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Washington Council EY
Tax Alert

9 March 2023

President Biden releases FY2024 Budget

President Biden's FY2024 Budget released March 9 calls for $3 trillion in deficit reduction including through tax increases on corporations and wealthy individuals "while ensuring that no one making less than $400,000 pays a penny in new taxes and cutting taxes for families with children and low-income workers." The proposals would include a previously outlined quadrupling of the Inflation Reduction Act (IRA) stock buyback excise tax from 1% to 4% and billionaire's tax to impose a 25% minimum tax – higher than the previously proposed 20% – on total income, inclusive of unrealized capital gains, for taxpayers with wealth of greater than $100 million.

The Budget is a blueprint for the President's preferred policies irrespective of their chances of being enacted, and generally is intended to strike a contrast with spending cuts called for by House Republicans, which may not be detailed until their budget resolution is released in May. It continues to call for tax provisions that fell out of the Build Back Better negotiations that eventually led to the Inflation Reduction Act, including:

- Raising the corporate tax rate to 28%
- Increasing the top marginal income tax rate (to 39. 6%) for high earners
- Reforming the taxation of capital income to tax capital gains of high earners at ordinary income rates
- Taxing carried interests as ordinary income
- Repealing deferral of gain from like-kind exchanges

The proposal to reform the taxation of capital income would tax long-term capital gains and qualified dividends of taxpayers with taxable income of more than $1 million at ordinary rates, with 39.6% generally being the highest rate, or 44.6% including the net investment income tax (as stated in footnote #20 of the Treasury Green Book).

President Biden's budget proposes to prolong the Medicare Trust Fund through provisions that include increasing the Medicare tax rate on earned and unearned income above $400,000 from 3.8% to 5%, similarly increasing the Net Investment Income Tax (NIIT) rate to 5% for those above that income threshold, and expanding the tax to include business income, as well as income from investments, wages, and self-employment.

The application of the NIIT to business income, which was in the House BBBA, and increase in the rate would raise $650 billion in additional revenue. The quadrupling of the stock buyback excise tax would bring in $238 billion in additional revenue. House-passed BBBA GILTI-related changes included in the Budget would raise nearly $500 billion and would be more taxpayer favorable than FY2022 budget proposals that were not included in the FY2023 budget because they were made part of that Budget's baseline. Overall, the FY2024 Budget includes $4 trillion in net tax increases, which is more than the $2.5 trillion in the FY2023 Budget, but that baseline assumed passage of the House-passed BBBA.

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GENERAL CORPORATE PROPOSALS

Business reforms

Business tax reform proposals include a corporate rate increase and increase to the excise tax on stock buybacks. Other proposals target corporate and partnership transactions and proposals that will tighten rules that deny deductions for executive compensation under IRC Section 162(m), allow for loss deferral rules in IRC Section 267, and deny REIT benefits for operating private correctional facilities. In total, the business reform proposals would raise $1,765,210 over the 10-year period (fiscal years 2024 - 2033).

The effective dates for the proposals would begin generally in 2024 (i.e., tax years beginning after December 31, 2023) but some key provisions (i.e., increase in the corporate tax rate and the increase in the excise tax on stock buybacks) would be in effect at the beginning of 2023. Changes to the reorganizations and liquidations provisions would be for transactions occurring after enactment.

Raise the corporate income tax rate to 28%

The proposal would increase the tax rate for C-corporations from 21% to 28%.

- The effective global intangible low-taxed income (GILTI) rate would increase to 14% under the proposal. The proposal Revise the Global Minimum Tax Regime, Limit Inversions, and Make Related Reforms described later in this text would further increase the effective GILTI rate to 21%.
- For tax years beginning before January 1, 2023, and ending after December 31, 2022, the corporate income tax rate would be equal to current 21% rate plus 7% times the portion of the tax year that occurs in 2023.

Revenue: $1.326 trillion

Increase the excise tax rate on repurchase of corporate stock
The proposal would increase the 1% rate to 4% in IRC Section 4501 (enacted by the Inflation Reduction Act). IRC Section 4501 currently applies the tax to the fair market value (FMV) of any stock repurchased during its tax year.

The proposal would apply to repurchases of stock after December 31, 2022.

Revenue: $237.9 billion

Tax corporate distributions as dividends

The proposal would amend the Code in a few ways to ensure that a transfer of property by a corporation to its shareholder(s) cannot be made through transactions that avoid dividend treatment for the corporation's shareholders.

- Basis in any distributed high-basis stock would not reduce earnings and profits (E&P), the measure by which dividends are determined, if made with a view to create and distribute high-basis stock of any corporation.

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- A leveraged distribution from a corporation to its shareholder(s) would be treated as the receipt of a dividend directly from a related corporation to the extent the distribution was funded by that related corporation with a principal purpose of not treating the distribution as a dividend from the funding corporation.
- A subsidiary's purchase of hook stock for property would be treated as a deemed distribution from the purchasing subsidiary to the issuing corporation and the hook stock purchased would be treated as a contribution by the issuer (through any intervening entities) to the subsidiary. The rule could broaden to purchases of interests in shareholder entities other than corporations through a grant of authority to the Secretary.
- The proposal would repeal the boot-within-gain limitation in reorganization transactions (i.e., the rule that limits gain recognition on non-qualifying property to the extent of the sum of money received and/or the fair market value (FMV) of any other property received) in which the shareholder's exchange is treated under IRC Section 356(a)(2) as having the effect of the distribution of a dividend. For this purpose, the Administration also proposes to align the available pool of earnings and profits to test for dividend treatment with the rules of IRC Section 316 governing ordinary distributions.

Each proposal would be effective for transactions occurring after December 31, 2023.

Limit tax avoidance through inappropriate leveraging of parties to divisive reorganizations

Two proposals would change the requirements to achieve a tax-free divisive reorganization. First, to limit monetization techniques relating to assumed fixed and contingent Controlled liabilities and transfers to Distributing's creditors, a new rule would create an excess monetization amount that if breached would cause Distributing to recognize gain in an otherwise tax-free reorganization. Second, new requirements would be added to the IRC Section 355 requirements to achieve tax-free status to ensure Controlled is adequately capitalized and economically viable after the reorganization.

Both parts of the proposal would be effective for transactions occurring after enactment.

Limit losses recognized in liquidation transactions

Repeated from the prior Budget, rules allowing recognition of losses on a taxable liquidation within a controlled group of corporations under IRC Section 331 would be denied by modifying IRC Section 267, where the assets of the liquidating corporation remain in the controlled group after the liquidation. The Secretary would be given authority to allow for the deferral (via IRC Section 267(f)), and to expand the rule to the use of controlled partnerships.

The proposal would apply to distributions after the date of enactment.

Prevent basis shifting by related parties through Partnerships

Repeated from the prior Budget, changes to the partnership election under IRC Section 754 that allows the partnership to increase basis of its non-distributed property would be made to limit the ability of a partner related to the partner receiving a distribution from benefitting from the partnership's basis step-up.

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The proposal would be effective for partnership tax years beginning after December 31, 2023.

Conform definition of "control" with corporate affiliation test

Repeated from the prior Budget, the proposal would conform the control test within the corporate provisions (between IRC Section 368(c) and the affiliation test under IRC Section 1504(a)(2)) to require ownership of at least 80% of the total voting power and at least 80% of the total value of stock of a corporation and therefore avoid the potential for manipulation between the definitions. The term "stock" would not include certain preferred stock that meets the requirements of IRC Section 1504(a)(4).

The proposal would be effective for transactions occurring after December 31, 2023.

Strengthen limitation on losses for noncorporate taxpayers

Repeated from the prior Budget, the proposal would make permanent the excess business loss limitation in IRC Section 461(l). It would also treat excess business losses carried forward from the prior year as current-year business losses instead of as NOL deductions.

The proposal would be effective for tax years beginning after December 31, 2023.

Accelerate and tighten rules on excess employee remuneration

IRC Section 162(m) generally disallows a deduction by a publicly held corporation for compensation in excess of $1 million paid to certain employees and former employees ("covered employees") in a tax year. The proposals to tighten the application of the rules would be:

- Accelerate the effective date of the expanded definition of covered employees from tax years beginning after December 31, 2026, to tax years beginning after December 31, 2023.
- Add an aggregation rule for measuring the deduction disallowance for compensation paid to these employees in excess of $1 million to members of a controlled group within the meaning of IRC Sections 414(b), (c), (m), and (o).
- Expand the scope of the denied deduction beyond the deductible expense paid directly by the publicly held corporation to affiliated partnerships.

The proposal would be effective for tax years beginning after December 31, 2023.

Prevent prison facility rent payments from contributing to qualification as a REIT

In furtherance of Executive Order (January 26, 2021) that prevents new or renewed contracts with privately operated criminal detention facilities and seeks to "reduce profit-based incentives to incarcerate," the proposal would remove the tax benefits of REIT status when the real estate is for the private operation of any detention facility. The proposal would be effective for tax years beginning after December 31, 2023.

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INTERNATIONAL TAX PROPOSALS

Revise GILTI

The budget would make several changes to the global intangible low-taxed income (GILTI) regime, including:

- Repealing the reduction in GILTI for a 10% return on qualified business asset investment (QBAI).
- Reducing the IRC Section 250 deduction from 50% to 25%, so generally increasing the effective tax rate to 21% (combined with the increase in the corporate tax rate).
- Replacing "global averaging" for calculating a U.S. shareholder's GILTI with a jurisdiction-by-jurisdiction calculation, creating a separate foreign tax credit (FTC) limitation for each jurisdiction. A similar jurisdiction-by-jurisdiction approach would apply to branch foreign income.
- Reducing the 20% "haircut" on GILTI FTCs to 5%, allow net operating losses (NOLs) to be carried forward within a single jurisdiction, and allow FTCs to be carried forward 10 years within a single jurisdiction.
- Repealing the high-tax exemption to subpart f, and the cross-reference to that provision in the GILTI regulations issued under IRC Section 951A, thus repealing the GILTI high-tax election.
- Because GILTI would be deemed to be a compliant global minimum tax due to other proposals in the budget, taxes paid under an IIR by a foreign parented group would be creditable against any GILTI tax paid by a U.S. domestic corporation that is a member of that group.
- Repealing the exclusion from GILTI tested income for foreign oil and gas extraction income (FOGEI).

The reduction in the IRC Section 250 deduction would be effective for tax years beginning after December 31, 2022, while all the other GILTI proposals would be effective for tax years beginning after December 31, 2023.

Revenue: $493.3 billion

BEAT repealed and replaced with UTPR

The proposal would repeal the base erosion and anti-avoidance tax (BEAT) and replace it with the Pillar Two undertaxed profits rule (UTPR) that is consistent with the UTPR described in the OECD Pillar Two Model Rules, including a global annual revenue threshold, de minimis exclusions and allocation among jurisdictions. Further, a U.S. domestic minimum top-up tax would be part of the UTPR proposal to protect U.S. revenues from the imposition of UTPR by other countries. The proposal expressly notes: "Separately, the proposal would provide a mechanism to ensure U.S. taxpayers would continue to benefit from U.S. tax credits and other tax incentives that promote U.S. jobs and investment." It's not clear, however, how those benefits would be preserved.

As explained, the UTPR would primarily apply to foreign-parented multinationals operating in low-tax jurisdictions and would not apply to income subject to the Pillar Two IIR, including income subject to GILTI. Both domestic corporations that are part of a foreign-parented multinational group and domestic branches of foreign corporations would be disallowed U.S. tax deductions in an amount determined by reference to the low-taxed income of foreign entities and foreign branches that are members of the same financial

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reporting group (including the common parent of the financial reporting group). A coordination rule would reduce the UTPR disallowance imposed by the U.S. to reflect any top-up tax collected by members of the group under a Qualified UTPR in one or more other jurisdictions.

The proposal to repeal the BEAT and replace it with the UTPR would be effective for tax years beginning after December 31, 2024.

Revenue: $549 billion

Repeal and replace the FDII tax benefit

The Budget would repeal the foreign derived intangibles income (FDII) tax benefit and utilize the revenue to provide other unspecified incentives to encourage R&D, effective for tax years after December 31, 2023. The repeal and replace proposal is intended to be revenue neutral.

Other international tax proposals in the Budget would:

- Limit the full IRC Section 245A dividends received deduction (DRD) to only those dividends remitted either by CFCs or by qualified foreign corporations, which includes corporations incorporated in a territorial possession of the U.S. and certain corporations eligible for the benefits of an income tax treaty. A smaller DRD would be provided for dividends from a foreign corporation that is not a CFC, with the reduced rate determined based upon the level of ownership in the foreign corporation, effective for distributions after the date of enactment.
- Expand the application of IRC Section 265 to disallow deductions allocable to a class of foreign gross income that is exempt from tax or taxed at a preferential rate through a deduction (e.g., a global minimum tax inclusion with respect to which an IRC Section 250 deduction is allowed or dividends eligible for an IRC Section 245A deduction). The proposal, which would be effective for tax years after December 31, 2023, would also repeal IRC Section 904(b)(4).
- Broaden the definition of an inversion transaction, effective for transactions after the date of enactment.
- Amend the rules for calculating basis in the stock of a foreign corporation in order to determine the loss on a U.S. shareholder's disposition of the stock when the income inclusion that gave rise to the basis was subject to a reduced rate of tax under IRC Sections 245A or 965, effective for dispositions after the date of enactment (regardless of the deductions under IRC Sections 265 or 965 were taken in a prior year).
- Expand the definition of foreign business entity to treat any taxable unit in a foreign jurisdiction as a "foreign business entity" for purposes of applying IRC Section 6038, so that information would be required to be reported separately with respect to each taxable unit, and penalties would apply separately for failures to report with respect to each taxable unit, effective for tax years of a controlling U.S. person that begin after December 31, 2023, and to annual accounting periods of foreign business entities that end with or are within such tax years of the controlling U.S. person.
- Modify the pro rata share rules to require a U.S. shareholder of a CFC that owns, directly or indirectly, a share of stock of the CFC for part of the CFC's tax year, but not on the last relevant day, to include in gross income a portion of the foreign corporation's subpart f income allocable to the portion of the year during which it was a CFC. The pro rata share rules for determining a U.S.

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shareholder's GILTI inclusion with respect to a CFC would similarly be revised, effective for tax years of foreign corporations beginning after the date of enactment and to tax years of U.S. shareholders in which or with which such tax years of foreign corporations' end.
- Eliminate the ability of taxpayers to take advantage of the two different calculations of E&P in a CFC by providing that the E&P of a CFC would be determined for all purposes by taking into account LIFO, installment sales, and the completed contract method of accounting. Thus, the E&P of a CFC generally would follow the income tax accounting treatment, including for purposes of determining the amount of E&P available for distribution under IRC Section 245A, effective for tax years of foreign corporations ending on or after December 31, 2023, and to tax years of U.S. shareholders in which or with which such tax years of the foreign corporations' end.
- For purposes of applying the foreign tax credit rules, the source and character of any item resulting from the disposition of the interest in a specified hybrid entity, or change in entity classification, would be determined based on the source and character of an item of gain or loss for the seller would have accounted upon the sale or exchange of stock (determined without regard to IRC Section 1248), effective transactions occurring after the date of enactment.
- Limit the deduction for interest expense a member of a "financial reporting group" if the group has net interest expense for U.S. tax purposes and the member's net interest expense for financial reporting purposes (computed on a separate company basis) exceeds the member's proportionate share of the financial reporting group's net interest expense reported on the group's consolidated financial Statements (excess financial Statement net interest expense). The proposal generally would apply to an entity that is a member of a multinational group that prepares consolidated financial Statement in accordance with U.S. GAAP, IFRS, or other method identified by the Secretary under regulations, and would not apply to financial services entities. The proposal would be effective for tax years beginning after December 31, 2023.
- Treat the portion of a payment on a derivative financial instrument (including a securities loan or sale-and-repurchase agreement) that is contingent on income or gain from a publicly traded partnership or other partnership specified by the Secretary as a dividend equivalent, to the extent that the related income or gain would have been treated as ECI if the taxpayer held the underlying partnership interest, effective for tax years starting after December 31, 2023.
- Modify the passive foreign investment company (PFIC) rules relating to when a taxpayer can make a qualified electing fund (QEF) election, effective on the date of enactment.
- Limit the amount of a levy that would qualify as a creditable foreign tax to the amount of tax that the dual capacity taxpayer would have paid to the foreign government if it were a non-dual capacity taxpayer, effective for tax years after December 31, 2023.

Incentive to bring jobs home

A new general business credit would equal 10% of the eligible expenses paid or incurred in connection with onshoring a U.S. trade or business that is linked to reducing or eliminating a trade or business or line of business currently conducted outside the United States or starting up, expanding, or otherwise moving the same trade or business within the United States, to the extent that this action results in an increase in U.S. jobs. Deductions would be disallowed for expenses paid or incurred in connection with offshoring a U.S. trade or business, including denying deductions against a U.S. shareholder's GILTI or subpart F income inclusions for any expenses paid or incurred in connection with moving a U.S. trade or business outside the

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United States. The proposal, which is revenue neutral, would be effective for expenses paid or incurred after the date of enactment.

INSURANCE

The Budget includes insurance tax provisions, including proposing what are characterized as technical corrections to the TCJA provisions addressing the capitalization of deferred acquisition costs (DAC) and the discounting of certain unpaid claims and other incurred losses for short-tail and long-tail property and casualty insurance businesses. Regarding DAC, the Budget proposal would change the capitalization rate of net premiums for group life insurance contracts from 2.05% to 2.45%, and the capitalization rate for other non-annuity specified life insurance contracts from 7.70% to 9.20%. The proposal, which is characterized as a technical correction, would be effective as if it were part of the TCJA and be treated as a change of accounting method for the tax year beginning in 2023. Regarding the discounting proposal, the second technical correction would include international and nonproportional reinsurance lines of business in the list of long-tail lines of business that are explicitly identified in the statute. This proposal is effective for tax years after December 31, 2023. New loss payment patterns for international and nonproportional reinsurance lines of business would be determined as if promulgated for the 2022 determination year.

Changes to the alternative tax regime that may be elected by certain small non-life insurance companies are proposed to address perceived abuses in the use of the alternative regime, effective for distributions, sales, and other transactions occurring in the tax years of a covered insurance company beginning after December 31, 2023.

A business-owned life insurance proposal would repeal the pro-rata interest-expense-disallowance rule for contracts covering employees, officers, or directors, while the exception for policies covering a 20% owner of a business would be retained. The proposal would apply to contracts issued after December 31, 2023, and certain material changes to an existing contract would be treated as an issuance of a new contract.

In addition, the rules would be modified in several respects for insurance products that fail the statutory definition of a life insurance contract, focusing on so-called frozen cash value (FCV) contracts. Taken together, the changes are designed to ensure that all future earnings credited to FCV contracts owned by U.S. person would be included in the U.S. policyholder's "income on the contract" for the tax year.   The proposal would be effective for such contracts on March 10, 2023, the day following publication of the proposals. Special rules are provided for the tax year including this effective date.

REAL ESTATE

The repeal of deferral of gain from like-kind exchanges proposal would allow the deferral of gain up to an aggregate amount of $500,000 for each taxpayer ($1 million in the case of married individuals filing a joint return) each year for real property exchanges that are like-kind. Any gains from like-kind exchanges in excess of $500,000 (or $1 million in the case of married individuals filing a joint return) in a year would be recognized by the taxpayer in the year the taxpayer transfers the real property subject to the exchange.

The carried interest proposal would generally tax as ordinary income a partner's share of income on an "investment services partnership interest" (ISPI) in an investment partnership, regardless of the

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character of the income at the partnership level if the partner's taxable income (from all sources) exceeds $400,000, meaning such income would not be eligible for the reduced rates that apply to long-term capital gains.

ENERGY

Also reproposed from the prior budget is a similar set of provisions to cut benefits for fossil fuel producers. These provisions include repeal of expensing of intangible drilling costs, repeal of %age depletion with respect to oil and natural gas wells, and repeal of the increased geological and geophysical amortization period for independent producers.

CHARITIES

Charity-related provisions would:

- Clarify that a distribution by a private foundation to a donor advised fund (DAF) is not a qualifying distribution unless funds are expended as a qualifying distribution by the end of the following tax year and the private foundation maintains adequate records or other evidence showing that the DAF has made a qualifying distribution within the required timeframe
- Provide that paying compensation or reimbursing expenses by a private foundation to a disqualified person (other than a foundation manager of such private foundation who is not a member of the family of any substantial contributor) is not a qualifying distribution that satisfies the payout requirement for private nonoperating foundations
- Modify the definition of a guaranteed annuity from a charitable lead annuity trust (CLAT) by requiring that the annuity payments made to charitable beneficiaries of a CLAT at least annually must be a level, fixed amount over the term of the CLAT, and that the value of the remainder interest at the creation of the CLAT must be at least 10 % of the value of the property used to fund the CLAT, thereby ensuring a taxable gift on creation of the CLAT
- Ignore trust interests held by additional tax-exempt organizations for purposes of the generation-skipping transfer (GST) tax, meaning the inclusion of such an organization as a permissible distributee of a trust would not prevent the occurrence of a taxable termination subject to GST tax

ESTATE & GIFT

Estate and gift provisions on grantor trusts would:

- Require the remainder interest in a GRAT to have, at the time the interest is created, a minimum value for gift tax purposes equal to the greater of 25% of the value of the assets transferred to the GRAT or $500,000
- Prohibit any decrease in the annuity during the GRAT term and prohibit the grantor from acquiring in an exchange an asset held in the trust without recognizing gain or loss for income tax purposes
- Require a GRAT to have a minimum term of 10 years and a maximum term of the life of the annuitant plus 10 years

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Another proposal would provide that the current-law exemption from the generation-skipping transfer (GST) tax, which is imposed on gifts and bequests by an individual transferor to transferees who are two or more generations younger than the transferor, would apply only to: (a) direct skips and taxable distributions to beneficiaries no more than two generations below the transferor, and to younger generation beneficiaries who were alive at the creation of the trust; and (b) taxable terminations occurring while any person described in (a) is a beneficiary of the trust.

INFORMATION REPORTING, INCLUDING CRYPTOCURRENCY

The Budget would expand the wash sale rules to include digital assets and also amend the rules to address derivative financial instruments more comprehensively, including modifications to the basis rules to prevent abuse. The House BBBA addressed bringing cryptocurrency into the wash sale rules.

Like last year's Budget, existing rules on financial account reporting would be expanded to include reporting on the account balance (including the cash value or surrender value of cash-value insurance and annuity contracts) for all U.S. office accounts of foreign persons and includes new reporting for other financial accounts held by foreign persons. Additionally, the proposal would add a third category of assets that may be marked-to-market at the election of a dealer or trader in those assets, which would be actively traded digital assets and derivatives on, or hedges of, those digital assets, under rules similar to those that apply to actively traded commodities.

RETIREMENT

The Budget would require a high-income taxpayer with an aggregate vested account balance under tax-favored retirement arrangements that exceeded $10 million as of the last day of the preceding calendar year to distribute a minimum of 50% of that excess. It would also prohibit a rollover to a Roth IRA of an amount distributed from an account in an employer-sponsored eligible retirement plan that is not a designated Roth account (or of an amount distributed from an IRA other than a Roth IRA) for a high-income taxpayer.

FUNDING FOR POST-RETIREMENT MEDICAL AND LIFE INSURANCE BENEFITS

The Budget would require post-retirement benefits to be funded over the longer of the working lives of the covered employees on a level basis or 10 years unless the employer commits to maintain those benefits over a period of at least 10 years.

CTC/EITC

The President called for the restoration of the full Child Tax Credit enacted in the American Rescue Plan, in 2021: $3,000 per child for children six years old and above, and $3,600 per child for children under six, plus full refundability to allow families to receive monthly advance payments. The President also called for the Earned Income Tax Credit expansion for childless workers to be made permanent.

The Treasury General Explanations of the Administration's Revenue Proposals document is available at: https://home.treasury.gov/system/files/131/General-Explanations-FY2024.pdf

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