Biden Administration Releases Fiscal Year 2022 Budget, Together With a "Greenbook" Providing Detailed Descriptions of Proposed Changes to Federal Tax Law and Accompanying Revenue Estimates

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Background

On May 28, 2021, the Administration released its fiscal year (FY) 2022 Budget, outlining a plan for $6 trillion of federal spending and $4.1 trillion in revenue for FY 2022 alone. Each year, the White House publishes the President's Budget request for the upcoming fiscal year, which begins on October 1st. The President's Budget lays out the Administration's proposals for discretionary spending, revenue and borrowing and typically marks the opening of a dialog with Congress that culminates in appropriations bills and, on a parallel path, tax expenditure and revenue-raising legislation.

Detailed descriptions of the Administration's legislative tax proposals have historically been provided in a "Greenbook" that includes revenue estimates generated by economists in Treasury's Office of Tax Policy.[1] With the December 2017 enactment of sweeping changes to the federal tax law in legislation commonly known as the "Tax Cuts and Jobs Act" (the "TCJA"),[2] the prior administration did not publish a separate document laying out new tax legislative proposals. Thus, for the first time since the Obama Administration's FY 2017 Budget (released in February 2016), the President's FY 2022 Budget includes a Greenbook with detailed proposals for changes to the federal tax law, including provisions that would modify, expand or add to existing tax expenditures and revenue-raising measures.

Although the Greenbook is only the opening chapter in the FY 2022 budget and appropriations process, the current unified Democratic control of both the White House and of Congress, albeit each House of Congress by small margins, suggests that at least some of its proposals have a significant, although by no means certain, likelihood of moving forward as part of the Appropriations process or in separate pieces of legislation like an infrastructure bill. Most notably, the narrow Democratic majority in the House and the potential use of "reconciliation" procedures in an evenly divided Senate allow Democratic Senators, if they all agree, to pass legislation in Congress without help from Senate Republicans. The prospect of Democrats enacting legislation into law without Republican buy-in provides a new dynamic this year and makes this the most anticipated set of administration legislative tax proposals in recent memory.

The following summaries focus on tax expenditure and revenue-raising proposals in the

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Greenbook that affect business taxpayers and their owners, as follows:

Part I: Increased Rates for Corporations and Individuals

Part II: Elimination of Certain Significant Benefits

Part III: Sea Changes for International Tax

Part IV: Changes to Prioritize Clean Energy

Part V: Improve Compliance and Tax Administration

PART I: INCREASED RATES FOR CORPORATIONS AND INDIVIDUALS

Corporate Income Tax Rate Raised to 28%

The Greenbook proposes to increase the federal income tax rate on C corporations from 21 percent to 28 percent, effective for taxable years beginning after the end of 2021 (with a phase-in rule for taxpayers that have a non-calendar taxable year).

Recent comments by President Biden caused many to expect a proposed increase to 25 percent, rather than 28 percent, and it remains possible that the Administration will end up agreeing to a smaller corporate rate increase. An increased corporate income tax rate may incentivize corporations to accelerate income into the 2021 calendar year and to defer deductions until a later calendar year. This proposal may also encourage the use of passthrough entities (although taxpayers must also take into account the proposed increase in individual rates). Moreover, the proposed increase would push the corporate rate well above the 23.51 percent average rate for trading partners in the Organisation for Economic Co-Operation and Development (the "OECD"), raising again the long-standing tension between avoiding a "race to the bottom" on rates and strengthening the global tax competitiveness of U.S.-based companies.

It is noteworthy that in proposing an increase in the corporate rate, the Greenbook makes no reference to repealing or modifying the deduction for qualifying business income of certain passthrough entities (*e.g.*, partnerships and S corporations) under Internal Revenue Code (the "Code") section 199A. That provision was included in the TCJA late in the legislative drafting process in order to create parity between corporations and business operated in passthrough form, such as partnerships, S corporations, and sole proprietorships. Setting the corporate rate at 28 percent (along with the proposed elimination of lower rates on qualified dividends above stated thresholds) may tend to shift the incentive in the opposite direction, although Code section 199A is scheduled to expire in 2025.

Corporate taxpayers with GAAP-based financial statements will have to consider the impact of any rate increase on the values of their deferred tax assets and liabilities.

New 15 Percent Minimum Tax on Book Earnings of Large Corporations

The Greenbook proposes a 15 percent minimum tax on worldwide pre-tax book income for corporations whose book income exceeds $2 billion annually.

This proposal, taken together with the proposal for disallowing interest deductions, would further integrate income tax treatment with financial statement accounting treatment. Historically, these treatments have operated independently, but began to be integrated for limited purposes with the enactment of Code section 451(b) in 2017. The link to financial statement treatment is one of two proposals in the Greenbook (along with the proposed SHIELD provision discussed below) that would significantly expand reliance on third-party accounting standards to determine federal tax liability, a notable shift from the long-

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standing assumption, recognized by the Supreme Court in *Thor Power Tool Co. v. United States*, that there are "differing objectives of tax and financial accounting" and the risks and challenges associated with conforming them. It would also re-introduce the complexity of parallel sets of tax rules that Congress sought to eliminate when it repealed the corporate alternative minimum tax as part of the TCJA.

The proposal would be effective for taxable years beginning after December 31, 2021.

Top Marginal Tax Rate for Individuals Raised to 39.6%

Under current law, the top marginal income tax rate for individuals is 37 percent (before accounting for the additional 3.8 percent tax rate on net investment income), but would revert to 39.6 percent (again, before accounting for the additional 3.8 percent tax rate on net investment income) for taxable years beginning on and after January 1, 2026. In 2021, the top marginal rate applies to taxable income that exceeds $628,300 (for married couples filing jointly) or $523,600 (for single filers).

The Greenbook proposes that, beginning in 2022, the new 39.6 percent (before accounting for the additional 3.8 percent tax rate on net investment income) top marginal income tax rate would apply to taxable income that exceeds $509,300 (for married couples filing jointly) or $452,700 (for single filers); the thresholds would be adjusted for inflation in taxable years after 2022. The proposed increase in individual tax rates was not accompanied by a repeal of the limitation on deductibility of state and local taxes.

Tax Certain Capital Gains at Ordinary Income Rates for High Earners

Currently, individual taxpayers are taxed at preferential rates on their long-term capital gains and qualified dividends as compared to ordinary income—the current highest rate for long-term capital gains and qualified dividends is 20 percent (23.8 percent, including the net investment income tax, if applicable).

The Greenbook proposes to tax individuals' long-term capital gains and qualified dividends at ordinary income tax rates to the extent that the individual's adjusted gross income exceeds $1 million ($500,000 for married filing separately), indexed for inflation after 2022. For example, an individual with $200,000 of long-term capital gains and $900,000 of wages would have $100,000 of long-term capital gains taxed at ordinary income rates (the $100,000 excess over $1 million).

Other than a brief period of time after passage of the Tax Reform Act of 1986, capital gains have received preferential federal income tax treatment since the 1920s. The Greenbook proposal will add to the long-standing debate on the merits of this preference and undoubtedly cause taxpayers to consider ways in which they can defer or avoid recognition events.The proposal would also remove a historic tax incentive to hold capital assets for one year, possibly resulting in earlier and more common dispositions of assets held for 10 or 11 months.

The proposal would be effective for gain recognized after the date of the announcement (understood to be April 28, 2021, the date when President Biden announced the proposal as part of the American Families Plan). As with other aspects of the Greenbook proposals, the effective date could change during the Budget reconciliation process.

"Deemed" or "Forced" Realization – New Realization Events for Gifts, at Death and for Certain Partnerships and Trusts

Under general tax principles, taxpayers take into account increases and decreases in the value of their assets only at the time of a realization event, such as a sale. Currently, gifts and transfers upon death are not treated as taxable events. This is the case on transfers on death, even though the heir generally takes a "stepped up" fair market value basis in the decedent's assets upon death, with no income tax due at that time.

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Under the Greenbook proposal, donors and decedents would recognize capital gain upon a transfer to a donee or heir, as applicable, based on the asset's fair market value at the time of transfer. A decedent would be permitted to use capital losses and carry-forwards to offset such capital gains.

The proposal would require the recognition of unrealized appreciation by partnerships, trusts, and other non-corporate entities that are the owners of the property if that property has not been subject to a recognition event in the prior 90 years. Because the look-back period begins January 1, 1940, this aspect of the proposal would not become operational until December 31, 2030. The operational aspects of this proposal – such as which property would be taxed, who would bear the incidence of tax, and the extent of adjustment to basis – are not addressed by the Greenbook.

The proposal also would treat otherwise tax-deferred contributions to, or distributions from, partnerships, trusts, and other non-corporate entities as taxable events. The description of this aspect of the proposal in the Greenbook is startling in its breadth. That is, if taken literally the proposal would upend the bedrock principles in partnership taxation that contributions to and distributions by partnerships generally are tax free. Presumably, the proposal was intended to address indirect donative transfers, and it is hoped that clarification will be forthcoming in short order.

Exclusions would apply to assets transferred to U.S. spouses and charities. Additionally, there would be a $1 million per-person exclusion (generally $2 million per married couple) that would be indexed for inflation. Payment of tax would be deferred in the case of certain family-owned and -operated businesses (which are not defined but would presumably be modeled on the payment extension provisions for estate taxes in Code section 6166) until the interest in the business is sold or the business ceases to be family-owned and -operated. Additionally, the proposal would allow a 15-year fixed-rate payment plan for the tax on appreciated assets transferred at death (excluding certain liquid assets and transfers of businesses for which the deferral election is made). This proposal has the potential to create substantial liquidity issues for closely held businesses. As proposed, no change would be made to the exclusion of certain capital gains under Code section 1202.

The proposal generally would be effective beginning January 1, 2022.

Eliminate Gap in Medicare Taxes for High Earners

The current 3.8 percent "net investment income tax" generally applies to passive income and gains recognized by high-income individuals, including trade or business income earned by taxpayers who do not materially participate in the business. The separate 3.8 percent "SECA" tax currently applies to self-employment earnings of high-income taxpayers—both taxes are intended to fund Medicare and are often colloquially referred to as "Medicare" taxes.

Neither form of Medicare tax currently applies to limited partners (many taxpayers believe that certain members of limited liability companies classified as partnerships for federal income tax purposes are "limited partners" for this purpose) and S corporation shareholders (who are subject to Medicare tax solely on "reasonable compensation" paid in an employee capacity) who are treated as materially participating in a trade or business. The Biden Administration likens this gap to a loophole because certain high-income taxpayers' distributive share of business income may escape Medicare taxation.

The Greenbook proposal would subject all trade or business income of high-income taxpayers (earned income exceeding $400,000) to the 3.8 percent Medicare tax (either through the net investment income tax or the SECA tax) and would apply to taxable years beginning on or after January 1, 2022. The Greenbook bases this change on fair and efficient tax administration. "Different treatment [for owners of different types of passthrough entities] is unfair, inefficient, distorts choice of organizational form, and provides tax planning opportunities for business owners, particularly those with high

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income, to avoid paying tax." Notwithstanding that explanation, the proposal goes to some lengths to ensure that it does not impact taxpayers with less than $400,000 in earned income, although it is noteworthy that the proposal is explicit in saying that this threshold would not be indexed for inflation. It is also noteworthy that the exclusion for these lower income taxpayers is linked to earned income rather than "taxable income (from all sources)," which is used elsewhere in the Greenbook as the trigger for proposed denial of capital gain treatment for carried interest.

PART II: ELIMINATION OF CERTAIN SIGNIFICANT BENEFITS

Tax Carried Interests as Ordinary Income

The Greenbook, following in the footsteps of many previously proposed bills, proposes to tax a partner's share of profits from, and gain from the disposition of, an "investment services partnership interest" as ordinary income, regardless of the character of the income at the partnership level.

Under current law, partnerships are generally able to issue a partnership interest to a service provider who then holds the interest as a capital asset, with the character of the partner's share of profits from the partnership being determined by reference to the character of the profits in the hands of the partnership. Thus, if the partnership recognizes capital gain, the service provider's share of such income would generally likewise be capital gain. These equity grants may take the form of a "profits interest," which is referred to as a "carried interest" in the private equity context, an "incentive allocation" in the hedge fund context, or a "promote" in the real estate context. The TCJA limited the ability to recognize long-term capital gain with respect to these profits interests by enacting Code section 1061, which generally treats gain recognized with respect to certain partnership interests held for less than three years as short-term capital gain.

The Greenbook proposal would eliminate this benefit, but only for partners whose taxable income (from all sources) exceeds $400,000. Partners whose taxable income does not exceed $400,000 would continue to be subject to Code section 1061, which generally treats gain recognized with respect to certain partnership interests or partnership assets held for less than three years as short-term . The "cliff" effect of this proposal would add considerable complexity to the tax law, requiring a parallel set of rules that may apply differently to different members of the same partnership.

The proposal would apply to profits interests held by persons who provide services to a partnership that is an "investment partnership." A partnership would be an investment partnership if (i) substantially all of its assets are investment-type assets and (ii) more than half of the partnership's contributed capital is from partners whose partnership interest is an investment (i.e., partners in whose hands the partnership interest is not held in connection with a trade or business). The proposal would not apply to a partnership interest attributable to any capital contributed by the service provider. The proposal includes certain anti-abuse rules intended to prevent the avoidance of the recharacterization rule through the use of compensatory arrangements other than partnership interests.

It appears that the most significant differences between the proposal in the Greenbook and existing law under Code section 1061 would be (i) unlimited time duration (Code section 1061 applies only to recharacterize long-term capital gain recognized with respect to an asset held for three years or less), (ii) treatment of the recharacterized amount as ordinary income rather than short-term capital gain (there is no rate differential, but there could be sourcing and other differences), and (iii) subjecting the income to SECA.

Given that final Treasury regulations under Code section 1061 were released only this year, the proposal to repeal and replace Code section 1061 in certain cases is somewhat surprising, although similar proposals have recently been introduced in Congress. If enacted, this proposal could meaningfully impact the taxation of individuals in the private

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equity, hedge fund, and real estate industries, and other service providers receiving a profits interest as a form of compensation. It should be noted that if the proposal ending the preferential treatment of long-term capital gain is also enacted, this carried interest proposal would materially affect only profits interests holders with taxable income below $1 million (the threshold in the long-term capital gain proposal).

The provision would be effective for taxable years beginning after December 31, 2021.

Make Permanent Excess Business Loss Limitation of Noncorporate Taxpayers

The TCJA requires that “excess business losses” be carried forward as net operating losses rather than deducted currently. Very generally, an excess business loss is the amount of losses from a business that exceeds the sum of the gains from business activities and a stated threshold ($524,000 for married couples filing jointly and $262,000 for other taxpayers).

Under current law, the excess business loss provision expires in 2027; the Greenbook would make the provision permanent.

Severely Limit Deferral of Gain from Like-Kind Exchanges

Code section 1031 currently provides for non-recognition of gain on exchanges of real property for other like-kind real property (like-kind exchanges). The Greenbook proposes to limit the applicability of Code section 1031 to exchanges that defer gain of less than $500,000 (or $1 million in the case of married individuals filing a joint return) in a taxable year. The proposal does not index the exclusion amounts to inflation, although it does apply those amounts on an annual basis.

This proposal represents a significant change for the real estate, oil and gas, and mineral industries, which together engage in billions of dollars of like-kind exchanges per year. In particular, the proposal could significantly impact the business of REITs, which must distribute at least 90 percent of their taxable income per year and often use Code section 1031 to reduce the amount of income subject to this distribution requirement in order to keep additional cash on hand to complete other real estate purchases. Further, oil and gas “acreage swaps” and mineral interest exchanges could be severely limited. If enacted, the $500,000 / $1 million exclusion included in the proposal could create an incentive to divide property and make partial, tax-deferred dispositions. It could also create an incentive for taxpayers to use tenant-in-common or other pooled structures, like tax partnerships, to facilitate transactions without triggering taxation.

The proposal would be effective for exchanges completed in taxable years beginning after December 31, 2021.

PART III: SEA CHANGES FOR INTERNATIONAL TAX

The TCJA introduced sweeping reform on international tax matters with the goal of incentivizing multinational companies to remain in the United States. Along these lines, not only did the TCJA lower the U.S. corporate income tax rate and provide a 100 percent dividends-received deduction for certain offshore dividends, but it also introduced new obstacles and penalties to discourage so-called inversions and established the global intangible low-tax income (GILTI) and base erosion anti-avoidance regimes to generally provide a minimum level of tax on certain foreign earnings.

The Greenbook, as described in further detail below, proposes to—again—usher in comprehensive changes and unscramble some of the TCJA complexity. Interestingly, several of these proposals are reminiscent of similar proposals made by the OECD. In fact, the Greenbook mentions the OECD four times (compared to zero mentions in the JCT’s Blue Book for the TCJA), suggesting a willingness to find common ground with the OECD on some principles of international taxation.

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The proposed changes to the international tax regime come less than four years after passage of the TCJA and inject a new level of uncertainty and instability into U.S.-based companies' decisions around the global deployment of capital. Moreover, the IRS is just now beginning to audit many of the returns filed for the 2018 tax year, the first year in which TCJA was in full effect. Beyond the front-end planning challenges for taxpayers, enactment of the Greenbook proposals will raise significant administrability issues for the IRS as it works with taxpayers to sort through several interlocking but materially different regimes for taxing cross-border activities.

Revised Global Minimum Tax Regime

The Greenbook proposal would increase the effective tax rate of U.S. multinational companies by overhauling the GILTI regime. Specifically, the so-called "QBAI" (or qualified business asset income) exemption would be eliminated, with the result that a U.S. shareholder's entire net tested income would be subject to tax (*i.e.*, net tested income would no longer be offset by a deemed 10 percent return on certain depreciable tangible property).

The elimination of the QBAI exemption would remove the last fig leaf of the quasi-territorial tax system that was announced with much fanfare in 2017. If enacted, the United States will stake new ground in the international tax arena by requiring U.S. shareholders to pay tax on all earnings in foreign companies, as compared to most countries that tax analogous shareholders only on certain foreign earnings (e.g., corporate earnings from low-tax countries or passive income). Moreover, since all foreign earnings would now be taxed, the Code section 245A dividend-received exemption would become increasingly irrelevant, since the earnings underlying the dividends would generally have been taxed under subpart F or GILTI at the time the foreign corporation earned the income.

It is also worth noting that QBAI is generally tangible property eligible for depreciation, such as buildings or machinery, but QBAI does not include assets that are not depreciable (such as land) nor intangible assets. As a result, the elimination of QBAI may disproportionately affect companies with more tangible assets, rather than companies whose value is primarily intangible assets (like intellectual property). In addition, the cost-benefit analysis of a potential Code section 338(g) election, which regularly arises in cross-border acquisitions, will change given that the step-up in asset basis will no longer produce a tax benefit in the form of QBAI to reduce future GILTI inclusions, though Code section 338(g) elections still have other benefits.

The proposal would also effectively increase the GILTI rate by reducing the Code section 250 deduction from 50 percent to 25 percent. Under current law, U.S. shareholders are entitled to a 50 percent deduction against a 21 percent tax rate, resulting in an effective 10.5 percent GILTI rate. The Greenbook proposal, however, would reduce the deduction to 25 percent. Taken together with the proposed corporate rate increase to 28 percent, this change would result in an effective GILTI rate of 21 percent. Interestingly, the Greenbook's proposal does not do away with the Code section 250 deduction. Rather, it achieves the 21 percent rate by changing the percentage of the deduction. This approach suggests a willingness to use the relative percentage deduction as a way to reach a compromise on the overall package.

Consistent with the general increase in corporate tax rates, this change to the effective GILTI rate may encourage taxpayers to accelerate gain recognition transactions and/or defer deductions.

In addition, the Greenbook proposes that U.S. shareholders of a controlled foreign corporation ("CFC") calculate their global minimum tax on a country-by-country basis. In other words, a U.S. shareholder's global minimum tax inclusion, and tax on such inclusion, would be determined separately for each country in which it or its CFCs operate, rather than permitting taxes paid to higher-taxed jurisdictions to reduce the residual U.S. tax paid on income earned in lower-taxed foreign jurisdictions. This proposed change

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results in a separate foreign tax credit limitation for each country.

The Greenbook does not suggest any changes to the 80 percent limitation that currently applies to GILTI foreign tax credits. If the 80 percent limitation still exists, GILTI will be exempt from further U.S. tax only if it is subject to foreign taxation at a rate of at least 26.25 percent, since 20 percent (or 5.25) of the foreign tax credit is disallowed under current law.

Finally, this proposal would also repeal the high tax exemption to subpart F income and repeal the cross-reference to that provision in the global minimum tax rules in Code section 951A. This proposal would end the controversy over the Treasury Regulations that provided a high tax exemption for GILTI.

In a proposal that is remarkable for its potential deference to the OECD, these general rules would be adjusted for foreign-parented multinational groups (consistent with the OECD/G20 Inclusive Framework on BEPS project's Pillar Two proposal (the "Pillar Two")).

These rules would be effective for taxable years beginning after December 31, 2021.

Expanded Application of Anti-Inversion Rules

To backstop the changes to the global minimum tax regime and prevent U.S. companies from moving offshore to avoid the global minimum tax, the Greenbook proposes a dramatic expansion of the anti-inversion regime under Code section 7874. Code section 7874 currently applies to the acquisition of a U.S. corporation by a foreign corporation if, after the transaction, the former shareholders of the U.S. corporation own more than 80 percent, by vote or value, of the foreign corporation and certain other conditions are satisfied. In this case, Code section 7874 applies to treat the foreign acquiring corporation as a domestic corporation for U.S. federal income tax purposes, assuming certain other conditions are satisfied. If the portion of the foreign corporation held by former shareholders of the U.S. corporation (the so-called ownership fraction) is between 60 and 80 percent, current law subjects the foreign corporation to the possibility of increased taxation, but does not treat it as a domestic taxpayer.

The Greenbook proposal would replace the current 80-percent threshold with a 50-percent threshold and would eliminate the current 60-percent test entirely. In addition, the proposal would expand the universe of acquisitions treated as inversions (regardless of ownership fraction) to include acquisitions where (1) immediately prior to the acquisition, the fair market value of the domestic entity is greater than the fair market value of the foreign acquiring corporation, (2) after the acquisition, the expanded affiliated group is primarily managed and controlled in the United States, and (3) the expanded affiliated group does not conduct substantial business activities in the country in which the foreign acquiring corporation is created or organized. The proposal would also broaden Code section 7874 in several important ways, by including certain asset acquisitions and stock distributions, picking up U.S. businesses operated by foreign partnerships, and by considering the spinoff of a foreign subsidiary the equivalent of an inversion under certain circumstances.

Code section 7874 is already exceedingly complex and broad in many respects and is thus a frequent trap for the unwary. These proposals, if enacted, will require careful scrutiny by taxpayers and practitioners to avoid dangerous foot faults. Introduction of the management and control and substantial business activities tests, in particular, would add a new level of subjectivity and uncertainty to the threshold question of whether the rules apply.

These rules would be effective for transactions that are completed after the date of enactment of such rules. The lack of an exception for transactions for which there is a binding contract as of the effective date could chill market activity even before passage.

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Repeal of Deduction for Foreign-Derived Intangible Income

The Greenbook proposes the repeal of the deduction currently available to domestic corporations with respect to 37.5 percent of any foreign-derived intangible income for taxable years beginning after December 31, 2021. This proposal was expected, and is framed by the Greenbook as the elimination of an inefficient subsidy to multinational corporations. Additionally, many commentators viewed the existing provision as violating World Trade Organization principles. The increased tax revenue that is estimated to come from repeal would be "used to encourage R&D" (presumably in the United States), although no details are provided on how the $123 billion would be deployed.

Replace BEAT with Stopping Harmful Inversions and Ending Low-Tax Developments (SHIELD) Rule

The Greenbook would replace the "base erosion and anti-abuse tax" ("BEAT") in Code section 59A with a new rule—the Stopping Harmful Inversions and Ending Low-Tax Developments ("SHIELD") rule—disallowing deductions by domestic corporations with respect to members in their financial reporting group whose income is subject to (or deemed to be subject to) an effective tax rate that is below either the rate agreed to under OECD Pillar Two or the U.S. global minimum tax rate of 21 percent. Disallowance may be complete or partial, depending on whether the payment is made directly to such low-taxed entities.

The rule would apply to financial reporting groups with greater than $500 million in global annual revenues, although the proposal permits the Treasury Department to exempt from SHIELD (i) certain financial reporting groups, if they meet a minimum effective level of tax (on a jurisdiction-by-jurisdiction basis) and (ii) payments to investment funds, pension funds, international organizations, or non-profit entities. It is unclear whether the exemption would extend to investors that rely on the Code section 892 exemption. As discussed above in connection with the proposed minimum tax on book earnings, the link to financial statement reporting would mark another notable shift to reliance on third-party standards for determining U.S. income tax liability.

This proposal could adversely impact entities that have already "inverted," or foreign-parented entities with domestic subsidiaries (and which conduct significant business in the United States). Foreign-parented entities that have substantial offshore intellectual property held in lower-tax jurisdictions may be particularly affected by this proposal.

The rule would be effective for taxable years beginning after December 31, 2022.

Limit Foreign Tax Credits from Sales of Hybrid Entities

The Greenbook would require that, for purposes of applying the foreign tax credit rules, the source and character of items of certain hybrid entities resulting from either a disposition of an interest in such a hybrid entity or a change in the U.S. tax classification of such entity that is not recognized for foreign tax purposes be determined as if the recognition event were a sale or exchange of stock.

The rule would be effective for transactions occurring after the date of enactment.

Restrict Interest Deductions for Disproportionate Borrowing in the United States

This proposal potentially disallows deductions for interest paid by an entity that is a member of a multinational group that prepares consolidated financial statements. Such an entity's interest deductions would be disallowed to the extent they exceed an amount determined by reference to the entity's proportionate share (based on its proportion of group earnings) of the group's net interest expense as reported on the group's consolidated financial statement.

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Alternatively, if an entity subject to the proposal fails to substantiate its proportionate share of the group's net interest expense for financial reporting purposes, or an entity so elects, the entity's interest deduction would be limited to the entity's interest income plus ten percent of the entity's adjusted taxable income (as defined under Code section 163(j)).

The proposal would not apply to financial services entities. The proposal also would not apply to groups that would otherwise report less than $5 million of net interest expense, in the aggregate, on one or more U.S. income tax returns for a taxable year.

The proposal would be effective for taxable years beginning after December 31, 2021.

Tax Incentive for Onshoring Jobs

This proposal would create a new general business credit equal to 10 percent of certain expenses paid or incurred in connection with moving a trade or business located outside the United States to the United States to the extent the action results in an increase in U.S. jobs.

The proposal would also reduce tax benefits associated with U.S. companies moving jobs outside of the United States by disallowing deductions for certain expenses paid or incurred in connection with offshoring a U.S. trade or business to the extent the action results in a loss of U.S. jobs.

The proposal would be effective for expenses paid or incurred after the date of enactment.

Expand Taxation of Foreign Fossil Fuel Income

Under current law, certain non-U.S. oil-and-gas-related income effectively is taxed at a lower rate than similar oil-and-gas-related income from activities within the United States. For example, "foreign oil and gas extraction income" is excluded from a controlled foreign corporation's "gross tested income" and may be repatriated tax free. In addition, taxpayers may claim a credit against U.S. income tax liability for certain levies paid to non-U.S. governments.

The Greenbook proposes scaling back the beneficial tax treatment afforded to non-U.S. oil-and-gas-related income. Specifically, the proposal would require foreign oil-and-gas-extraction income to be included in a CFC's gross tested income for purposes of GILTI and would limit the situations in which taxpayers can claim a credit for levies paid to non-U.S. governments.

The proposal would be effective for taxable years beginning after December 31, 2021.

PART IV: CHANGES TO PRIORITIZE CLEAN ENERGY

Extension of Tax Credits for Wind, Solar and Other Renewable Generation Facilities

The production tax credit ("PTC") and investment tax credit ("ITC") are long-standing renewable energy incentives. The PTC is a production-based incentive, available as power produced from qualifying renewable resources (*e.g.*, wind, solar) is sold to unrelated parties. The ITC is a cost-based incentive, determined as a percentage of eligible basis, that arises when a qualifying renewable energy facility is placed in service. The credits have historically been subject to a complicated patchwork of rules for different resources (*e.g.*, when construction of a facility needs to begin, when the facility must be placed in service, etc.), the qualification rules have changed frequently and often unpredictably, and the credits have been non-refundable. Taken together, these features have presented challenges in the development and financing of renewable energy projects.

The Greenbook proposes a long-term extension of the rules, with the full PTC and ITC

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both being available for facilities whose construction begins after December 31, 2021 and before January 1, 2027, followed by a predictable, stepped phase-down period. Moreover, unlike the current PTC and ITC, taxpayers would have the option to elect a cash payment in lieu of the tax credits (the so-called "direct pay" option).

If enacted, these proposals would bring greater predictability to project developers and, through the direct pay option, make it meaningfully easier for taxpayers lacking sufficient tax "appetite" to efficiently participate in renewables transactions, spurring additional investment in renewable energy generation facilities. While not described in detail, this "direct pay" option would appear to effectively make the credits refundable, meaning that funding is available irrespective of whether the taxpayer has positive income tax liability. Although this could reduce the incentive to use partnership structures to utilize the credits, it would also add a new level of complexity to their administration and raise concerns from the IRS about the potential for abuse.

The proposal would be effective for taxable years beginning after December 31, 2021.

Expansion of Tax Credits to Stand-Alone Energy Storage and Energy Transmission Assets

Historically, energy storage assets (such as battery storage projects) have been eligible for the ITC only when paired with certain renewable energy resources, and the ITC has been unavailable with respect to energy transmission property. The Greenbook proposes to make certain stand-alone energy storage assets and energy transmission infrastructure assets eligible for the ITC. Moreover, as with the generation facility credit, taxpayers would be eligible to elect a cash payment in lieu of tax credits.

We expect that these proposals to increase the scope of ITC-eligible assets will provide strong incentives for investment in infrastructure designed to make the nation's electric grid more reliable and resilient.

The proposal would be effective for taxable years beginning after December 31, 2021.

New Tax Credits for Qualifying Advanced Energy Manufacturing

Existing law authorizes a tax credit for the establishment of certain clean energy manufacturing facilities (*e.g.*, facility to manufacture wind or solar equipment), but the amount of the credit is subject to a relatively low cap, which makes the incentive unavailable to certain otherwise-qualifying credit applicants. The Greenbook would expand the availability of the credit to include various new manufacturing facilities (including those focused on energy storage equipment, electric grid modernization equipment, energy conservation technology, and carbon oxide sequestration equipment) and significantly expand the cap, with a material portion of the credit being specifically allocable to projects in coal communities. Again, taxpayers would be eligible to elect a cash payment in lieu of tax credits. Taken together, the proposal intends to spur the production of domestic manufacturing of clean energy property.

The proposal would be effective for taxable years beginning after December 31, 2021.

Eliminate Fossil Fuel Tax Preferences

Current law provides a number of tax incentives meant to encourage oil and gas production. These incentives were targeted for repeal under the Obama Administration's Greenbook in each year beginning with the 2011 fiscal year. The Biden Administration's fiscal year 2022 Greenbook picks up where the Obama Administration left off, proposing to repeal a nearly identical set of fossil fuel-related tax incentives. Specifically, the Greenbook proposes repealing: (1) the enhanced oil recovery credit for eligible costs attributable to a qualified enhanced oil recovery project; (2) the credit for oil and gas produced from marginal wells; (3) the expensing of intangible drilling costs; (4) the

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deduction for costs paid or incurred for any tertiary injectant used as part of a tertiary recovery method; (5) the exception to passive loss limitations provided to working interests in oil and natural gas properties; (6) the use of percentage depletion with respect to oil and gas wells; (7) two-year amortization of independent producers' geological and geophysical expenditures, instead allowing amortization over the seven-year period used by integrated oil and gas producers; (8) expensing of exploration and development costs; (9) percentage depletion for hard mineral fossil fuels; (10) capital gains treatment for royalties; (11) the exemption from the corporate income tax for publicly traded partnerships with qualifying income and gains from activities relating to fossil fuels; (12) the Oil Spill Liability Trust Fund excise tax exemption for crude oil derived from bitumen and kerogen-rich rock; and (13) accelerated amortization for air pollution control facilities.

If enacted, the repeal of these incentives would make the production of oil and gas costlier by increasing producers' effective tax rate. That said, some of these incentives, like the intangible drilling cost deduction, predate the Internal Revenue Code itself and have survived numerous political cycles. Efforts to repeal a nearly identical set of incentives proved difficult for the Obama Administration, even where the revenue generated from repeal was projected to be higher during the Obama Administration.

The proposal generally would be effective for taxable years beginning after December 31, 2021, although the repeal of item 11 above (exception for certain publicly traded partnerships) will only become effective for taxable years beginning after December 31, 2026.

Expand and Enhance the Carbon Oxide Sequestration Credit

Current law provides a tax credit for the capture and sequestration of certain types of carbon oxide captured with carbon-capture equipment placed in service at certain qualifying facilities, with the amount of the credit dependent on when and how the carbon oxide is sequestered.

The Greenbook proposes increasing the value of the sequestration credit by (i) $35 dollars per metric ton for carbon oxide that is more difficult to capture, such as carbon oxide from cement production, steelmaking, or hydrogen production, and (ii) $70 per metric ton for direct air carbon capture projects. Further, the "begin construction" date for qualifying facilities eligible for the credit would be extended five years to January 1, 2031. As is the case for the Greenbook's other clean energy proposals, taxpayers could elect to receive a direct cash payment in lieu of the credits. The enhanced credits, together with the begin construction date extension and the direct pay option, should spur investment in carbon capture facilities and technologies.

The proposal would be effective for taxable years beginning after December 31, 2021.

Other Clean Energy Proposals

- Establish Tax Credits for Heavy- and Medium-Duty Zero Emissions Vehicles
- Provide Tax Incentives for Sustainable Aviation Fuel
- Provide a Production Tax Credit for Low-Carbon Hydrogen
- Extend and Enhance Energy Efficiency and Electrification Incentives
- Provide Disaster Mitigation Tax Credit
- Extend and Enhance the Electric Vehicle Charging Station Credit
- Reinstate Superfund Excise Taxes and Modify Oil Spill Liability Trust Fund Financing

PART V: IMPROVE COMPLIANCE AND TAX ADMINISTRATION

The Administration has been vocal in recent months in calling for an increase in IRS funding to reverse more than a decade of declining budgets and staff attrition, and to address information technology infrastructure challenges, all of which have driven

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historically low audit rates. On April 9, 2021, the Office of Management and Budget released an outline of the President's request for fiscal year 2022 discretionary spending that would provide the IRS with $13.2 billion in funding for next year alone, a $1.2 billion or 10.4 percent increase over enacted IRS funding for 2021.[3] This increase would be used in part to improve taxpayer service but a major focus of the increased funding would be on increasing taxpayer compliance with existing law, reducing the "gap" between what is paid over to Treasury in taxes each year and what is actually owed. The most recent official estimates, covering the 2011 – 2013 tax years, are that this "tax gap" is roughly $441 billion annually (reduced by existing enforcement efforts to roughly $ $281 billion), although IRS Commissioner Charles Rettig recently suggested that a more accurate number may be closer to $1 trillion.

While there are some estimates that the IRS can collect $4 in additional tax for every $1 in increased IRS funding, those estimates cover a broad range of enforcement activity and are likely skewed toward low-cost/high-return functions like automated matching of information returns, rather than audits of complex tax returns. And, in the context of those more complex returns, there is considerably more uncertainty around what tax is actually owed, given ambiguities in the underlying law. Moreover, according to the IRS's own estimates, over time the voluntary compliance rate has remained remarkably constant at just under 85 percent, even during periods of significantly declining budgets and enforcement activity, raising the question as to whether a material increase in IRS funding will translate into the expected increase in compliance.

Introduce Comprehensive Financial Account Reporting to Improve Tax Compliance

Recognizing that increased funding for the IRS alone will not be sufficient to make the necessary dent in the tax gap, the Greenbook includes several proposals that would equip the IRS with better information to address noncompliance with existing tax laws. The premise for these proposals is that third-party reporting can increase voluntary compliance rates from below 50 percent to as high as 95 percent. From that premise, the Administration proposes to create a "comprehensive financial account reporting regime," that would require financial institutions to report gross transfers into and out of accounts, including accounts owned by the same taxpayer. This proposal is estimated to raise $8.3 billion in FY 2022 alone and, once fully implemented, to raise over $462 billion over the next 10 years. While increased information reporting will undoubtedly improve voluntary compliance, by how much is an open question. The proposed reporting regime falls several steps short of the Form W-2 reporting that ties directly into taxable income and also falls short of most existing Form 1099 reporting, which ties directly into gross income. Rather, like merchant card reporting under Code section 6050W, the comprehensive reporting regime would provide the IRS with information about fund flows that could lead to uncovering unreported taxable income (or encourage taxpayers to more accurately report taxable income to begin with) but will not do so directly. Whether this helps move compliance from under 50 percent to closer to 95 percent will depend on a number of variables, including the extent to which and how quickly financial institutions can implement a new reporting requirement and whether the IRS has the resources in place to effectively utilize the new information through deployment of artificial intelligence and comprehensive audit follow up. Successful implementation of the program will present additional challenges to the extent that, as proposed, it covers crypto assets, where a longer period of time for implementation could be needed, and unique substantive issues around transfers of "property," as the IRS has characterized cryptocurrency, are likely to be raised. Even with established financial institutions that have deep experience with reporting information to the IRS, implementation of prior information reporting regimes including broker accounts and FATCA have proven far more complicated and burdensome than first expected.

Oversight of Paid Tax Return Preparers

The Greenbook proposes to provide the Secretary with explicit authority to regulate paid tax return preparers. This proposal has been included in several pieces of introduced

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legislation and was proposed in a number of prior-year Budget requests. In the past it was met with resistance from some in the tax professional community as well as members of Congress who oppose imposing new regulatory requirements on small businesses.

The proposal would be effective for taxable years beginning after December 31, 2021.

Modifications to Partnership Audit Rules

Under the BBA Centralized Partnership Audit Regime signed into law in 2015 and generally effective for tax years beginning in 2018, partners in the "adjustment" year of a partnership's return are responsible for any tax payment obligation arising from adjustments going back to the "reporting year" return at issue. The BBA generally permits partnerships undergoing audit for certain tax years to make a "push out" election whereby the reporting year partners, and not the adjustment year partnership, become responsible for payments arising from an audit adjustment. If an adjustment reduces, instead of increases, a partner's tax liability, the partner can use the decrease to offset its tax liability in the current year, but not below zero, with any reduction in excess of its tax liability in the current year being lost. The proposed change would treat the excess as a tax overpayment, potentially allowing a refund. This proposal reflects the Administration's priority on increased enforcement for flow-through entities.

The proposal would be effective upon enactment.

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[1] The term "Bluebook" has also been used in prior administrations. Greenbook and Bluebook legislative proposals dating back to 1990 are available on the Treasury Department's website, https://home.treasury.gov/policy-issues/tax-policy/revenue-proposals. The Joint Committee on Taxation ("JCT") periodically publishes a general explanation of recently enacted tax legislation in a publication that is also known as a "Blue Book." In December 2018, JCT released a Blue Book that explains the TCJA, which can be found at https://www.jct.gov/publications/2019/jcs-2-19/.

[2] TCJA is formally titled "An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018," Pub. L. No. 115-97, 131 Stat. 2045.

[3] https://www.whitehouse.gov/wp-content/uploads/2021/04/FY2022-Discretionary-Request.pdf.

This alert was prepared by Jennifer Sabin, John-Paul Vojtisek, Dora Arash, Michael D. Bopp, James Chenoweth, Michael J. Desmond, Pamela Lawrence Endreny, Roscoe Jones, Jr., Kathryn Kelly, Brian W. Kniesly, David Sinak, Eric Sloan, Jeffrey M. Trinklein, Edward Wei, Lorna Wilson, Daniel A. Zygielbaum, Michael Cannon, Jennifer Fitzgerald, Evan M. Gusler, Brian Hamano, James Jennings, James Manzione and Collin Metcalf.

Gibson Dunn lawyers are available to assist in addressing any questions you may have regarding these developments. Please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Tax or Public Policy practice groups, or the following authors:

Jennifer Sabin – New York (+1 212-351-5208, jsabin@gibsondunn.com)
John-Paul Vojtisek – New York (+1 212-351-2320, jvojtisek@gibsondunn.com)
Dora Arash – Los Angeles (+1 213-229-7134, darash@gibsondunn.com)
James Chenoweth – Houston (+1 346-718-6718, jchenoweth@gibsondunn.com)
Michael J. Desmond – Los Angeles/Washington, D.C. (+1 213-229-7531, mdesmond@gibsondunn.com)

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Pamela Lawrence Endreny – New York (+1 212-351-2474, pendreny@gibsondunn.com)
Kathryn A. Kelly – New York (+1 212-351-3876, kkelly@gibsondunn.com)
Brian W. Kniesly – New York (+1 212-351-2379, bkniesly@gibsondunn.com)
David Sinak – Dallas (+1 214-698-3107, dsinak@gibsondunn.com)
Eric B. Sloan – Co-Chair, New York (+1 212-351-2340, esloan@gibsondunn.com)
Jeffrey M. Trinklein – London/New York (+44 (0) 20 7071 4224 /+1 212-351-2344), jtrinklein@gibsondunn.com)
Edward S. Wei – New York (+1 212-351-3925, ewei@gibsondunn.com)
Lorna Wilson – Los Angeles (+1 213-229-7547, lwilson@gibsondunn.com)
Daniel A. Zygielbaum – Washington, D.C. (+1 202-887-3768, dzygielbaum@gibsondunn.com)

Public Policy Group:
Michael D. Bopp – Washington, D.C. (+1 202-955-8256, mbopp@gibsondunn.com)
Roscoe Jones, Jr. – Washington, D.C. (+1 202-887-3530, rjones@gibsondunn.com)

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