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News

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Ways and Means Budget Reconciliation Recommendations, Subtitle I: Summary and Analysis

On Monday, Sept. 13, House Ways and Means Committee Chair Richard Neal (D-MA) introduced the final portion of the committee's budget reconciliation recommendations. This alert provides a comprehensive summary and analysis of these provisions.

Overview

The latest section—Subtitle I, Responsibly Funding Our Priorities—contains tax increases on high-income individuals, corporate and international companies and funding to increase Internal Revenue Service enforcement, among other provisions. In addition to a **section-by-section summary**, the **full text can be found here**.

The tax code changes under this section would raise federal revenues to offset spending proposed by the rest of the budget reconciliation package. When it released the legislation, the Ways and Means Committee estimated that the bill contains $2.9 trillion in revenue raisers and $600 billion in economic growth. Together, Ways and Means Democrats claim the plan would fully offset the $3.5 trillion package, should Democrats elect to include that much spending.

Shortly after the committee released the text, however, the Joint Committee on Taxation (JCT) published an **updated revenue estimate** for the package that found it would generate $2.1 trillion over 10 years. The estimate changed to $871 billion in net new revenue when taking tax incentives into account, according to JCT.

Review

The Ways and Means Committee began its budget reconciliation markup on Thursday, Sept. 9. Since then, it has approved the following Subtitles as of this writing:

- Subtitle A: **Universal Paid Family and Medical Leave** (***Brownstein analysis***)
- Subtitle B: **Retirement** (***Brownstein analysis***)
- Subtitle C: **Child Care Access and Equity**
- Subtitle D: **Trade Adjustment Assistance**
- Subtitle D: Elder Care (**Pathways to Health Careers**, **Elder Justice**, **Skilled Nursing Facilities and Medicare Dental, Hearing, and Vision Coverage**)

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The Ways and Means Committee continued its markup on Tuesday, Sept. 13, when it resumed consideration of the following Subtitles:

- Subtitle F: **Infrastructure Financing**
- Subtitle G: **Green Energy**
- Subtitle H: **Social Safety Net**
- Subtitle I: **Responsibly Funding Our Priorities**
- Subtitle J: **Prescription Drugs**

The Brownstein Tax Policy Team has **analyzed these Subtitles, with the exception of Subtitle I, here**.

Next Steps

The Ways and Means Committee is expected to conclude its marathon markup on Wednesday, Sept. 15. Once the House Ways and Means Committee and the other House committees approve their respective budget recommendations, which House Democratic leaders have requested be completed by Sept. 15, the entire package will be compiled by the House Budget Committee and then sent to the House Rules Committee for the debate process for House floor consideration.

PART 1 – CORPORATE AND INTERNATIONAL TAX REFORMS

SUBPART A – CORPORATE TAX RATE

Section 138101. Increase in Corporate Tax Rate.

- Replaces the flat corporate income tax with the following three-step graduated rate structure:
    - Taxable income not over $400,000 will be taxed at an 18% rate
    - Taxable income over $400,000 but not over $5 million will be taxed at a 21% rate
    - Taxable incomes over $5 million will be taxed at a 26.5% rate
- An additional 3% tax is imposed on a corporation's taxable income in excess of $10 million. The maximum additional tax is $287,000. This essentially claws back the tax savings that result from the lower tax brackets, effectively reducing the benefit of the graduated rate.
- Certain personal services corporations (PSCs), as defined in section 448(d)(2), will not be eligible for the graduated rates and will be taxed at a rate of 26.5%.
- Makes a proportional adjustment to the dividend received deduction rate from 50% to 60%. For 20%-owned corporations, adjusts the dividends received deduction rate to 72.5%.
- Makes conforming changes to section 1561, the limitation on accumulated earnings credit in the case of certain controlled corporations.
- Special normalization rules apply to regulated utilities.
- Effective for taxable years beginning after Dec. 31, 2021.
- Impact: Significantly Increases the corporate income tax rate for corporations with over $5 million in taxable income. For many sectors of the economy still recovering from COVID-19, this could result in a substantial reduction in cash available for investment.

SUBPART B – INTEREST EXPENSE OF INTERNATIONAL FINANCIAL REPORTING GROUPS

Section 138111. Limitations on Deduction for Interest Expense.

- Limits the deductibility of interest of a domestic corporation that is a member of an international financial reporting group (IFRG) to 110% of the domestic corporation's allocable share of the IFRG's net interest expense.

- Limitation does not apply to certain small businesses, S corporations, real estate investment trusts or regulated investment companies.
- The domestic corporation's allocable share of the IFRG's reported net interest expense is based on the domestic corporation's allocable share of the IFRG's net interest expense, which is determined according to a ratio of the domestic corporation's earnings before net interest expense, tax expense, depreciation, depletion and amortization (EBITDA) to the IFRG's EBITDA for the reporting year.
- Disallowed interest paid or accrued in a taxable year beginning after Dec. 31, 2021, can be carried forward for five years and is allowed as a deduction on a first-in, first-out basis.
- Impact: The provision adds additional complexity to the calculation of interest expense and may further restrict a U.S. multinational's ability to deduct its interest expenses.

SUBPART C – OUTBOUND INTERNATIONAL PROVISIONS

Section 138121. Modifications to Deduction for Foreign-Derived Intangible Income and Global Intangible Low-Taxed Income.

- Increases the tax rate on Global Intangible Low-Taxed Income (GILTI) effectively to 16.5625%—the provision reduces the section 250 deduction with respect to GILTI from 50% to 37.5%, which results in the increased tax rate when coupled with the overall increase in the corporate rate to 26.5% (*see section 138101*).
- Increases the tax rate on Foreign-Derived Intangible Income to 20.78%—the provision reduces the section 250 deduction with respect to FDII from 50% to 21.875%, which results in the increased rate when coupled with the overall increase in the corporate rate to 26.5% (*see section 138101*)).
- Allows excess section 250 deductions relating to GILTI and FDII to become net operating losses and be taken into account in future years.
- Applies to taxable years beginning after Dec. 31, 2021, with a proportional transition rule for fiscal years straddling the calendar year.
- Impact: Increases the United States' global minimum tax (in excess of the 15% rate proposed by the Organisation for Economic Co-operation and Development (OECD) on the foreign operations of U.S. companies and decreases the FDII incentive for U.S. production activities by increasing the rate from the current 13.125% to 21.875%.

Section 138122. Repeal of Election for 1-Month Deferral in Determination of Taxable Year of Specified Foreign Corporations.

- Repeals the provision that allowed a specified foreign corporation to elect a taxable year beginning one month earlier than the majority U.S. shareholder.
- Applies to tax years of specified foreign corporations beginning after Nov. 30, 2021. A transition provides that a taxpayer's first tax year beginning after Nov. 30, 2021, shall end either with the year of the majority U.S. shareholder or, if there is not a majority U.S. shareholder, the year provided under regulations.
- Impact: This, along with all the changes to the international tax rules, would further tighten rules that apply to U.S. multinational corporations.

Section 138123. Modifications of Foreign Tax Credit (FTC) Rules Applicable to Certain Taxpayers Receiving Specific Economic Benefits.

- Modifies the FTC rules with respect to dual-capacity taxpayers, which generally are U.S. companies that are subject to levy/tax in a foreign country or U.S. possession but also receive certain tax benefits.
- Limits the FTCs of dual-capacity taxpayers to the amount of tax that the corporation would have paid to the foreign country or possession if it were not a dual-capacity taxpayer.
- Applies generally to taxable years beginning after Dec. 31, 2021.

- Impact: Limits the FTCs and increases U.S. tax on companies in the extractive and gaming industries where they pay country-specific levies/taxes on their foreign income that are separate from, or in addition to, a generally applicable income tax.

Section 138124. Modifications to Foreign Tax Credit Limitations.

- Imposes a country-by-country regime on the determination of FTC, which prevents the cross-crediting of high- and low-tax FTCs to reduce overall foreign income. The country-by-country rules are applied based on the "taxable units" of a U.S. taxpayer that are tax residents of the same foreign country.
- Applies the country-by-country regime to the separate foreign income basket for GILTI, passive and general income. The proposal repeals the current branch basket. As a result, foreign branch income will tier up to the legal entity of which it is a branch.
- Modifies the expense allocation rules so that for purposes of determining GILTI, deductions for interest, stewardship and research and development expenses do not have to be allocated to foreign source income and thus do not affect the taxpayer's FTC limitation.
- Applies the country-by-country regime to separate loss limitations and provides a separate loss rule to income in the GILTI FTC limitation category.
- Repeals the carryback of excess FTC and limits the carryforward of FTC to five years, rather than the current 10 years.
- Repeals the rule requiring applicable U.S. corporations to determine the foreign-source income of its foreign subsidiary by disregarding certain tax-exempt dividends.
- Applies the principles of section 338(h)(16) in determining the source and character of a "covered asset acquisition" for purposes of the FTC rules.
- Modifies the rules applicable to redeterminations of credit or deductions for foreign taxes paid.
- Applies to taxable years beginning after Dec. 31, 2021, and with respect to the modifications to the carryback or carryforward of FTC, it applies to taxes paid in taxable years beginning after Dec. 31, 2021.
- Impact: Imposes a country-by-country regime that will create significant compliance burdens and costs, while limiting a U.S. company's ability to cross-credit taxes across the aggregate of its foreign income relating to the GILTI, passive and general income categories.

Section 138125. Foreign Oil Related Income to Include Oil Shale and Tar Sands.

- Expands the definition of foreign related income for purposes of the FTC rules to include oil shale and tar sands in addition to the current oil and gas wells.
- Applies generally to taxable years beginning after Dec. 31, 2021.
- Impact: Expands the base of foreign oil related income subject to U.S. taxation.

Section 138126. Modifications to Inclusion of Global Intangible Low-Taxed Income.

- Requires that GILTI be determined on a country-by-country basis. The provision uses that same "taxable unit" concept as applies to the FTC limitation provision. *(See section 138124 above)*
- Applies the same country-by-country regime to the determination of net controlled foreign corporation (CFC) tested income, net deemed intangible return, qualified business asset investment (QBAI), and other items and amounts with respect to each CFC taxable unit of a U.S. taxpayer that is a tax resident of a particular country.
- Permits excess losses with respect to a CFC tested unit in a country to be carried forward to the succeeding years.
- Reduces the deemed rate of return on QBAI from the current 10% to 5%, except in U.S. possessions where the percentage remains 10%.
- Repeals the exclusion from GILTI of foreign oil and gas extraction income (FOGEI), requiring such income to be included in the determination of tested income and loss.

- Applies generally to taxable years beginning after Dec. 31, 2021.
- Impact: Imposes a country-by-country regime on the determination of GILTI, which will create significant compliance burdens and costs. While GILTI will increase for companies with significant investments in assets, given the reduction of the deemed rate of return on QBAI, losses may be carried forward, thereby mitigating some volatility in taxable income. The provision will also increase the tax liability for oil and gas companies due to the inclusion of FOGEI under the GILTI rules.

Section 138127. Modifications to Determination of Deemed Paid Credit for Taxes Properly Attributable to Tested Income.

- Reduces the current 20% FTC haircut to 5% for purposes of determining GILTI.
- Expands the definition of tested foreign income tax under GILTI to include foreign income taxes properly attributable to amounts taken into account to determine tested income or tested loss.
- Grants the Treasury Secretary authority to expand the definition of tested foreign income tax further to include taxes paid or accrued by a foreign corporation (other than a CFC) that owns, directly or indirectly, 80% or more of a U.S. corporation, provided certain conditions are met.
- Applies generally to taxable years beginning after Dec. 31, 2021.
- Impact: Reduces the tax penalty with respect to foreign taxes taken into account in determining a U.S. corporation's GILTI tax liability.

Section 138128. Deduction for Foreign Source Portion of Dividends Limited to Controlled Foreign Corporations, Etc.

- Amends section 245A to limit the deduction for dividends received for the foreign source portion of dividends only to dividends received from a controlled foreign corporation (i.e., a foreign corporation with more than 50% of its ownership interest held by a corporation). Current law allows a dividends-received reduction for the foreign-source portion of dividends received by a corporation that owns 10% or more of the foreign corporation.
- Restores the attribution rule under section 958(b)(4), which was repealed in TCJA, and provides a limitation rule in new section 951B for downward attribution from a foreign person in certain instances.
- Applies to dividend distributions after date of enactment. The attribution rules generally apply after 2017.
- Impact: Increases the U.S. tax liability of U.S. corporations that own between 10% and 50% of a foreign corporation.

Section 138129. Limitation on Foreign Base Company Sales and Services Income.

- Limits foreign based company sales income and foreign based company services income to residents of the United States and pass-through entities and branches in the United States (i.e., a taxable unit that is a U.S. resident).
- Subjects a U.S. shareholder to tax on its pro-rata share of the controlled foreign corporation's income if it owns the controlled foreign corporation's stock for any day during the taxable year.
- Applies generally to taxable years beginning after Dec. 31, 2021, with certain modifications applying after 2017.
- Impact: Increases the number of U.S. taxpayers that have Subpart F inclusions.

SUBPART D – INBOUND INTERNATIONAL PROVISIONS

Section 138131: Modifications to Base Erosion and Anti-Abuse Tax (BEAT).

- Accelerates the scheduled increase in the BEAT rate so the 12.5% rate applies in 2024 and 2025.
- Increases the BEAT tax rate to 15% in 2026.
- Excludes outbound payments to a related foreign party that are subject to U.S. taxation.

- Excludes as base erosion payments amounts paid to a related foreign party that are subject to an effective foreign rate of tax that is not less than the BEAT tax rate then in effect.
- Permits general business tax credits and net operating losses (as adjusted) to reduce BEAT liability.
- Base erosion payments to acquire inventory exclude the direct cost incurred by the foreign related party, with an alternative 20% safe harbor.
- Effective in 2024, the base erosion percentage (i.e., the 3% generally and 2% for banks and securities dealers) will be repealed.
- Impact: Acceleration of the BEAT tax rate, repeal of the application threshold and inclusion on inventory markups will increase the number of taxpayers that are subject to BEAT. However, the exclusion of base erosion payments that are subject to U.S. tax or a sufficient tax in the foreign jurisdiction will likely provide relief for many taxpayers currently subject to BEAT. In addition, the changes suggest the BEAT will act more like a top-up tax (similar to the under-taxed payment rule in the OECD's Pillar 2).

SUBPART E – OTHER BUSINESS TAX PROVISIONS

Section 138141. Credit for Clinical Testing of Orphan Drugs Limited to First Use or Indication.

- Limits the credit for qualified clinical testing expenses to expenses related to the first use or indication for an orphan drug under section 526 of the Federal Food, Drug and Cosmetic Act, or if the drug is a biologic, the first date that a license is first issued.
- Clarifies that clinical testing expenses for a drug that has already received a marketing approval for other uses or indications, will not qualify toward the credit.
- Effective beginning after Dec. 31, 2021.
- Impact: Limits the use of qualified clinical testing expenses for drugs used to treat rare diseases to those involving the first use or indication.

Section 138142. Modifications to Treatment of Certain Losses.

- Amends section 165(g) to provide that losses with respect to securities are treated as realized on the day worthlessness is established (instead of the last day of the taxable year).
- Expands the rules relating to worthless securities to include certain securities issued by partnerships (bonds, debentures, notes or certificates, or other forms of indebtedness with interest coupons or in registered form), and treats a loss on a worthless partnership interest as a sale or exchange of a partnership interest.
- Defers losses in complete taxable liquidations of corporate subsidiaries when the corporations are members of the same controlled group. No loss may be recognized by the distributee corporation (with respect to the stock of the distributing corporation received in the liquidation) until the distributee corporation disposes of substantially all of the properties received in the liquidation to an unrelated third party.
- The partnership provisions apply to taxable years beginning after Dec. 31, 2021. The liquidation provisions apply to transactions on and after the effective date of the bill.
- Impact: This provision accelerates the timing of the loss resulting from a worthless security, provides capital treatment (subject to section 751) for worthless partnership interests, and delays loss recognition of taxable liquidations of corporate subsidiaries until the liquidated property is sold to a third party.

Section 138143. Adjusted Basis Limitation for Divisive Reorganization.

- The provision amends section 361(b) to provide that a distributing corporation recognizes gain in a divisive reorganization under sections 368(a)(1)(D) and 355 to the extent the amount of debt securities received by the distributing corporation and transferred to its creditors in connection with the reorganization exceeds the aggregate adjusted basis of the assets transferred, as reduced by the total amount of (1) liabilities of the

distributing corporation assumed by the controlled corporation, and (2) money and fair market value of other property received by the distributing corporation from the controlled corporation.
- The provision applies to reorganizations occurring on or after the date of enactment.
- Impact: This provision limits the amount of debt securities of the controlled corporation that the distributing corporation may transfer to its creditors without gain recognition.

Section 138144. Rents from Prison Facilities Not Treated as Qualified Income for Purposes of the REIT Income Tests.
- Excludes from qualifying REIT income any amounts received or accrued, directly or indirectly, with respect to any real or personal property that is primarily used in connection with any correctional, detention or penal facility.
- Applies to taxable years beginning after Dec. 31, 2021.
- Impact: Effectively precludes REITs from owning private prisons.

Section 138145. Modifications to Exemption for Portfolio Interest.
- Amends definition of 10% shareholder to include, in the case of an obligation issued by a corporation, any person who owns 10% or more of the total value of the stock of such corporation.
- Applies to obligations issued after the date of enactment.
- Impact: Expands interest payments to nonresident alien individual shareholders that are subject to withholding tax by requiring the shareholder to own less than 10% of the stock, measured by vote and value, in order to qualify for the portfolio interest exemption.

Section 138146. Certain Partnership Interest Derivatives.
- Expands the 30% tax on nonresident alien individuals to include any payment made pursuant to a sale-repurchase transaction, or a specified notional principal contract that is determined by reference to income or gain in respect of an interest in a specified partnership.
- A specified partnership is any publicly traded partnership or any other partnership identified by the Treasury Department.
- This provision does not apply to any contract or transaction that the Treasury Department determines does not have the potential for tax avoidance.
- Amends the withholding rules for nonresident aliens to include gain resulting from this new provision.
- Applies to payments made on or after the day that is 180 days after enactment.
- Impact: Prevents nonresident aliens from using partnerships to avoid tax and withholding on dividend equivalent payments.

Section 138147. Adjustments to Earnings and Profits of Controlled Foreign Corporations.
- Aligns the general rule for determining the earnings and profits (E&P) applicable to controlled foreign corporations (CFC) with the rules for purposes of determining its Subpart F inclusion. Specifically, the E&P of a CFC is determined without regard to the LIFO inventory adjustments, installment sales and the completed contract method of accounting
- Applies generally to taxable years beginning after Dec. 31, 2021.
- Impact: Requires the E&P of a CFC generally to follow the income-tax treatment for domestic corporations.

Section 138148. Certain Dividends from Controlled Foreign Corporations to United States Shareholders Treated as Extraordinary Dividends.
- Treats dividends received from a controlled foreign corporation that are attributable to earnings before the shareholder owned the foreign corporation or attributable to periods before the payor was a controlled foreign corporation as extraordinary dividends. To the extent it is nontaxable, the extraordinary dividend may reduce the shareholder's basis in the foreign corporation.

- Applies to distributions made after the date of enactments.
- Impact: Provides a potentially favorable rule for taxpayers that receive dividends that reflect earnings attributable to periods prior to the shareholder's ownership of the corporation.

Section 138149. Modification of Partnership Interests Held in Connection with the Performance of Services.

- Modifies the definition of net applicable partnership gain (which is treated as short-term capital gain). Net applicable partnership gain is gains and losses with respect to an applicable partnership interest, and any other amount treated as capital gain or subject to tax at the rate applicable to capital gain.
- Extends the holding period from three to five years. This is measured from the latest date on which (1) the taxpayer acquires all the applicable partnership interests or (2) the partnership has acquired substantially all of the assets held by the partnership.
- Continues to apply a three-year holding period to: (1) taxpayers with an adjusted gross income of less than $400,000 and (2) any income with respect to a real property trade or business. A real property trade or business is any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing or brokerage trade or business.
- Modifies the definition of an applicable partnership to provide that:
    - An employee of an unrelated entity that provides services to an applicable trade or business that holds a partnership interest in the applicable trade or business is covered by the provision.
    - Except as provided by the Treasury Department, a specified asset includes an interest in a partnership if that partnership has an interest in a specified asset (such as securities or commodities).
    - Provides the Treasury Department additional flexibility to determine what an applicable partnership interest does not include.
- Provides that gain shall be recognized on the transfer of an applicable partnership interest notwithstanding any other provision of this subtitle.
- Provides additional authority to the Treasury Department to issue guidance dealing with the avoidance of the provision and to apply the section to financial instruments, contracts or interests in entities other than partnerships to carry out the provision.
- Applies to tax years beginning after Dec. 31, 2021.
- Impact: The significant modifications, including the longer holding period, the inclusion of real property trade or businesses, and the additional authority, substantially expand the provision. Additionally, the provision applies to 1231 gain. This is likely to affect more taxpayers and result in changes to partnerships that use "carried interests."

Section 138150. Limitation on Certain Special Rules for Section 1202 Gains.

- Amends section 1202(a) to limit the 75% and 100% exclusion rates for gains realized from certain qualified small business stock to taxpayers with adjusted gross income of less than $400,000 that are not trusts or estates. The 75% and 100% exclusion also does not apply to trusts or estates.
- Applies to sales and exchanges on or after Sept. 13, 2021, unless the sale or exchange is made pursuant to a written binding contract that was in effect on Sept. 12, 2021, and is not materially modified thereafter.
- Impact: For any 1202 stock acquired after Feb. 17, 2009, taxpayers with adjusted gross income equal to or greater than $400,000, as well as all trusts and estates, may only exclude 50% of the gain.

Section 138151. Constructive Sales.

- Adds certain digital assets to the definition of appreciated financial position subject to the constructive sales rules so that a taxpayer must recognize gain as if the position with respect to the digital asset were sold, assigned or otherwise terminated at its fair market value on the date of the constructive sale.
- Applies to sales and other dispositions after Dec. 31, 2021.

- Impact: Expands constructive sales rules to digital assets.

Section 138152. Rules Relating to Common Control.

- Provides that for purposes of the aggregation rules of section 52(b) that treats all employees of trades or businesses that are under common control as employed by a single employer, a trade or business includes any activity treated as a trade or business under section 469(c)(5) (activity involving research or experimentation) or 469(c)(6) (certain investment activity).
- Applies to taxable years beginning after Dec. 31, 2021.
- Impact: This provides clarity that certain activities are treated as trades or businesses subject to the aggregation rules of section 52(b).

Section 138153. Wash Sales.

- Expands wash sale rules to certain commodities, currencies and digital assets to taxpayers (and related parties) in order to prevent taxpayers from claiming tax losses while retaining an interest in the loss asset.
- Expands wash sale rules to acquisition of substantially identical specified assets by a related party (other than the taxpayer's spouse). The basis of the substantially identical specified assets is not adjusted to include the disallowed loss and the basis of the acquired specified assets is increased by the amount of the disallowed loss.
- Provides a business needs and hedging exception for certain foreign currencies and commodities.
- Effective for taxable years beginning after Dec. 31, 2021.
- Impact: Expands wash sales rules to digital and other assets as well as acquisition of substantially identical assets.

PART 2 – TAX INCREASES FOR HIGH-INCOME INDIVIDUALS

Section 138201. Increase in Top Marginal Individual Income Tax Rate.

- Reinstates the 39.6% rate bracket for:
  - Married individuals filing jointly with over $450,000 in taxable income
  - Heads of households with over $425,000 in taxable income
  - Unmarried individuals with over $400,000 in taxable income
  - Married individuals filing separate returns with over $225,000 in taxable income
  - Estates and trusts with over $12,500 in taxable income
- Effective for taxable years beginning after Dec. 31, 2021.
- The new rates remain effective for taxable years beginning after Dec. 31, 2025, effectively eliminating the 35% bracket starting on this date. As a result, the new rate brackets will be 10%, 15%, 25%, 28%, 33% and 39.6% starting in 2026.
- Makes adjustments in the tax tables such that inflation will not result in tax increases. Dollar amounts for the 39.6% rate bracket may not be adjusted in 2022.
- Impact: Increases the top marginal individual income tax rate for individuals earning over $400,000 and eliminates the 35% rate bracket starting in 2026. Along with limitations on the section 199A deduction, the broader application of the net investment tax, the 3% surcharge on high-income individuals and the increase in the capital gains rate, this increase in the top rate is one of several policies designed to raise significant revenue from taxpayers that make more than $400,000.

Section 138202. Increase in Capital Gains Rate for Certain High Income Individuals.

- Increases the top regular capital gains rate in section 1(h)(1)(D) from 20% to 25%. This section is effective for taxable years beginning after Sept. 13, 2021. The rates for unrecaptured section 1250 gain and collectible gain remain the same.

- Realigns the 25% capital gains rate threshold with the new 39.6% income tax rate threshold, effective for taxable years beginning after Dec. 31, 2021.
- Clarifies that rules for apportioning taxable income for the year in the event of a rate change during a taxable year (section 15) does not apply to this provision.
- Creates a transitional rule for 2021, providing that the gains and losses incurred on or before Sept. 13, 2021, are separately taken into account and net capital gain is subject to a top marginal regular capital gains rate of 20%. Gains and losses incurred after Sept. 13, 2021, are also separately taken into account and net capital gain is subject to a top marginal regular capital gains rate of 25%. A similar transition rule applies for purposes of the AMT.
- For purposes of the transition rule, if gain arises from a transaction that occurs pursuant to a written binding contract entered into on or before Sept. 13, 2021, then any capital gain recognized after Sept. 13, 2021, shall be treated as recognized prior to this date, and therefore taxed at the lower 20% regular capital gains rate. This safe harbor shall not apply if the written binding contract is modified in any material respect after Sept. 13, 2021.
- If the taxpayer has gains or losses allocated from a passthrough entity, the determination of when the gain or loss is taken into account is made at the entity level.
- <u>Impact</u>: Increases the top regular capital gains tax rate to 25%, effective immediately. Along with limitations on the section 199A deduction, the broader application of the net investment tax, the 3% surcharge on high-income individuals and the increase in the top individual rate to 39.6%, this increase in the capital gains rate is one of several policies designed to raise significant revenue from taxpayers that make more than $400,000.

Section 138203. Application of Net Investment Income Tax to Trade or Business Income of Certain High-Income Individuals.

- Applies the 3.8% Medicare tax to the greater of net investment income or specified net income derived in the ordinary course of a trade or business for the taxpayer, regardless of whether such taxpayer materially participates in the trade or business, when modified adjusted gross income is greater than $250,000 (for married individuals filing separately), $500,000 (joint filers and surviving spouses), and $400,000 (any other case).
- The 3.8% Medicare tax also applies to trusts and estates, applying at the lesser of: (1) the greater of undistributed specified net income or undistributed net investment income, or (2) the excess of adjusted gross income over the dollar amount at which the highest income tax bracket applicable to an estate or trust begins.
- Specified net income, reduced by deductions properly allocable to such income, is the sum of: (1) gross income from interest, dividends, annuities, royalties and rents, (2) other gross income from a trade or business, and (3) net gain attributable to the disposition of property.
- Wages already subject to FICA, amounts subject to SECA, and net operating losses are not considered in determining net investment income. Foreign income under sections 951, 951A, 1293 and 1296, however, is included when determining net investment income.
- Applies to taxable years beginning after Dec. 31, 2021, subject to transition rules to be provided by regulation or other guidance regarding the determination of net investment income for taxable years beginning on or before Dec. 31, 2021.
- <u>Impact</u>: Closes the loophole for certain high-income individuals with respect to the application of the 3.8% Medicare tax to net investment income.

Section 138204. Limitation on Deduction of Qualified Business Income for Certain High-Income Individuals.

- Creates a new limitation for the section 199A. Now the deduction may not exceed (i) $500,000 for joint filers or surviving spouses, (ii) $250,000 for those filing as married filing separately, (iii) $10,000 for a trust or estate or (iv) $400,000 for any other taxpayer.
- Applies to taxable years beginning after Dec. 31, 2021.

- Impact: Under the new limitations, the maximum amount of qualifying business income eligible for the deduction is $2.5 million. This could result in a significant tax increase on many pass-through business owners.

Section 138205. Limitations on Excess Business Losses of Noncorporate Taxpayers.

- Makes the section 461(l) excess business loss limitation for non-corporate taxpayers permanent.
- Modifies section 461(l)(2) to allow disallowed losses for a particular year to be carried forward to the next taxable year as part of the aggregate deductions allowed under this section for the next taxable year.
- Repeals the limitation on excess farm losses under section 461(j).
- Effective for tax years beginning after Dec. 31, 2020.
- Impact: Makes limitations on excess business losses for noncorporate taxpayers permanent.

Section 138206. Surcharge on High-Income Individuals, Estates and Trusts.

- Imposes a 3% surcharge on the modified adjusted gross income that exceeds $5 million (married filing jointly, single and head of household), $2.5 million (married filing separately) and $100,000 (estate or trust).
- Defines "modified adjusted gross income" for individuals as adjusted gross income reduced by any deduction not taken into account for investment interest. For estates and trusts, the regular rules for determining adjusted gross income apply.
- In the case of a nonresident alien, the tax only applies to the extent the individual has effectively connected income.
- The provision does not apply to a charitable remainder trust if all the remainder interests are devoted to charitable purposes.
- Applies to tax years beginning after Dec. 31, 2021.
- Impact: Creates a new income tax bracket for amounts that exceed the thresholds. Combined with an increase in the top rate to 39.6% and the expansion of the 3.8% net investment tax, this would mean a top rate of 46.4%.

Section 138207. Termination of Temporary Increase in Unified Credit.

- Terminates the temporary increase in the unified credit against estate and gift taxes, reverting the credit from the current $11,700,000 per person to its 2010 level of $5 million per individual, indexed for inflation.
- Applies to estates of decedents dying and gifts made after Dec. 31, 2021.
- Impact: Significantly reduces the unified credit years earlier that anticipated and will likely lead to substantial estate planning before the end of the year.

Section 138208. Increase in Limitation of Estate Tax Valuation Reduction for Certain Real Property Used in Farming or Other Trades or Businesses.

- Increases the special valuation reduction available for qualified real property used in a family farm or family business, which allows decedents who own real property used in a farm or business to value the property for estate tax purposes based on its actual use rather than fair market value.
- Increases the allowable reduction from $750,000 to $11,700,000.
- Applies to estates of decedents dying after Dec. 31, 2021.
- Impact: This increase is meant to limit the negative effect of the reduction in the unified credit to family farms and businesses. However, many rules apply to special valuation that often result in this option not being useful. The reduction in the unified credit, even with special valuation relief, is likely to cause significant problems for family-owned farms and businesses.

Section 138209. Certain Tax Rules Applicable to Grantor Trusts.

- Adds new rules to limit the use of grantor trusts in estate planning.
- New section 2901 pulls grantor trusts into a decedent's taxable estate when the decedent is the deemed owner of the trusts. In addition, any distribution to a beneficiary from the deemed owner's or deemed owner's spouses share would be considered a gift. Lastly, if at any time the deemed owner is no longer treated as the owner, all assets attributable to that share will be treated as a gift transfer by the deemed owner.
- New section 1062 treats sales between grantor trusts and their deemed owner as equivalent to sales between the owner and a third party.
- Both new sections apply to trusts created on or after the date of enactment and to any port of a trust established before the date of enactment that is attributable to a contribution made on or after such date.
- <u>Impact</u>: Prior new section 2901 taxpayers were able to use grantor trusts to push substantial assets out of their estate and to essentially make additional tax-free gifts to the trust by paying the trust's income taxes. New section 1062 will effectively eliminate some popular estate planning techniques, such as intentionally defective grantor trusts and asset sales to intentionally defective grantor trusts. Thus, both provisions will limit the use of grantor trusts for estate and gift planning purposes.

Section 138210. Valuation Rules for Certain Transfers of Nonbusiness Assets.

- Amends the gross estate valuation rules to provide that when a taxpayer transfers nonbusiness assets, those assets should not be afforded a valuation discount for transfer tax purposes.
- Nonbusiness assets are passive assets that are held for the production of income and not used in the active conduct of a trade or business. Exceptions are provided for assets used in hedging transactions or as working capital of a business.
- Passive assets include cash, stock in a corporation or any other equity, profits or capital interest in a partnership, real property and commodities.
- A look-through rule provides that when a passive asset consists of a 10% interest in some other entity, the rule is applied by treating the holder as holding its ratable share of the assets of that other entity directly.
- Applies to transfers after the date of enactment.
- <u>Impact</u>: This will increase the gift and estate tax costs of passing these types of assets to heirs. Along with a decrease in the unified credit, should significantly increase the potential for estate tax liability for wealthy individuals.

PART 3 – MODIFICATION OF RULES RELATING TO RETIREMENT PLANS

SUBPART A – LIMITATIONS ON HIGH-INCOME TAXPAYERS WITH LARGE RETIREMENT ACCOUNT BALANCES

Section 138301. Contribution Limit for Individual Retirement Plans of High-Income Taxpayers with Large Account Balances.

- Limit's contributions when combined defined contribution plan and IRA account balances exceed $10 million.
- Rollover contributions, inherited IRAs count toward the $10 million threshold that triggers the limit on additional IRA contributions.
- Applies to taxpayers with taxable income above $400,000 ($425,000 for head of household and $450,000 if married filing jointly).
- The contribution limit is enforced by an excise tax on contributions in excess of the limit.
- Requires IRS reporting by plan administrators for defined contribution accounts of $2.5 million or more, including reporting participant's identity and account balance.
- Effective tax years beginning after Dec. 31, 2021.

- Impact: High-income individuals would no longer be permitted to contribute to an IRA when the individual's aggregate balance in their defined contribution accounts and IRAs reaches $10 million.

Section 138302. Increase in Minimum Required Distributions for High-Income Taxpayers with Large Retirement Account Balances.

- Generally requires the excess of the high-income taxpayer's Roth balances over $20 million (2 x $10 million) to be distributed.
- Requires 50% of the excess of the account balances over $10 million to be distributed, reduced by the required distributions from the Roth balances above.
- The distributions must be made regardless of the taxpayer's age.
- The general excise tax that applies to required minimum distributions that are not timely made also applies to distributions required by this provision.
- Distributions are subject to mandatory 35% federal tax withholding.
- Additional 10% tax on early distributions does not apply to these distributions.
- Treasury Department to issue guidance allowing 2022 distributions to be spread over multiple years.
- Effective tax years beginning after Dec. 31, 2021.
- Impact: High-income individuals with Roth accounts would be required to distribute all amounts above $20 million. Fifty percent of amounts above $10 million in all defined contribution accounts and IRAs must also be distributed, less the Roth distributions. The provision would require distributions to occur as early as 2022, although the Treasury Department is authorized to extend the distribution period. Distributions from non-Roth accounts are immediately taxable at ordinary rates. For most taxpayers under age 59 1/2, the distribution of Roth account income would also be immediately taxable at ordinary rates.

SUBPART B – OTHER PROVISIONS RELATING TO INDIVIDUAL RETIREMENT ACCOUNTS

Section 138311. Tax Treatment of Rollovers to Roth IRAs and Accounts.

- No taxpayer, regardless of income level, can convert employee after-tax contributions in eligible retirement plans or traditional IRAs to a designated Roth account or a Roth IRA after 2021.
- High-income taxpayers cannot do a Roth conversion with respect to any distributions or transfers from, or contributions to, eligible retirement plans or IRAs after 2031. For this purpose, high-income taxpayers are single taxpayers (or taxpayers married filing separately) with taxable income over $400,000; married taxpayers filing jointly with taxable income over $450,000; and heads of households with taxable income over $425,000 (all indexed for inflation).
- Impact: Closes the "back-door" Roth IRA strategies that had become available in 2010.

Section 138312. Prohibition of IRA Investments Conditioned on Account Holder's Status.

- After 2021, an IRA cannot be newly invested in any security if the issuer of the security requires the IRA owner to (i) have a minimum level of income or assets, (ii) have completed a specified minimum level of education, or (iii) hold a specific license or credential.
- IRA owners whose accounts currently hold such investments will have two years beginning after 2021 to divest such investments from their IRAs. Failure to timely divest prior to 2024 will cause the IRA to lose its tax-exempt status.
- Impact: IRAs can no longer hold investments that are available only to "accredited investors" because the investment is not registered under the federal securities laws. To some extent this investment prohibition is part of the provisions aimed at eliminating mega-IRAs.

Section 138313. Statute of Limitations with Respect to IRA Noncompliance.

- Extends the deadline by which the IRS may assess taxes for (i) any substantial error in reported values of investment assets of IRAs or (ii) prohibited transactions involving section 401(a) and 403(a) retirement plans, IRA arrangements, Archer MSAs, HSAs, and Coverdell educational savings accounts.
- The new deadline is six years after the date on which the plan's applicable tax return is filed.
- Has some retroactive application as this provision applies to all affected plans for which the pre-amendment three-year limitations period ends after 2021.
- Impact: This lengthens the time that the IRS has to investigate and pursue penalty taxes for these two specific noncompliance violations.

Section 138314. Prohibition of Investment of IRA Assets in Entities in Which the Owner Has a Substantial Interest.

- After 2021, an IRA owner cannot invest his or her IRA assets in a non-publicly traded corporation, partnership, trust or estate in which the IRA owner has a 10% or greater interest, or in which the IRA owner is, or has the powers of, an officer or director.
- IRA owners whose accounts currently hold such investments will have two years beginning after 2021 to divest such investments from their IRAs. Failure to timely divest prior to 2024 will cause the IRA to lose its tax-exempt status and the fair market value of the IRA is deemed distributed as of the first day of the first taxable year of noncompliance.
- Impact: This new provision is intended to limit the ability of IRA owners to invest in closely held businesses they own and/or control.

Section 138315. IRA Owners Treated as Disqualified Persons for Purposes of Prohibited Transactions Rules.

- Clarifies that, for purposes of applying the section 4975 prohibited transaction rules with respect to an IRA after 2021, (i) the IRA owner (including an individual who inherits an IRA as beneficiary after the IRA owner's death); (ii) a family member of the IRA owner; (iii) a corporation, partnership or trust or estate in which an interest of 50% or more is held directly or indirectly by the IRA owner; and (iv) a 10% or more (in capital or profits) partnership or joint venture of the IRA owner is a disqualified person with respect to the IRA.
- Impact: Applies the prohibited transaction rules to the IRA owner.

PART 4 – FUNDING THE INTERNAL REVENUE SERVICE AND IMPROVING TAXPAYER COMPLIANCE

Section 138401. Funding of the Internal Revenue Service.

- Provides the following amounts to the IRS for FY 2022:
  - $78.935 billion for strengthening tax enforcement, increasing voluntary compliance, expanding audits and other enforcement activity
  - $410 million for the Treasury Inspector General for Tax Administration to provide oversight of the IRS, including ensuring taxpayer privacy and that no undue burden is imposed on small businesses from enforcement efforts
  - $157 million for the U.S. Tax Court for adjudicating tax disputes
- Specifies that use of the additional resources for tax enforcement is not intended to increase taxes on any individual with a taxable income under $400,000.
- Funding available for IRS costs and initiatives until Sept. 30, 2031.
- Impact: The additional funds may increase audit activity. However, the intent to not increase taxes of those individuals with taxable income under $400,000 may be extremely difficult to achieve and may lead to more aggressive behavior by those taxpayers knowing that they will not be audited.

Section 138402. Application of Backup Withholding with Respect to Third Party Network Transactions.

- Provides that third-party settlement organizations are not subject to backup withholding for payments made in settlement of third-party network transactions unless 1) the aggregate amount of all previous payments made to the participating payee during the calendar year equals or exceeds $600, or 2) the third-party settlement organization was required to file an information return for its payments to the participating payee.
- Further specifies that for payments made during calendar year 2022, third-party settlement transactions that are required to be reported on a return will only be subject to backup withholding if the aggregate number of such transactions in that year exceeds 200.
- Amends the code to clarify that third-party network transactions in amounts equal to and exceeding $600 are subject to information reporting in alignment with the $600 or higher aggregate transaction threshold imposed for backup withholding as enacted by this section.
- Effective for calendar years beginning after Dec. 31, 2021.
- Impact: Provides that third-party settlement organizations are not subject to backup withholding requirements unless the aggregate annual payment to the payee is equal to or exceeds $600. Provides a transition rule for 2022 requiring that the aggregate number of annual transactions between the third-party organization and payee exceeds 200.

Section 138403. Limitation on Deduction for Qualified Conservation Contributions Made by Pass-Through Entities, Etc.

- Amends the charitable contribution rules to provide that a contribution by a partnership will not be considered a qualified conservation contribution if the amount of the contribution exceeds 2.5 times the sum of the partner's relevant basis in the partnership.
- Defines relevant basis as the partner's basis as determined by the partnership immediately before the contribution, without regard to basis increases related to partnership debt and any other adjustments required by the Treasury Department.
- Provides that the rules do not apply if the three-year holding requirements are met.
- Allows taxpayers to cure certain defects within 90 days of notification by the Treasury Department with the deed that fails to meet the requirement that the qualified conservation requirement be granted and protected in perpetuity. This opportunity does not apply to any listed transaction or any contribution that is not treated as a qualified conservation contribution.
- Imposes additional penalties on gross valuation misstatements and allows the imposition of penalties even if the valuation is not accepted.
- Applies in general to contributions made after Dec. 23, 2016. The provisions allowing the taxpayer to cure defective deeds applies to returns filed after date of enactment and any returns filed on or before such date if the period for assessment is still open. In the case of an easement for an historic structure, these changes apply to tax years beginning after Dec. 31, 2018.
- Impact: Significantly changes the charitable deduction for conservation easements held by partnerships with the imposition of retroactive rules that limit the amount of the deduction based on the partner's basis and the potential for penalties on valuations that have not been determined to be gross misstatements. Would effectively end the qualified conservation easement contribution except in very limited circumstances.

Section 138404. Modifications of Procedural Requirements Relating to Assessment of Penalties.

- Repeals the requirement that a penalty assessment first be approved by a supervisor of the employee making such assessment.
- Amends section 6751 to provide that each supervisor must certify quarterly that the supervised employees have followed the statutory requirements relating to penalty assessment computations and required notices.

- Repeal of the prior supervisory approval is effective as if included in section 3306 of the Internal Revenue Service Restructuring and Reform Act of 1988 and the proposal for quarterly certification is effective after the date of enactment.
- Impact: This will cut down on IRS red tape by allowing IRS employees to assess penalties without prior supervisory approval.

PART 5 – OTHER PROVISIONS

Section 138501. Modifications to Limitation on Deduction of Excessive Employee Remuneration.

- Accelerates American Rescue Plan Act (ARPA)'s expansion of section 162(m). As a result, up to 10 individuals, including the principal executive officer, principal financial officer and the next eight highest-paid employees, may be covered employees and subject to limitation on the deductibility of compensation.
- Clarifies the definition of applicable employee remuneration to include performance-based compensation, commissions, post-termination compensation, and beneficiary payments, regardless of whether or not such remuneration is paid directly by the publicly held corporation.
- Adds aggregation rules for purposes of determining who is the employer.
- Provides Secretary with authority to issue anti-avoidance guidance, including guidance that would address avoidance through the performance of services other than as an employee or by providing compensation through a passthrough or other entity.
- Effective for taxable years beginning after Dec. 31, 2021.
- Impact: Accelerates the expansion of denying the deduction for compensation above $1 million for certain highly compensated employees.

Section 138502. Extension of Tax to Fund Black Lung Disability Trust Fund.

- Extends the temporary increase termination date for the coal excise taxes that fund the Black Lung Disability Trust Fund to Dec. 31, 2025. The higher rate of tax continues to apply to coal sales after Dec. 31, 2021.
- Impact: Allows the increased tax rate to apply to sales of coal for an additional four years.

Section 138503. Prohibited Transactions Relating to Holding DISC or FSC in Individual Retirement Account.

- Amends the definition of prohibited transaction under section 4975 to include an IRA that holds a direct or indirect interest in a domestic international sales corporation (DISC) or a foreign sales corporation (FSC) that, in each case, receives any commission or other payment from an entity that is at least 10% owned by the individual for whose benefit the IRA is maintained.
- Provides that the exception from the excise taxes under section 4975, which ordinarily applies to prohibited transactions involving an IRA that loses its tax-favored status, does not apply to an IRA that engages in a prohibited transaction involving a DISC or FSC.
- This new prohibited transaction rule applies to stock and other interests acquired or held by an IRA after 2021 and also applies to accounts that lose tax-exempt status as an IRA.
- Impact: This provision seeks to close a path through which some individuals have attempted to bypass the Roth IRA contribution limits by shifting value into Roth IRA-owned corporations.

Section 138504. Increase in Tax on Certain Tobacco Products and Imposition of Tax on Nicotine.

- Doubles the rates of tax for small (from $50.33 to $100.66) and large cigarettes (from $105.69 to $211.39), small cigars (from $50.33 to $100.66) and roll-your-own tobacco (from $24.78 to $49.56).
- Changes the tax on large cigars from an ad valorem to a weight basis ($49.56 per pound), but not less than 10.06 cents per cigar.

- Increases taxes on smokeless tobacco (from $1.51 to $26.84 per pound), chewing tobacco (from 50.33 cents to $10.70 per pound), and pipe tobacco (from 2.8311 cents to $49.56 per pound). Imposes a new tax in the amount of $100 per thousand on discrete single-use units of product that contain tobacco but are not intended to be smoked.
- Expands the definition of roll-your-own tobacco to include processed tobacco.
- Imposes a tax on nicotine used for vaping and defines "taxable nicotine" to include nicotine that has been extracted, concentrated or synthesized, to be taxed at the equivalent rate for cigarettes ($100.66 per 1,810 milligrams of nicotine). Products that have been approved by the Food and Drug Administration (FDA), or have an investigational use exemption from FDA, or are combination products, are exempt from taxation. Includes taxable nicotine as a tobacco product for purposes of I.R.C. Sec. 5702(c).
- While the committee and JCT summaries indicate that the excise tax is intended to be indexed for inflation, the bill text is unclear.
- Adds a floor stocks tax to cigarettes, small cigars, cigarette papers and tubes, smokeless tobacco, pipe tobacco and roll-your-own tobacco that are removed before the effective date, with a de minimis exemption amount of $1,000.
- The effective date for tax increases imposed on cigarettes, small cigars, smokeless tobacco, pipe tobacco and roll-your-own tobacco applies to articles removed in calendar quarters after the date of enactment. The effective date for taxes imposed on large cigars, discrete single-use units and taxable nicotine is calendar quarters beginning 180 days after date of enactment.
- Impact: Increases tax rates on tobacco products and imposes a new tax on discrete single-use units and taxable nicotine.

Section 138505. Clarification of Rules Regarding Tobacco Drawback.

- Ends the practice of allowing exported tobacco products that are not subject to any excise tax from being used as part of a double drawback, allowing refunds on excise taxes on other tobacco products when they are imported.
- This provision applies to drawback claims made on or after Dec. 18, 2018.
- Impact: Makes exported tobacco products that are not subject to any excise tax ineligible for a drawback claim.

Section 138506. Termination of the Employer Credit for Paid Family Leave and Medical Leave.

- Accelerates the termination of the TCJA employer credit for paid family and medical leave from Dec. 31, 2025, to Dec. 31, 2023. This date is consistent with the House Reconciliation bill's creation of its Universal Paid Family and Medical Leave set forth in **Subtitle A, Section 2202**, which is proposed to begin July 2023.
- Impact: Accelerates the termination of the TCJA employer credit for paid leave, replacing it with a new program that allows employers that meet certain conditions to be reimbursed for 90% of the cost of providing 12 weeks of qualified paid leave.

Section 138507. Clarification of Treatment of DISC Gains and Distributions of Certain Foreign Shareholders.

- Provides that foreign shareholders of DISCs and FSCs are deemed to have a permanent establishment in the U.S., from which any DISC or DSC gains or distributions are derived.
- Effective for distributions on or after Dec. 31, 2021.
- Impact: Provides clarity on the treatment of certain gains and distributions to foreign shareholders.

Section 138508. Access to Self-Employment Income Information for Paid Leave Administration.

- Provides an exemption from the section 6103 confidentiality rules. Upon written request from the Treasury Secretary, Treasury Department officers and employees will have access to tax return information for self-employed taxpayers when the self-employment income is relevant to determining eligibility for, or the correct amount of, paid family and medical leave under the House Reconciliation bill's Universal Paid Family and Medical Leave set forth in Subtitle A.

- Information that may be disclosed is limited to: (i) taxpayer identity information, (ii) self-employment income, and (iii) the taxable year to which the self-employment income relates.
- Effective upon date of enactment.
- Impact: Allows Treasury Department access to self-employment income information for a limited purpose.

Section 138509. Temporary Rule to Allow Certain S Corporations to Reorganize as Partnerships Without Tax.

- Allows a corporation that was an S corporation on May 13, 1996, and at all times thereafter, to convert, tax free, to a partnership.
- Applies to reorganization transaction occurring in 2022 and 2023.
- Impact: Facilitates the transition of older S corporations to partnership status.

Section 138510. Treatment of Certain Qualified Sound Recording Productions.

- Amends the special rule under Section 181 permitting expensing of qualified film, television and live-theatrical products to include "any qualified sound recording production." Cost of such productions may be expensed up to $150,000. Sound recordings are "works that result from the fixation of a series of musical, spoken or other sounds" but does not include "sounds accompanying a motion picture or other audiovisual work," which must be produced and recorded in the United States to qualify.
- Amends Section 168 to include qualified sound recording under "qualified property" eligible for bonus depreciation.
- Applies generally to productions in 2021 through 2025, when section 181 is set to expire.
- Impact: Provides a tax benefit through immediate expensing for artists in the sound recording industry.

Section 138511. Payment to Certain Individuals Who Dye Fuel.

- Creates a new refund mechanism for refunds, without interest, to a taxpayer who removes eligible indelibly dyed diesel fuel or kerosene from a terminal for non-taxable use. The taxpayer must establish to the satisfaction of the Treasury Department that the tax for the fuel (under section 4081) has already been paid.
- Defines eligible indelibly dyed diesel fuel or kerosene as a diesel fuel or kerosene with respect to which tax was paid under section 4081 but is exempt from tax under section 4082.
- Applies to eligible indelibly dyed diesel fuel or kerosene moved on or after the day that is 180 days after the date of enactment.
- Impact: The new refund mechanism will allow taxpayers to claim a refund on dyed fuels.

Section 138512. Extension of Credit for Portion of Employer Social Security Taxes Paid with Respect to Employee Tips to Beauty Service Establishments.

- Extends the employer social security credit for employer social security tax paid with respect to employee tips ("tip credit") to include tips received for providing beauty services to a client or customer. Previously this credit was only available in connection with providing or delivering food or beverages.
- The effective date of this provision is taxable years beginning after Dec. 31, 2021.
- Impact: Allows employers in beauty service establishments to claim the social security credit for employer social security taxes paid with respect to employee tips.

Section 138513. Enhancement of Work Opportunity Credit During COVID-19 Recovery Period.

- This provision increases the Work Opportunity Tax Credit (WOTC) to 50% of qualified first-year wages up to $10,000, up from $6,000. Also increases qualified second-year wages up to a maximum of $10,000 for individuals who are not qualified summer youth employees and are hired after the date of enactment and before Jan. 1, 2023.

- Effective through Dec. 31, 2023, for all WOTC targeted groups except for: (1) summer youth employees; (2) qualified veterans who are entitled to compensation for a service-connected disability, and who are hired within one year of discharge; (3) qualified veterans who are entitled to compensation for a service-connected disability, and who have been unemployed for an aggregate of at least six months during the one-year period ending on the hiring date; and (4) qualified veterans unemployed for at least six months (whether or not consecutive) during the one-year period ending on the date of hiring.
- The credit applies to the following WOTC target groups: (1) families receiving TANF, (2) qualified ex-felons, (3) designated community residents, (4) vocational rehabilitation referrals, (5) qualified supplemental nutrition assistance program benefits recipients, (6) qualified SSI recipients, (7) long-term family assistance recipients, and (8) long-term unemployment recipients.
- Impact: This provision increases the incentive for employers to hire individuals within certain target categories.

Section 138514. Allowance of Deduction for Certain Expenses of the Trade or Business of Being an Employee.

- Allows an individual a deduction of up to $250 from gross income for dues paid to a labor organization.
- Expenses must be attributable to the performance of services by a taxpayer as an employee and the taxpayer must remain a member of the organization through the end of the year.
- Applies to tax years beginning after Dec. 31, 2021.
- Impact: Promotes membership to labor organizations by subsidizing the costs of annual dues.

Section 138515. Cover Over of Certain Distilled Spirits Taxes.

- Repeals the limitation on cover over of distilled spirits to Puerto Rico and the U.S. Virgin Islands for distilled spirits brought into the United States after Dec. 31, 2021—commonly known as “rum cover over.”
- For cover over to Puerto Rico equal to or greater than $10.50 per proof gallon, requires Puerto Rico to transfer to the Puerto Rico Conservation Trust Fund an amount equal to at least one-sixth of the difference between $10.50 and the cover-over rate (not to exceed $13.25).
- Applies to distilled spirits brought into the United States after Dec. 31, 2021.
- Impact: Repeals the limitation on distilled spirit taxes covered over for Puerto Rico and the U.S. Virgin Islands, increasing the federal excise tax revenues that are returned to Puerto Rico and the U.S. Virgin Islands on distilled spirits produced in those possessions.

Section 138516. Research and Experimental Expenditures.

- Delays for four taxable years the effective date for the modifications made to section 174 by TCJA, which would require research and experimentation expenses to be amortized over five years, rather than deducted in the year paid or incurred. The provision would continue current-law treatment of research and experimentation costs (e.g., current deduction, capitalization or 10-year amortization) through 2025.
- Impact: This provision allows (for four more years) the current deduction of section 174 expenses, which will encourage domestic research activities.

Section 138517. Payroll Credit for Compensation of Local News Journalists.

- Provides an employment tax credit for the hospital insurance (HI) amount, 1.45%, to a local newspaper for employing a local news journalist for at least 100 hours of service during such calendar quarter. The wages paid to such local news journalist cannot exceed $12,500 for any calendar quarter.
- Local newspaper is defined as a print or digital publication whose content is from primary sources and relates to news and current events in a region or local community. Such publisher must employ at least one local news journalist during any calendar quarter and cannot employ more than 750 employees for the credit to apply.

- The payroll credit equals 50% of the wages for the first four calendar quarters and 30% of wages for each calendar quarter thereafter.
- The credit shall not exceed the applicable HI taxes owed by the local newspaper; but any excess is treated as an overpayment and is refundable.
- The credit does not apply to the federal government or any state or political subdivision.
- The Treasury Secretary shall issue forms, instructions, regulations and guidance to implement this section, including the application of the credit to third-party payors, such as professional employer organizations, certified professional employer organizations or agents.
- The section shall apply to calendar quarters during the first five calendar years after date of enactment.
- Impact: Permits local newspapers to claim an HI employment tax credit for employing local news journalists.

Section 138518. Treatment of Financial Guaranty Insurance Companies as Qualifying Insurance Corporations under Passive Foreign Investment Company Rules.

- Amends section 1297 to provide special rules of financial guaranty insurance companies under the current passive foreign investment company (PFIC) rules.
- Defines applicable insurance liability to include unearned premium reserves, subject to specific guidelines.
- Applies generally to taxable years beginning after 2017.
- Impact: Provides limited relief from the PFIC rules for investments in financial guaranty insurance companies.

Section 138519. Credit for Qualified Access Technology for the Blind.

- Establishes a new refundable credit for spending on qualified access technology for use by a qualified blind individual (the taxpayer, taxpayer's spouse or dependent).
- Limits the credit to $2,000 per three consecutive taxable-year spans.
- Qualified access technology means hardware, software or other information technology that is used to convert or adapt information that is visually represented into forms or formats usable by blind individuals,
- Applies to tax years beginning after Dec. 31, 2021. It does not apply to amounts paid or incurred in tax years beginning after Dec. 31, 2026.
- Impact: Creates a credit for expenditures on technology designed specifically to enhance accessibility for blind individuals.

Section 138520. Modification of REIT Constructive Ownership Rules.

- Modifies the REIT constructive ownership rules to turn off the attribution of stock to a REIT owned by a partnership, estate, trust or corporation that is a shareholder of the REIT.
- Applies to taxable years ending after the date of enactment.
- Impact: Ensures that REITs will not violate ownership limitations due to attribution rules where the REIT does not have access to the necessary information regarding the attributed entity.

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Nancy Strelau
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Harold Hancock
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