

Ways & Means Unveils Build Back Better Act Tax Increase Proposals

13 September 2021



House Ways & Means Committee Chairman Richard Neal (D-MA) September 13 released over \$2 trillion in net tax increase proposals to partially fund the Build Back Better Act reconciliation bill. The reconciliation bill is expected to evolve during the September 14-15 markup and prior to floor consideration, then must be reconciled with a tax package expected to emerge from the Senate. Thus, these proposals should be considered as a key part of a process but not necessarily a final product that will be enacted into law.

Several of the provisions are consistent with proposals put forward by President Biden in the FY2022 budget, albeit with some different rates and details, especially on international tax issues. Highlights of the tax title include an increase in the top corporate tax rate to 26.5% and, on international tax issues, a GILTI rate of about 16.5%, with the foreign tax credit GILTI haircut reduced to 5% and GILTI calculated on a country by country basis. The scheduled increase in the BEAT rate to 12.5% would be accelerated and the BEAT would be modified to narrow the scope of base erosion payments to low-taxed entities, similar to the President's SHIELD proposal and

Revenue impact of major elements

Corporate		Individual		
Increase corporate rate to 26.5% \$540b	BEAT \$25b	Capital gains increase to 25% \$123b	Top individual rate increase to 39.6% \$170b	Excess business loss limitation made permanent \$167b
	Anti-earnings stripping \$35b	NIIT expansion \$252b	Limit 199A deduction \$78b	3% surtax on high-income individuals, \$127b
Outbound international (GILTI, FDII, FTCs, etc.) \$275b	Other business & tax provisions \$180b	Retirement, deferred comp. \$21b	Carried interest \$14b	Estate tax changes \$82b

proposals being developed by the OECD. The FDII rate reduction to 21.875% currently set to take hold after 2025 would be accelerated.

On the individual side, the top capital gains rate would be increased to 25%, and the top individual income tax rate returned to 39.6%. Other individual raisers extend provisions from the American Rescue Plan Act.

New provisions include an expansion of the net investment income tax to cover net income derived in the ordinary course of a trade or business for taxpayers with greater than \$400,000 in taxable income (single filer) or \$500,000 (joint filer). A 3% surtax would be imposed on individuals with AGI in excess of \$5 million.

Some Biden proposals are omitted like changing stepped-up basis. Carried interest is addressed with an extension of the holding period to 5 years, not by requiring ordinary income tax treatment. The TCJA \$10,000 SALT deduction cap is not addressed, though Chairman Neal and key members released a statement saying they will keep working toward meaningful SALT relief. Descriptions of select provisions follow.

International tax

	Description	Eff. Date	10yr score
GILTI & other outbound provisions	<p>The proposal covers a new calculation for GILTI as well as a new determination of the GILTI FTC basket that is expanded into the other foreign tax credit baskets and notably proposes a repeal of the current foreign branch income tax basket. Importantly, the proposal would dramatically limit the allocation of U.S. expenses to the GILTI FTC basket.</p> <p>The calculation of GILTI will be measured on country-by-country (CBC) basis using a taxable unit concept that is linked to the expansion of CBC in the foreign tax credit rules. A taxable unit is defined separately for CFCs, interests in pass-through entities, and activities of branches. The CBC method applies to net tested income (the net of a taxable unit's income and loss), net deemed tangible income return, qualified business asset investment (QBAI), interest expense, and generally, foreign taxes paid by the taxable unit follow each item of tested income (or loss) earned by the taxable unit for purposes of the FTC rules.</p> <p>The proposal will also change the constructive ownership rules in determining CFC status of a foreign corporation, effective for taxable years beginning after 12/31/2017, by removing the repeal of section 958(b)(4) that had prevented a US subsidiary from being treated as owning stock in a foreign-owned brother-sister subsidiary.</p> <p><u>GILTI calculation</u></p> <p>In determining the items relevant to measure the GILTI inclusion, several changes are proposed:</p> <ul style="list-style-type: none"> • Country-specific tested losses will be carried forward for the succeeding taxable year, allowing these losses to reduce country-specific tested income. • QBAI has been retained but reduced from 10% under current law to 5% for CFCs that are not territories of the United States. • Tested income would be increased by foreign oil and gas extraction income (FOGEI) that is currently excluded as tested income. • The section 250 deduction would be reduced by accelerating the scheduled decrease in the deduction from 2026 to 2022. This results in a stated GILTI rate of 16.5% (using the proposed 26.5% corporate rate with a 37.5% section 250 deduction). The taxable income limitation in section 250 is also changed to create a net operating loss when taxable income is less than the deduction. 	Generally effective for taxable years after beginning after December 31, 2021, with the exceptions noted	Items within the outbound provisions raise approx. \$275b

International tax (continued)

	Description	Eff. Date	10Yr score
GILTI & other outbound provisions	<p>Current law reduces the allowable deduction when this occurs, increasing the GILTI rate when there are domestic losses. A net operating loss will include the deduction allowed under section 250 by removing the reference in section 172(d)(9) that disregards the deduction.</p> <p><u>Foreign tax credits</u> Foreign taxes allowable to offset the inclusion of GILTI are also addressed. As stated above, the taxes will be measured on a CBC basis, but the 20% haircut will be reduced to a 5% haircut, and limitations on GILTI FTCs that arise under current law will change in the following ways: GILTI FTCs will have a 5-year carry forward period, and no carryback. This rule is extended to other foreign income baskets (reducing their carry forward under current law from 10 years to five and removing the one-year carry back) under sections 904, 907, and 960. The reduction in the carryover period and removal of the carryback rule for foreign oil and gas taxes will be retroactive to tax years beginning after 12/31/2017.</p> <p>U.S. expenses allocable to foreign source income that reduce GILTI FTCs are paired back and relate only to directly allocable expenses. There also appears to be a favorable rule on the treatment of US interest expense related to exempt dividends under section 245A.</p> <p><u>FDII</u> Deduction limited to 21.875%, so 20.7% FDII rate</p> <p><u>Regulatory authority</u> US treasury will be given ample authority to address issues of effective rate determination, anti-abuse provisions, and to generally ensure there is proper reflection of income. Specific authority related to determining QBAI and basis adjustments for tested losses would apply to taxable year beginning after 12/31/2017.</p>	Generally effective for taxable years after beginning after December 31, 2021, with the exceptions noted	Items within the outbound provisions raise approx. \$275b
BEAT	<p>increases the BEAT rate, but excludes from the scope of the BEAT payments to a foreign entity subject to an ETR above the BEAT rate, and payments subject to U.S. tax by the payor or payee.. The rules for determining if a payment is subject to an ETR above the BEAT rate would be based on applicable financial statements, but the Secretary is given authority to develop the procedures for calculating the ETR. Moreover, the base erosion minimum tax amount is determined taking into account foreign tax credits and other business tax credits.</p>	Generally effective for taxable years after beginning after December 31, 2021, with the exceptions noted	\$25b

International tax (continued)

	Description	Eff. Date	10yr score
BEAT (cont.)	<p>The current 10% BEAT rate will apply to tax years beginning before January 1, 2024, will increase to 12.5% in taxable years beginning after December 31, 2023, and before January 1, 2026, and to 15% thereafter. The one percentage point higher rate for certain financial services firms is retained.</p> <p>Changes are also made to the treatment of net operating losses under the BEAT. The proposal effectively creates a separately tracked BEAT NOL, so that companies with NOL carryforwards can use their NOL to offset 80% of their BEAT liability.</p> <p>The base erosion thresholds (3% generally and 2% for banks and broker dealers) are repealed after 2023. Other proposals to expand the scope of the BEAT include treating as base erosion payments indirect costs that are required to be included in inventory costs due to Section 263A, as well as costs incurred in acquiring property that is inventory in the hands of the taxpayer to the extent such costs exceed the sum of the direct costs of the property in the hands of the foreign related party and the Section 263A indirect costs of the property in the hands of the foreign related party that have been paid or accrued to an unrelated party.</p> <p>Taxpayer are allowed a simplifying election relating to these indirect costs as well. In addition the proposal clarifies the current exception for payments subject to the services cost method under Section 482 does not include any mark up for the service. Base erosion payments will continue to include payments related to reinsurance premiums. Qualified derivative payments appear to be treated as under current law.</p>	Generally effective for taxable years after beginning after December 31, 2021, with the exceptions noted	\$25b
Limitations on deduction for interest expense	<p>New Section 163(n) would limit the interest deduction for certain domestic corporations that are part of an international reporting group, defined as a group or at least two members, one of which is foreign. The limitation would be the allowable percentage of 110% of their net interest expense. The allowable percentage is equal to the ratio of the domestic corporation's allocable share of the entire group's net interest expense over such corporation's reported net interest expense. The domestic company's allocable share of the group's net interest expense is the portion of such expense that bears the same ratio to the total group expense as the domestic company's EBITDA bears to the group's total EBITDA. The provision applies to domestic corporations with average excess interest expense paid or accrued over a three-year period over the average interest includable in the gross income of the company for that period exceeds \$12 million but not to corporations exempt under the small business exception of section 163(j)(3), S corporations, REITs, or RICs.</p>	TYBA 12/31/21	\$34.8b

International tax (continued)

	Description	Eff. Date	10yr score
Limitations on deduction for interest expense (cont.)	An aggregation rule treats all domestic corporations of the same international reporting group as one corporation. Additional changes are made to change the application of section 163(j) for partnerships from a partnership-level under Section 163(j)(4) to a partner-level determination. The same change is made for S corporations, applying section 163(j) to at the shareholder level. The carryforward provisions for disallowed interest under subsection (j)(1) or (n)(1) are allowed, but limited to whichever applies the lower limitation, and can be carried forward for five years. Interest will be treated as allowed as a deduction on a FIFO basis.	TYBA 12/31/21	\$34.8b
Foreign-source DRD limited to CFCs	Section 245A exemption applies only to foreign portions of dividends received from CFCs. Also, a narrow rule under Section 951B applies for downward attribution from a foreign person in certain cases.	Distributions after DOE; however, downward attribution change applies retroactively	\$451m
Foreign base company sales and services income	Limits Foreign Base Company Sales and Services Income to residents of the United States and passthrough entities and branches in the United States, plus "loophole closers"	TYBA 12/31/21	\$20.6b
E&P of CFCs	Relocates 952(c)(3) rule to section 312(n)	Foreign corps.' TYBA 12/31/21, US shareholders in which or with which such taxable years of foreign corps. end	\$4.88b
Certain dividends from CFCs to US shareholders treated as extraordinary dividends	Any disqualified CFC dividend is treated as an extraordinary dividend without regard to the period the taxpayer held the stock to which such dividend relates	Distributions after DOE	
Clarification of treatment of DISC gain, distributions of foreign shareholders	Clarifies that gains from the sale or exchange of, and distributions by a DISC or FSC to a foreign shareholder are treated as effectively connected with the conduct of a trade or business conducted through a permanent establishment deemed to be had by the shareholder in the United States	Distributions on or after 12/31/21	\$915m

Business tax

	Description	Eff. Date	10yr score
Corporate tax rate	<p>Replaces the flat corporate income tax with a graduated rate structure:</p> <ul style="list-style-type: none"> • 18% on the first \$400,000 of income, • 21% on income above \$400,000 and up to \$5 million, and • 26.5% on income above \$5 million <p>The graduated rate phases out for corporations making more than \$10,000,000. Personal services corporations are not eligible for graduated rates.</p>	TYBA 12/31/21	\$540b
Credit for clinical testing of orphan drugs limited to first use or indication	Limits the credit for qualified clinical testing expenses to expenses related to the first use or indication for an orphan drug as designated under section 526 of the Federal Food, Drug, and Cosmetic Act, certain clinical testing expenses do not qualify for the credit		\$2.72b
Modifications to treatment of certain losses relating to worthless securities	Amends section 165(g) to provide that losses with respect to securities are treated as realized on the day that the event establishing worthlessness occurs, rather than on the last day of the taxable year, makes changes relating to the treatment of partnership indebtedness with regard to worthless securities		\$1.77b
Adjusted basis limitation for divisive reorganization	A distributing corporation in a divisive reorganization recognizes gain to the extent of controlled corporation debt securities transferred to the creditors of the distributing corporation in excess of the basis in assets transferred from the distributing corporation to the controlled corporation in the transaction	Reorgs. after DOE	\$20.7b
Rents from prison facilities not treated as qualified income for purposes of REIT income tests	Provides that income received with respect to property primarily used as a prison or other detention facility does not qualify for the purpose of REIT income tests	TYBA 12/31/21	\$130m
Modification to exemption for portfolio interest	Modifies the definition of "10-percent shareholder," whose interest is exempt from portfolio interest. In the case of an obligation issued by a corporation, any person who owns 10% or more of the total vote or value of the stock of such corporation is not eligible for the portfolio interest exemption.	Obligations issued after DOE	\$2.1b
Payments equivalent to PTP income payments	Amends section 871(m) to provide that payments pursuant to sale-repurchase agreements, specified notional principal contracts, or any other similar payment with respect to PTPs and other partnerships are treated as dividend equivalents. The payments are sourced based on the residence of the payor, so are US source and subject to 30% withholding.	Applies to payments on or after date that is 180 days after DOE	\$90 million

Business tax (continued)

	Description	Eff. Date	10yr score
Carried interest	Generally extends from 3 to 5 years the holding period required for gain attributable an applicable partnership interest to qualify for long term capital gain treatment	TYBA 12/31/21	\$14b
1202 gains	75% and 100% exclusion rates for gains realized from certain qualified small business stock will not apply to taxpayers with AGI equal or exceeding \$400,000	Sales, exchanges after 9/13/21	\$5.7b
Rules relating to common control	Provide that a taxpayer engaged in any activity in connection with a trade or business or any for-profit activity is subject to the aggregation rules under section 52(b)	DOE	\$19.6b
Wash sales	Includes commodities, currencies, and digital assets in the wash sale rule, intended to prevent taxpayers from claiming tax losses while retaining an interest in the loss asset	TYBA 12/31/21	\$16.8b
Constructive sales	Includes digital assets in the constructive sale rules previously applicable to other financial assets		
R&D expensing	Delays TCJA 5-year amortization requirement from 2022 to 2026	DOE	-\$4b
Employer credit for FMLA	Accelerates termination of employer credit for wages paid to employees during family and medical leave to taxable years beginning after 2023	TYBA 2023	\$642m
WOTC during COVID-19 Recovery	Increases WOTC to 50% for the first \$10,000 in wages, through December 31, 2023, for all WOTC targeted groups except for summer youth employees	TYEA DOE	-\$6.14b
Modification of REIT Constructive Ownership Rules	Stock, assets, and net profits constructively owned by a partnership, estate, trust, or corporation by reason of the application of the 318(a)(3) "downward" attribution rule not considered as owned for purposes of making another person the constructive owner of such stock, assets, or net profits		Loss of less than \$500,000
Cover Over of Distilled Spirits Taxes	Permanently eliminates the limitation on distilled spirit taxes covered over to Puerto Rico and the U.S. Virgin Islands	Brought into US after 12/31/21	-\$1.87b

Individual tax

	Description	Eff. Date	10yr score
Rate	Increases the top marginal individual income tax rate to 39.6%: applies to married individuals filing jointly with taxable income over \$450,000, to heads of households with taxable income over \$425,000, to unmarried individuals with taxable income over \$400,000, to married individuals filing separate returns with taxable income over \$225,000, and to estates and trusts with taxable income over \$12,500	TYBA 12/31/21	\$170.5b
Capital gains & dividends	Increases the highest capital gains and qualified dividend rates to 25%	Capital gains and qualified dividend income recognized after 9/13/21, except for capital gains and qualified dividends arising from transactions pursuant to a written binding contract entered into before 9/14/21 (and not materially modified thereafter)	\$123.4b
NIIT	Expanded to cover net investment income derived in the ordinary course of a trade or business for taxpayers with greater than \$400,000 in taxable income (single) or \$500,000 (joint), as well as for trusts and estates	TYBA 12/31/21	\$252.2b
Pass-through deduction	Maximum allowable deduction: \$500,000 (joint), \$400,000 (individual), \$250,000 (married filing separate), \$10,000 (trust or estate)		\$78b
Excess Business Losses	Limitations on excess business losses of noncorporate taxpayers made permanent, with carryforward modification		\$166.8b
High-income surcharge	3% of MAGI in excess of \$5,000,000 (\$2,500,000 married filing separately). MAGI = AGI reduced by any section 163(d) deduction for investment interest		\$127.3b
Estate tax	TCJA exemption amount expiration accelerated, so unified credit reverts to 2010 level of \$5,000,000 per individual, indexed for inflation	Estates of decedents dying & gifts after 12/31/21	\$54.3b
	Section 2032A valuation reduction increased from \$750,000 to \$11,700,000		-\$317m

Estate tax (cont.)	Grantor trusts included as part of a decedent's taxable estate when decedent is deemed owner	Created on, after DOE	\$7.9b
	Clarify that when taxpayer transfers nonbusiness assets, those assets should not be afforded a valuation discount for transfer tax purposes	Transfers after DOE	\$20b

Retirement

	Description	Eff. Date	10yr score
Mega-IRA contribution limits	<p>Prohibits new contributions, defined not to include rollovers, to a Roth or traditional IRA if the total value of the individual's IRA and defined contribution accounts exceeds \$10 million as of the last day of the previous year (speculation had centered on the possibility that limits would apply to individuals with account balances exceeding \$5 million).</p> <p>The prohibition would not apply to taxpayers with income below \$400,000. The provision also creates a new annual reporting requirement under which employer defined contribution plans must report to the taxpayer and to the IRS "aggregate account balances" over \$2.5 million.</p>	TYBA 12/31/21	\$1.8b
Minimum Required Distributions	Imposes new minimum distribution requirements on individuals whose combined Roth IRA, traditional IRA, and defined contribution plan accounts exceed \$10 million and whose income exceeds \$400,000. These individuals would be required to take a distribution of 50% of the amount by which their aggregate accounts exceed \$10 million. For individuals whose aggregate account balances exceed \$20 million, the individual would be required to withdraw the lesser of the amount needed to bring the aggregate balance down to \$20 million or all funds in Roth accounts, IRAs or defined contribution plans. Effectively the provision would bar individuals with more than \$20 million in retirement accounts from holding Roth funds.	TYBA 12/31/21	
Roth Conversion Limits	Eliminate so-called "backdoor" Roth conversions of traditional IRA or employer plan accounts for individuals with income above \$400,000. Individuals whose income exceeds the limits on Roth contributions, currently at \$140,000, from making nondeductible contributions to a traditional IRA and then converting the funds to a Roth account	TYBA 12/31/31	\$749m
	The bill includes a separate provision that would prohibit after-tax IRA or employer plan contributions from being converted to Roth accounts for individuals of all income levels	For distributions, transfers, and contributions made after 12/31/21	

Retirement (continued)

	Description	Eff. Date	10yr score
Prohibitions on Certain IRA Investments	Prohibit any IRA from holding any security if the issuer of the security requires the IRA owner to have a minimum level of assets or income, to have completed a minimum level of education, or to have obtained any specific license or credential, applicable to securities that have not been registered under federal securities laws. IRAs holding such investments would lose their IRA status	TYBA 12/31/21; IRAs holding prohibited securities or investments required to divest within two years DOE	\$1.7b
IRA Non-compliance Statute of Limitations	Extend the statute of limitations for IRA noncompliance related to valuation-related misreporting and prohibited transactions from 3 years to 6 years	Applicable to taxes for which the current 3 year statute of limitations expires by	\$8m
Prohibition on Self-interest Investment of IRA Assets	Prohibit investment of IRA assets where the IRA owner has a 10 percent ownership interest for investments that are not tradable on an established securities market, regardless of whether the IRA owner has a direct or indirect interest or in any entity of which the IRA owner is an officer. IRAs that do not comply would lose their IRA status.	TYBA 12/31/21, but IRAs currently holding such investments would have two years to divest	\$42m
IRA Owners as Disqualified Persons	Clarify that IRA owners, including owners of inherited IRAs, are always disqualified persons for purposes of applying prohibited transactions rules	Transactions occurring after 12/31/21	\$13m
Holding DISC or FSC in IRA	Holding interest in a DISC or FSC that receives commission or payment from an entity owned by the individual for whose benefit the IRA is established is a prohibited transaction	Stock acquired or held on or after 12/31/21	\$1.94b

Executive compensation

	Description	Eff. Date	10yr score
Acceleration of Deduction Limits for Executive Comp.	Move the effective date of the expansions of the 162(m) provision from the ARPA from 2027 to 2022. ARPA expanded the employees covered by the 162(m) limitation to include the eight most highly compensated officers other than the chief executive and chief financial officers of publicly-traded companies. The additional five employees covered under ARPA are not permanently covered by the provision. That is, they are covered only for years in which they are among the most-highly compensated employees. The provision would apply to employee remuneration "including performance-based compensation, commissions, post-termination compensation, and beneficiary payments."	TYBA 12/31/21	\$16.9b

Tax Compliance

	Description	Eff. Date	10yr score
Backup withholding and third party network transactions	<p>Adds to the list of reportable payments under section 3405(b) any payments in settlement of third party network transactions, but only if (1) the aggregate annual payment made by the third party settlement organization to the payee is \$600 or more, (2) the third party settlement organization was required under section 6050W to file a return for the preceding year with respect to the payee, or (3) if during the preceding calendar year the payment organization made reportable payments to the payee with respect to which amounts were required to be deducted and withheld under section 3406(a).</p> <p>Includes a transition rule for 2022 that requires the aggregate number of annual transactions between the third party settlement organization and the payee to exceed 200.</p>	Applies to calendar years beginning after 12/31/21	-\$4m
Limitation on conservation easement deductions	<p>Limits deduction for qualified conservation contributions made by pass-through entities if the amount of the contribution exceeds 2.5 times the sum of each partner's adjusted basis in the partnership that relates to the donated property.</p> <p>Does not apply to donations of property that meet the requirements of the 3-year holding period rule, and contributions by family partnerships.</p> <p>Certain taxpayers whose deeds are found to have certain defects and are notified by the Commissioner have the opportunity to correct those defects within 90 days of notice.</p>	<p>Applies to contributions made after 12/23/16. For historic structures, tyba 12/31/18. Ability to cure defective deeds permitted for returns filed after DOE</p>	\$12.5b
Modification of procedural requirements relating to assessment of penalties	<p>Repeals the requirement that any assessment of penalties must be approved by a supervisor of the employee making such determination.</p> <p>Also requires that each supervisor certify quarterly by letter to the Commissioner whether employees have followed the procedural requirements with respect to issuance of notices of penalty.</p>	<p>Effective as if included in section 3306 of the IRS RRA 98, i.e. notices issued, and penalties assessed, after 12/31/00. The new supervisor certification applies to notices of penalty issued after the date of enactment.</p>	\$1.4b

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