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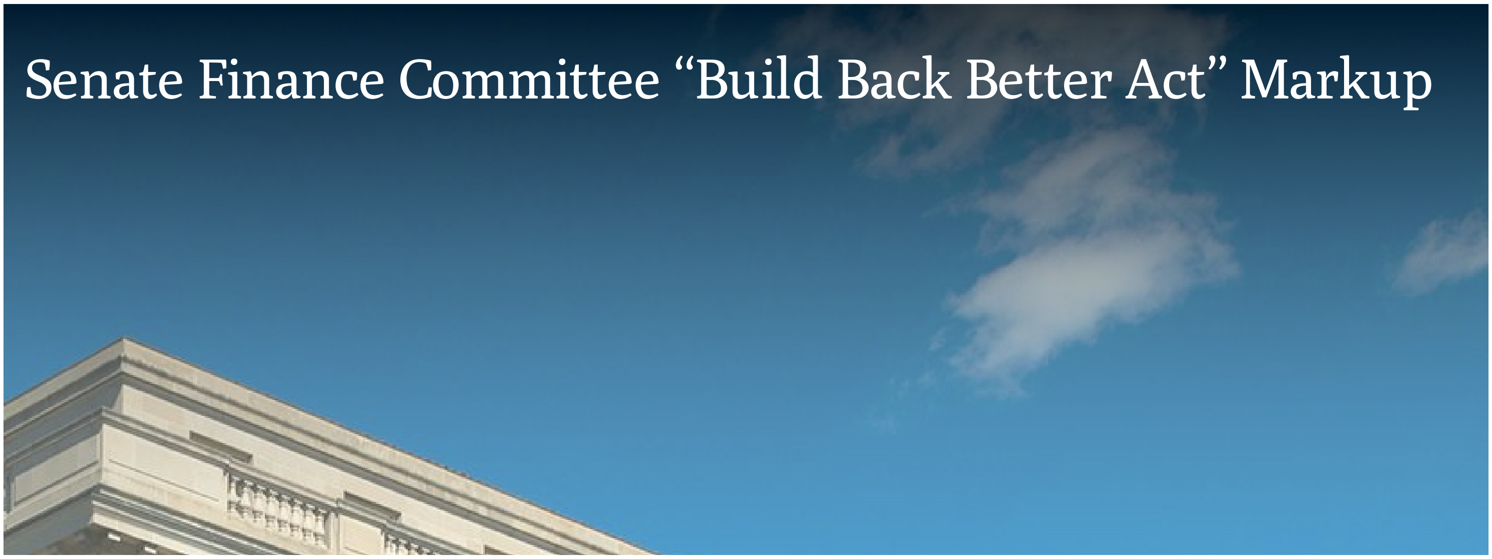
BLOG

Senate Finance Committee “Build Back Better Act” Markup



DECEMBER 14, 2021

Over the weekend, the Senate Finance Committee released an update (1,180 pages) to portions of the “Build Back Better Act” (H.R. 5376) passed by the House on November 19, 2021. The Finance Committee draft bill, among other changes, modifies a number of tax provisions contained in the House bill, while at the same time adding new provisions and deleting others, as set forth below. Notably absent are some of the more widely debated modifications to the Code, such as the state and local tax (“SALT”) deduction/cap and the Finance Committee’s previously proposed “Billionaires Income Tax.”

What Is New

The Finance Committee draft bill modifies or adds certain new provisions to the Build Back Better Act, including:

Corporations

- **Corporate Alternative Minimum Tax.** Adds adjustments for defined benefit pensions and tax-exempt entities to the House bill’s 15% alternative minimum tax on the excess of “adjusted financial statement income” (calculated under Section 56A) over the corporate AMT foreign tax credit for corporations with a three-year average of such financial statement income in excess of $1 billion. The three-year average income threshold is reduced to an amount in excess of $100 million for “foreign-parented corporations.” The Finance Committee draft also modifies the AMT foreign tax credit for foreign corporations.
- **Interest Expense Limitations.** Modifies the Act’s proposed new Section 163(n) interest expense limitation applicable to certain members of a foreign reporting group by adding an election to compute the limitation on the adjusted basis of assets instead of EBITDA.
- **Section 7874 Anti-Inversion Rules.** Modifies the anti-inversion rules of Section 7874 to lower the stock-ownership threshold for having a surrogate foreign corporation from 60% to 50% and changes the stock-ownership test for treating an acquiring foreign corporation as a domestic corporation from 80% to 65%. The draft bill also expands the threshold for testing whether there is a “substantially all” acquisition under the inversion rules.

- **BEAT Changes.** Amends Section 59A to include indirect costs in inventory under Section 263A when determining the 3% base erosion percentage. The draft bill otherwise retains previously proposed modifications to the BEAT regime, including the increase in the rates for future years.
- **Foreign Dividend Received Deduction ("DRD").** Modifies current Section 245A to provide for a 65% DRD for dividends received by a U.S. shareholder *directly* from a 10/50 corporation.
- **Other Proposed Changes.** The bill makes a number of additional changes, including modifications to various energy tax incentives and low-income housing tax-credit provisions, as well as revising the increased IRS compliance appropriation to include increased funds to examine e-filing.

What Is (Still) In

The Finance Committee bill retains many of the major provisions of the House version, including:

Individuals

- **Surcharge on High-Income Individuals.** Imposes a 5% tax on modified adjusted gross income in excess of $10 million ($5 million for taxpayers filing as married filing separately). An additional 3% tax would apply to modified adjusted gross income over $25 million ($12.5 million for taxpayers filing as married filing separately).
- **Application of 3.8% Net Investment Income ("NII") Tax to Trade or Business Income.** Subjects all trade or business income to the 3.8% tax. The NII tax already applies to investment income (g., interest, dividends, and capital gains). Under the Act, the new NII tax treatment for trade or business income would apply to taxpayers earning more than $400,000 annually ($500,000 for married filing jointly). Net operating losses would no longer be accounted for in determining NII.

Trusts

- **Surcharge on Non-Grantor Trusts.** A 5% tax would apply to the modified adjusted gross income of a non-grantor trust in excess of $200,000. An additional 3% tax would apply to the modified adjusted gross income of a non-grantor trust in excess of $500,000.
- **Application of 3.8% NII Tax to Trade or Business Income.** Subjects all trade or business income to the 3.8% tax. The NII tax would continue to apply to trust income over a relatively low threshold (currently $13,050—subject to typically modest adjustments to account for inflation). Net operating losses would no longer be accounted for in determining NII.

Corporations

- **Stock Redemption Excise Tax.** Imposes a 1% excise tax on publicly traded U.S. corporations based on the fair market value of the stock that is repurchased by the corporation.
- **GILTI and FDII Modifications.** Reduces the Section 250 deduction for both FDII (to 24.8%) and GILTI (to 28.5%). In combination with the current corporate rate, this yields an effective 15% GILTI rate and 15.8% FDII rate.
  - Also reduces the QBAI exemption from 10% to 5%. And provides for country-by-country application of the GILTI regime under Section 951A.

Other Business Tax Provisions

- **Exemption for Portfolio Interest.** Modifies the definition of a "10-percent shareholder" in the case of an obligation issued by a corporation to include both any person who owns 10% or more of the total vote or value of the stock of such a corporation.
- **1202 Stock.** Maintains language from previous versions, including the September 13, 2021 effective date, by amending Section 1202(a) to provide that the special 75% and 100% exclusion rates for gains realized from certain qualified small business stock will not apply to taxpayers with adjusted gross income equal to or exceeding

$400,000 for sales and exchanges after September 13, 2021. The baseline 50% exclusion remains available for all taxpayers. And the bill maintains the binding-contract exception to the retroactive date.

Appropriations

- Appropriates $78.946 billion for necessary expenses for the IRS to strengthen tax enforcement activities, increase voluntary compliance, and modernize information technology to effectively support enforcement activities.
- Appropriates $403 million for necessary expenses for the Treasury Inspector General for Tax Administration to provide oversight of the IRS. And appropriates $104 million to the Treasury's Office of Tax Policy to carry out functions related to promulgating regulations under the Code.
- **Tax Court.** Appropriates $153 million for the Tax Court.

What Is Out

The Finance Committee draft does not add back any of the proposals from the Green Book released in the Spring that were left out of the Act passed by the House in November (e.g., increases to the top marginal individual income tax rates and capital gains rates, increases in the corporate rate, and changes carried interest under Section 1061). However, notably absent from the Finance Committee draft are:

- **Modification to SALT Cap.** The House version would have raised the SALT cap to $80,000 ($40,000 in the case of an estate, trust, or married individual filing a separate return); and extended the cap through 2031 (rather than 2025). The Finance draft eliminated any reference to the SALT deduction.
- **Billionaires Income Tax.** A previous Finance proposal would have imposed a limited mark-to-market regime that would apply to certain individuals, estates or trusts meeting certain income ($100 million) and asset thresholds at the close of the tax year ($1 billion).

Winston & Strawn will continue to monitor these developments, as additional changes to the Act are likely and key legislators have expressed an intention of passing legislation by the Christmas holiday or early 2022.

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