domestic Agenda; Outlook for Bill Uncertain

On September 25, 2021, the House Budget Committee approved legislative text for the Build Back Better Act. This action followed approval of a series of component bills by the House Ways and Means Committee a couple weeks earlier. While the text of the bill at this stage is by no means final, the approval of the text by two committees begins to paint a picture of the basic proposals that might be included, in one form or another, in a final package approved by Congress sometime this fall.

The Build Back Better Act is a massive proposal containing the majority of President Biden's domestic policy agenda. Following on the heels of the American Rescue Plan Act (ARPA) in March 2021, negotiations between members of both side of the aisle and the White House began. The result was two major pieces of legislation: a bipartisan infrastructure bill, which is still pending in the House, and the strictly Democratic "human infrastructure" bill: the Build Back Better Act.

The proposed Build Back Better Act includes a massive expansion of the social safety net, including the extension of many popular tax benefits originally part of the American Rescue Plan Act, an expansion of Medicare, increased funding for health and education, investment in green infrastructure and much more. The cost of the bill, initially, is estimated to be \$3.5 trillion, largely funded by increases in tax rates. These increases are generally limited to higher income taxpayers and corporations, but also include reforms to the taxation of foreign businesses and the overseas activity of domestic businesses, as well as increased funding for the IRS to ensure that all the taxes that should be collected are collected.

As of this point, it is not clear that the bill proposed can pass either chamber of Congress. GOP members of Congress have sworn to oppose any bill of this size or that increases taxes, so in order to get approval in the Senate, Democrats plan to use the budget reconciliation process, which limits the contents of the legislation, but allows passage by a simple majority of the evenly-divided Senate. Meanwhile, razor-thin majorities for Democrats in the House mean that any bill cannot afford to lose more than a handful of Democratic votes, and many Democratic House members would rather see movement on other legislative priorities before this. Overarching all of this is an ongoing pandemic, and impending deadlines on averting a government shutdown and breaching the debt ceiling.



COMMENT. Because of the legislative brinksmanship going on in Congress as of the writing of this Tax Briefing, the contents of the proposal are likely to see vast changes throughout the process. This Briefing will attempt to cover the highlights and more significant proposals of the legislation, but any of these proposals are likely to see changes.

BUSINESS PROVISIONS

Corporate Tax Rate

Under the proposal, effective for tax years beginning after 2021, the corporate tax rate structure would generally return to a graduated format from the current flat 21% rate applicable as a result of the Tax Cuts and Jobs Act (TCJA). The proposal would actually lower the tax rate on smaller corporations, while raising it to 26.5% on larger corporations.

Proposed Tax Rate on Corporations Proposed by the Build Back Better Act:

Taxable Income	Tax rate (percent)
Not over \$400,000	18
Over \$400,000 but not over \$5,000,000	21
Over \$5,000,000	26.5

An additional 3% tax would be included on the taxable income of a corporation in excess of \$10,000,000, with a maximum additional tax of \$287,000

 **COMMENT.** *The additional 3% tax essentially eliminates the benefit of the 18% bracket for these larger corporations.*

Special rules apply to corporations using the normalization method of accounting to adjust for the change in tax rate.

Dividends-Received Deduction

The deduction claimed by corporations for dividends received is increased by the proposal. The deduction for dividends received from a 20 percent-owned corporation is increased to 72.5% from the current 65%. The deduction for dividends received from any other corporation (except for a corporation in the same affiliated group) is increased to 60%, from the current 50% amount. Corporations continue to have a 100% deduction for dividends received from corporations in the same affiliated group.

 **COMMENT.** *The dividends received deduction was reduced to the current 50 and 65 percent amounts from 70 and 80 percent, respectively, by the TCJA.*

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 averaged 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.

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);
- Expansion of the expensing treatment for qualified film, television, and live theater productions to qualified sound recording productions;
- 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;
- Acceleration of the termination of the employer paid family and medical leave credit to December 31, 2023 (from December 31, 2025);
- Extension of the excise tax on coal to fund the Black Lung Disability Trust Fund through 2025; and
- Modification of excise taxes on tobacco while also imposing an excise tax on nicotine.

INTERNATIONAL PROVISIONS

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 proposed legislation, these reductions would be accelerated to apply to tax years beginning after 2021.

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 proposal eliminates the limitation and allows for the deduction to be used in calculating NOLs.

CFC One-Month Deferral

The proposed legislation 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, 2021.

Foreign Tax Credit

The proposal 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 proposed legislation seeks to apply 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 proposal also replaces the 20 percent "haircut" on tested foreign income taxes paid with a five percent "haircut."

GILTI Inclusion Modification

The proposed legislation requires that the inclusion of GILTI in the income of a shareholder of a CFC apply 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 2021.

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 proposal is effective upon the enactment of the proposed legislation.

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 proposed bill modifies the application of the base erosion and anti-abuse tax (BEAT) for tax years beginning after 2023. Under the proposal, the current rule that limits the application of the BEAT to taxpayers for which base erosion tax benefits from base erosion payments exceed

"The Build Back Better Act is a massive proposal containing the majority of President Biden's domestic policy agenda."

three percent of total deductions is limited. 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. Additional modifications to the calculation of BEAT are also proposed.

Additional International Changes

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

- 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 180 days after enactment); and
- Modification of the calculation of the earnings and profits of a CFC.

INDIVIDUAL PROVISIONS

Ordinary Income Tax Rates

Under the proposed legislation, effective for tax years beginning after 2021, the highest ordinary income tax rate applicable to individual taxable income would be increased to 39.6%.

Currently, individual ordinary income is taxed at seven graduated rates: 10%, 12%, 22%, 24%, 32%, 35%, and 37%. For 2022, the 37% bracket is projected to begin at the following income levels, depending on filing status:

Projected 2022 37% Rate Bracket Threshold Amount	
Filing Status	Projected 2022 Amount
Single	\$539,900
Married Filing Jointly.....	\$647,850
Married Filing Separately	\$323,925
Head of Household.....	\$539,900

Under the proposal, the 37% rate bracket is eliminated and replaced with a 39.6% bracket, which also begins at a lower threshold amount:

Proposed 2022 39.6% Rate Bracket Threshold Amount	
Filing Status	Proposed 2022 Amount
Single	\$400,000
Married Filing Jointly.....	\$450,000
Married Filing Separately	\$225,000
Head of Household.....	\$425,000

Additionally, for estates and trusts, the current 37% ordinary income bracket projected to begin at \$13,450 for 2022 would be taxed at 39.6%.

The current seven-rate tax structure was implemented in the TCJA, and was subject to sunset after 2025 and revert to the seven-rate structure (10%, 15%, 25%, 28%, 33%, 35%, 39.6%) in place prior to 2018. The proposed legislation makes the replacement of the top rate permanent, and eliminates the 35% rate bracket that would otherwise return in 2026.

Capital Gain Rates

Under current law, graduated rates apply to individuals' long-term capital gains and qualified dividends depending upon the amount of taxable income. The "breakpoints" at which the rate increases from zero percent to 15 percent to 20 percent are adjusted annually for inflation, and are projected to be as shown in the table below for 2022.

Under the proposal, the top 20 percent rate would be replaced with a 25 percent rate. Additionally, the "breakpoint" for the beginning of the new 25 percent bracket would be lowered to align with the income amounts applicable for the new 39.6 percent ordinary income bracket (discussed above). The low-end "breakpoints" for the 15 percent bracket would not be affected.

The proposal to increase the top rate to 25 percent takes effect for tax years *ending* after September 13, 2021. However, a transition rule applies to tax years that include September 13, 2021 (for example, calendar year taxpayers) that makes the 20 percent rate applicable for sales and exchanges before September 13, 2021 and the 25 percent rate applicable to sales and exchanges after that date.

Income Tax Surcharge

The proposed legislation would apply a three-percent tax on the modified adjusted gross income of individuals, estates, and trusts in excess of certain amounts. For single filers, heads of households, and joint filers, that threshold amount is \$5 million. For married taxpayers filing separate returns, it is \$2.5 million. For estates and trusts, it is \$100,000. Modified adjusted gross income is adjusted gross income reduced by the deduction for investment interest, which is not allowed in calculating adjusted gross income. However, the threshold is reduced by foreign earned income of foreign housing amounts excluded from income. The three-percent surcharge would be effective for tax years beginning after 2021.

2022 Projected Long-Term Capital Gains and Qualified Dividends Rates for Taxpayers with Taxable Income in the Specified Ranges Under Current Law			
	0%	15%	20%
Married filing jointly	\$0 – \$83,350	\$83,351 – \$517,200.....	over \$517,200
Married filing separately.....	\$0 – \$41,675	\$41,676 – \$258,600.....	over \$258,600
Head of household	\$0 – \$55,800	\$55,801 – \$488,500.....	over \$488,500
Unmarried.....	\$0 – \$41,675	\$41,676 – \$459,750.....	over \$459,750
Estates and trusts.....	\$0 – \$ 2,800	\$2,801 – \$ 13,700.....	over \$ 13,700

Net Investment Income Tax

The proposed legislation 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 do not materially participate in the trade or business would no longer be exempt from the 3.8 percent tax. The proposal is effective for tax years beginning after 2021.

Qualified Business Income Deduction

For tax years beginning after 2017 and before 2026, taxpayers are allowed a 20 percent deduction on the qualified business income from an S Corporation, partnership, or sole proprietorship, subject to limitations based upon the taxpayer's taxable income. The proposed legislation also imposes a limitation on the amount of the deduction, effective for tax years beginning after 2021. The deduction limitations are \$500,000 for joint filers or surviving spouses, \$250,000 for married filing separately, \$10,000 for estates or trusts, and \$400,000 for all other taxpayers. These amounts are not adjusted for inflation.

Excess Business Losses

Under the proposed legislation, 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.

Child Tax Credit

ARPA significantly modified the child tax credit in several ways, but only for 2021. The proposed legislation 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 proposed bill also provides for the \$3,000 and \$3,600 amounts to be increased for inflation, beginning in 2022.

While the proposal only extends the current form of the credit through 2022, it does provide for a monthly child tax credit in 2023 through 2025. While this is a separate credit under the Code with slightly different administrative requirements, the result is a monthly amount that is equal to the advanced amount currently in effect for 2021 (and proposed for 2022).

The proposal also extends the full refundability of the credit to 2025 and beyond, but does not provide for any monthly or advance payment of the credit.

Child and Dependent Care

ARPA also expanded the child and dependent care credit, but only for 2021. The amount of the credit was increased to \$8,000 for taxpayers with one qualifying individual and \$16,000 for those with two or more, and it was made fully refundable. Similar to the child tax credit, the amount of the credit phases out in two stages.

The proposed bill makes these changes permanent. It also makes the \$8,000 and \$16,000 amounts subject to inflation adjustments, as well as the first stage of the two-stage phaseout.

ARPA also increased the annual exclusion from income for employer-provided dependent care from \$5,000 to \$10,500, but for 2021 only. The proposed bill makes this increase permanent, and adjusts the \$10,500 exclusion amount for inflation.

The proposed legislation also provides a payroll tax credit for up to 50 percent of the costs of a caregiver, up to \$4,000. The credit can be claimed for the care provided by a licensed care provider for the taxpayer's spouse or qualifying relative who lives in the taxpayer's home. The proposal is effective for tax years beginning after 2021 and before 2026.

A child care provider (for example, a daycare) is also provided a payroll tax credit for the payment of wages, up to \$2,500 per calendar quarter, to a child care employee at the taxpayer's child care facility. The credit is proposed to be effective for calendar quarters beginning after 2021.

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 proposed bill would make the increased EITC for childless taxpayers permanent.

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 federal poverty level for a family of the size involved. These provisions in ARPA were for 2021 only, but the proposed legislation makes the changes permanent. Other changes to the premium assistance credit are also proposed.

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

ESTATES AND TRUSTS

Unified Credit

TCJA increased the unified credit applicable to estate and gift taxes after 2017, effectively doubling the amount exempted from estate and gift taxes. For 2022, this increase in the credit is projected to effectively shield \$12,060,000 from estate and gift taxes. This increase in the unified credit is scheduled to expire after 2025. Under the proposed legislation, the expiration of the increase would be accelerated to 2022. However, the current amount could still be used for farming property, at the election of the estate's executor.

Grantor Trusts

The proposed legislation would make the rules applicable to the taxation of grantor trusts more closely align with those applicable to income and transfer taxes. The changes applicable to grantor trusts would be effective upon enactment.

RETIREMENT PLANS

Contribution Limits for Higher-Income Taxpayers

The proposed legislation would cap the amount of allowable retirement account balances for high-income taxpayers at \$10 million. For purposes of the limit, a "high-income taxpayer" is one who is subject to the new 39.6 percent income tax rate (or the 25% rate on long-term capital gains). These taxpayers would be subject to an excise tax on additional contributions where their aggregate

account balances exceed \$10 million (subject to annual inflation adjustments).

Additionally, taxpayers with \$10 million in aggregate account holdings would be subject to increased required minimum distributions.

The proposal is generally effective for tax years beginning after 2021.

Rollovers to Roth IRAs

The proposed legislation would prohibit the rollover of traditional IRAs, as well as amounts in 401(k), 403(b), and 457(b) plans to Roth IRAs by high income taxpayers. "High income taxpayers," for these purposes, are taxpayers subject to the new 39.6 percent income tax rate (or the 25 percent rate on long-term capital gains). The provision is generally applicable after 2031.

Also proposed is a general prohibition (regardless of income level) against the conversion to a Roth IRA or designated Roth IRA of any amounts consisting of after-tax contributions in an employee-sponsored plan. This proposal would be effective after 2021.

Additional Retirement Changes

Several other changes are proposed by the legislation. The below proposals would be effective after 2021:

- A prohibition on the investment of IRA funds in a security that required the purchaser to hold minimum assets, have a minimum level of education or hold a specific license or credential;
- The extension of the time to assess tax in the case of certain IRA-related prohibited transactions;
- A prohibition of the investment of IRA funds in a non-publicly traded entity if the IRA owner has more than a ten-percent interest in the entity;
- Treatment of IRA owners as disqualified persons for purposes of the prohibited transaction rules; and
- 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.

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 proposed legislation looks to close the tax gap by allocating an increased amount to the IRS to improve enforcement. The bill also proposes to improve IRS enforcement by modifying the rules applicable to third party settlement organizations. Finally, the bill imposes a limit on the contribution of conservation property, and more to the point, clarifying the accuracy-related penalty that can be levied for violations of this limitation. Finally, the bill proposes to allow the IRS more freedom in assessing certain penalties.

GREEN ENERGY

While much of the proposed Build Back Better Act is devoted to the expansion of the social safety net, a significant chunk of it is devoted to investing in and encouraging growth of green energy projects and infrastructure. The bill proposes to promote investment in green energy through a mix of new tax credits and the extension and modification of existing credits.

New Green Energy Credits

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

- The energy credit is increased for solar facilities placed in service with low-income communities, through 2031;
- Taxpayers can elect to receive a direct payment rather than a tax credit for projects eligible for certain energy credits, including the alternative fuel refueling property credit, the renewable electricity production credit, and the qualifying advanced energy project credit;
- A six percent investment tax credit for investments in qualifying electric transmission property, through 2031;
- A 30 percent investment tax credit for qualified investments in qualified property which is part of a zero emissions facility (a facility that produces electricity, goes not generate greenhouse gasses, and is not eligible for another credit);
- 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;
- A credit for the purchase of a previously owned plug-in electric vehicle, effective for purchases after 2021 and before 2032;
- A credit for the purchase of a qualified electric commercial vehicle after 2021 and before 2032; and
- A credit for qualified electric bicycle purchases; effective after the date of enactment through 2031.

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Extended and Modified Green Energy Credits

The Build Back Better Act also modifies existing energy credits while also extending them. The bill's proposed changes include:

- The credit for the production of electricity using certain renewable resources, including solar, is generally extended through 2033;
- The energy investment tax credit is extended through 2033, with modifications expanding the scope of qualifying projects;
- 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 credit for nonbusiness energy property is modified and extended through 2031;
- The residential energy efficient property credit is extended through 2033;
- 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 plug-in electric drive vehicles is significantly increased, but subject to income phaseouts, 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.