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# 2022 Tax Policy Outlook: Managing constant change

Washington National Tax Services (WNTS)

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# Executive summary

The stakes continue to be high as businesses seek to manage potential changes to US and global tax policy, and respond to a world of technological disruption, fractured geopolitics, the enduring impacts of the COVID-19 pandemic, and increased focus on environmental, social, and governance (ESG) concerns. A key challenge for business in this environment is to identify strategic opportunities for growth and expansion. Tax is at the center of all of these discussions and can be a catalyst for delivering trust and driving strategic business outcomes.

## Overview

President Biden took office in 2021 with the promise to deliver a shift in policy from the previous administration in a number of areas, but the outlook for US tax policy remains uncertain as the 117th Congress begins its second session. This is due in large part to the fact that a narrow House Democratic majority and an evenly divided Senate have limited the ability of President Biden and Democratic Congressional leaders to advance many of the corporate, international, and individual tax proposals that the president announced in early 2021.

*Observation:* Engagement by the business community with policy makers to illustrate the potential negative effects of certain tax proposals on their employees, job creation, and investments in the United States also has played a critical role in affecting the ongoing legislative process. While the tax increase proposals that are currently under consideration in the Senate would still result in higher taxes being paid by many businesses and individuals, for many taxpayers, the tax provisions in the House-passed bill would result in smaller tax increases than the tax provisions originally proposed by the Biden administration.

While Democrats are able to use budget reconciliation procedures to advance tax legislation over the objections of Congressional Republicans, to do so they must secure the near-unanimous support of House Democrats and the unanimous support of all 50 Democratic Senators.

As a result, the fate in the Senate of the House-passed "Build Back Better Act" (H.R. 5376) remains very much in question. In particular, Democratic leaders continue to face the challenge of addressing specific objections that have been raised by Senators Joe Manchin (D-WV) and Kyrsten Sinema (D-AZ), while also retaining the support of the other 48 Senate Democrats and nearly all House Democrats.

*Observation:* There remains a significant risk that Congress will ultimately agree to enact major corporate and individual tax increases if Senate Democrats can pass a revised version of the reconciliation tax bill. Senator Manchin has stated that he is a "no" on the current House-passed Build Back Better bill—due to objections that focus primarily on spending provisions and broader economic and fiscal concerns—but he also has endorsed rolling back corporate and individual tax cuts that were enacted as part of the 2017 tax reform act. House Democrats currently are expected to accept whatever changes Senate Democrats need to make to gain the critical 50th vote of Senator Manchin, so that a final bill can be passed and signed into law by President Biden.

Significant tax increase proposals that are under consideration by Congress include:

- a 15% corporate alternative minimum tax based on adjusted financial statement book income,
- a 1% excise tax on corporate stock repurchases,
- significant changes to US international tax rules, including a new 15% global minimum tax rate on foreign earnings that would be applied on a per-country basis, and
- a 5% surcharge on an individual's modified adjusted gross income (AGI) in excess of $10 million and an additional 3% surcharge (total of 8%) on a taxpayer's modified AGI in excess of $25 million.

Administration officials and Democratic Congressional leaders continue to express optimism that a revised Build Back Better budget reconciliation bill can be enacted. Democratic leaders would like to pass the legislation before President Biden's State of the Union address on March 1; however, another goal may be to pass a bill by the Congressional spring recess (April 11-22).

The federal government currently is operating under a temporary 'continuing resolution' (CR) that provides FY 2022 funding for departments and agencies through February 18, 2022. House and Senate leaders are working on an omnibus appropriations package that would run through the September 30 end of FY 2022. Congress may need to adopt another CR before the current temporary funding measure expires to avoid a partial government shutdown.

*Action item:* With the potential for Senate Democrats to have the final say in shaping the tax provisions of the Build Back Better bill, business stakeholders, and especially CEOs and CFOs, should communicate with Senate policy makers on the potential effects of tax increase proposals on their employees, job creation, and investments in the United States.

## What are the fiscal effects of the Build Back Better legislation?

Senator Manchin has raised certain specific objections to the fiscal effects of the Build Back Better legislation, while endorsing in general efforts to roll back some corporate and individual tax cuts that were enacted as part of the 2017 Act. While at times indicating his willingness to support legislation that spends up to $1.8 trillion over 10 years, Senator Manchin has criticized reducing the cost of some spending provisions by making the spending temporary, while the tax provisions in the House-passed bill generally are proposed to be permanent.

A provision that has been a particular concern of Senator Manchin is the proposal to extend for only one year, through the end of 2022, expanded child tax credit benefits that had been provided on a monthly basis last year. Under the March 2021 pandemic-relief American Rescue Plan Act (ARPA), the child tax credit was increased on a temporary basis through the end of 2021. The child credit was increased from $2,000 per child in 2020 to $3,600 for each child under age six; for each child ages 6 to 16, the child tax credit was increased from $2,000 to $3,000. ARPA also made 17-year-olds eligible for the $3,000 credit. In addition, the credit was made fully refundable. Senator Manchin has expressed concerns about the cost of the expanded credit and has objected to the expanded refundability of the credit to parents without earned income.

The Joint Committee on Taxation (JCT) staff has estimated that the proposed one-year extension of the expanded child tax credit would cost $185 billion, but has projected that the cost of this provision would increase to $1.6 trillion if it were made permanent. Significant additional cost increases have been projected for other temporary provisions—such as childcare and preschool funding and health insurance premium subsidies—in the House-passed bill if they were to be made permanent.

The Congressional Budget Office (CBO) projected an overall increase in net spending of $1.7 trillion over 10 years for the House-passed bill, with its mix of both temporary and permanent spending and refundable tax proposals. After accounting for net tax revenue effects and other offsets as well as separate CBO estimates of revenue savings from increased Internal Revenue Service (IRS) enforcement, CBO projects that the bill as passed would increase federal deficits by $160 billion.

Democrats generally have argued that the House-passed bill is fully offset since they believe CBO has underestimated revenues from increased IRS enforcement. At the same time, President Biden and most Democrats have expressed hopes that a future Congress will make the expanded child tax credit and other temporary provisions permanent. In response to a request of Congressional Republicans, CBO estimated that the cost of Build Back Better would increase federal deficits by $3 trillion over the next 10 years if certain provisions were to be made permanent.

*Note:* The current-law version of the child tax credit at $2,000 per child itself is a temporary measure that was enacted as part of the 2017 tax reform act under budget reconciliation procedures that limited the deficit costs of that legislation to $1.5 trillion between 2018 and 2027. The child tax credit is scheduled to revert to $1,000 per child after 2025, when the higher per-child amount and related modifications expire along with other individual and pass-through business tax provisions that were enacted in 2017.

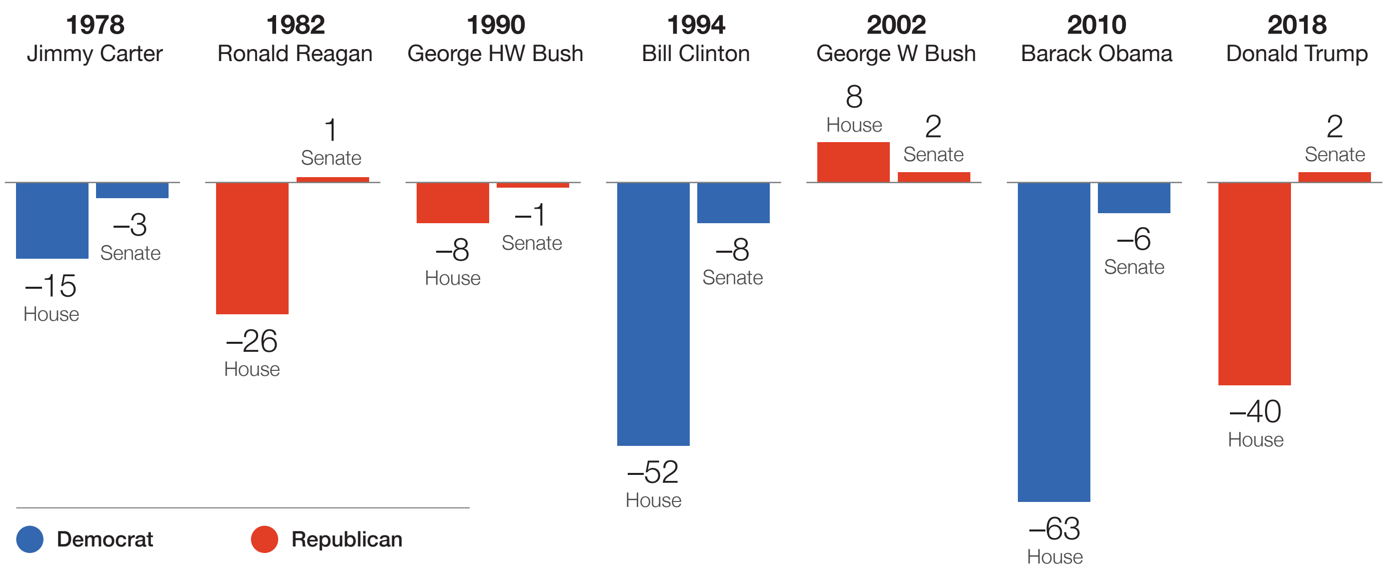
*Observation:* It is likely that significant changes to the spending provisions in the House-passed bill will be necessary to secure the support of Senator Manchin for a revised reconciliation bill. The West Virginia Democrat and other Senate Democrats appear to be less focused on making significant changes to proposed tax increase provisions, although changes could be made to certain provisions in response to ongoing concerns raised by taxpayers.

## Looking ahead to the 2022 midterm elections

Historically, the President's political party has lost seats in the Congressional midterm elections during the President's first term. This trend is be particularly noteworthy at a time when Democrats hold a slim majority in the House and the Senate is evenly divided.

As shown in Figure 1, since 1978 there has been only one occasion—in 2002 during the first term of President George W. Bush—when the President's party gained seats in both the House and Senate. The 2002 midterm elections took place during a period when the United States was responding to the September 11, 2001 terrorist attacks and President Bush's approval rating was around 60%.

**Figure 1: Congressional gains/losses by a first-term President's party in midterm elections**




The party not holding the White House also often has performed better in off-year state elections than it did in the previous year's presidential election. In November 2021, Republican Glenn Youngkin defeated Democrat Terry McAuliffe in the Virginia governor's race, while New Jersey's Democratic incumbent Governor Phil Murphy defeated Republican Jack Ciattarelli by a small margin. The results of the gubernatorial elections in Virginia and New Jersey—states that President Biden won by large margins in the 2020 Presidential election—may suggest a greater level of political intensity and mobilization among voters supporting the party that does not hold the presidency.

Midterm election results are not reliable predictors of the following presidential election results. For example, both Presidents Barack Obama and Donald Trump saw their parties lose significant numbers of House seats in their first midterm elections, but President Obama went on to be re-elected while President Trump did not.

*Observation:* The prospect of losing Democratic control of one or both chambers means President Biden and Congressional Democrats face additional pressure to act on their agenda during the current Congress.

## Global tax and trade policy concerns

### OECD tax proposals

While policymaking in Washington continues to command C-suite attention, sweeping global tax changes will come into greater focus in 2022. In the wake of last year's historic political agreement on the Organisation for Economic Co-operation and Development's (OECD) digital tax project, countries will grapple with the task of finalizing and implementing the newly agreed-upon rules, which are scheduled to take effect from 2023.

*Observation:* While these reforms originally were meant to target the "digitalization of the economy," they will apply across sectors and have potentially significant and far-reaching implications for US multinational enterprises (MNEs). Businesses will need to prepare to adapt quickly to changing rules and closely track how the rest of the world moves to implement them.

## Supply chain concerns

Meanwhile, the uncertainty that has impacted global trading and geopolitical systems for the past several years continues to be as fluid as at any time in recent memory. Global events such as COVID-19 also have exposed existing challenges across supply chains and have been a catalyst for businesses to adapt to dramatic shifts in supply and demand. Stretched supply chains—driven by shortages of intermediary inputs, warehousing, and labor—combined with historic demand for goods have led to shortages around the world.

Supply chain concerns have been a key factor driving what has been a significant level of recent deals activity. Such considerations are expected to play an ongoing role in merger and acquisition (M&A) transactions.

*Observation:* While it is anticipated that macro supply challenges eventually will clear, geopolitical risks to supply chains likely will continue unabated. Political risks stemming from US-China rivalry, growing volatility in international politics, and trade and security disputes disrupting transport networks and access to resources likely will continue as key downside risks to supply chains. Companies are responding by transforming their supply chains through digitization, upskilling their talent pool, and evaluating their onshoring, nearshoring, and offshoring arrangements.

## Geopolitical risks

While US-Russia relations and events in Europe related to Ukraine currently are the focus of attention, the economic, military, and human rights actions taken by the government of China are an area of growing bipartisan focus among US policymakers. Key officials in the Biden administration and in Congress have signaled their intent to pursue bilateral and multilateral initiatives as well as new legislation to address these concerns.

One area of immediate focus is an effort to enact a trade and economic investment incentive bill that was passed by the Senate in June 2021. This legislation—the US Innovation and Competition Act (USICA) (S. 1260)—seeks to boost US semiconductor production, scientific research, development of artificial intelligence, and space exploration to address growing economic, technological, and military competition from China.

There are some indications that the House may hold a floor vote in early February on its version of USICA. House leaders have indicated that rather than resolving differences beforehand, they intend to pass their version of the legislation and then seek to resolve the differences between the two versions of the bill.

The House version of USICA is expected to include trade provisions—including possibly some trade adjustment assistance provisions that also are included in the House-passed Build Back Better bill—that would make it a revenue measure.

*Observation:* It remains to be seen whether USICA could become a potential legislative vehicle to address other tax issues that are pending consideration as part of the Build Back Better bill. One such provision is a measure that would reinstate the ability of businesses to deduct certain Section 174 research expenditures. A provision of the 2017 tax reform act that became effective at the beginning of 2022 requires businesses to capitalize and amortize expenses that they have traditionally been able to deduct currently.

## ESG and the growing role of tax

Environmental, social, and governance practices and related global policy issues were front and center in 2021, and that momentum is not slowing down in 2022. US and foreign policymakers are pursuing a broad range of policies—from tax incentives for investments in lower emissions technologies to increased regulatory requirements—to address climate change. As ESG issues come to the forefront, a widening array of stakeholders—including customers, nongovernmental organizations (NGOs), employees, and the public at large—will expect more corporate governance and attention focused on these issues.

*Observation:* Companies are increasingly looking to build a narrative around sustainability, growth, and acting in the interests of society as a whole. While tax may not be thought of as being at the forefront of this development, it has been involved from the beginning—and its role has been expanding. The tax aspect of ESG traditionally has been tied to transparency, but the lens now has a much broader focus than just reporting. When it comes to tax, companies need to have a sound strategy for governance issues, like addressing risk and leadership structure.

The European Union is continuing work toward implementation of a "carbon border adjustment mechanism" (CBAM) designed to ensure that certain imported goods (initially including cement, electricity, fertilizers, iron and steel, and aluminum) bear the same implied price of carbon emissions as those produced in the EU. In addition, with support from some Finance Ministers, the OECD is seeking to secure a mandate from the G20 to develop a new multilateral framework, similar to the existing Inclusive Framework, to facilitate international dialogue around a minimum level of carbon pricing, after wrapping up its digital tax project. While the focus initially may be on environmental taxes, the OECD has expressed the possibility of revisiting and rewriting the guidelines on MNEs in 2022 to address a range of governance and social policy issues.

*Observation:* MNEs that are potentially subject to the CBAM should take steps to understand what data will be required for compliance with information reporting starting in 2023 and begin modeling the potential costs. Many companies also may benefit from applying a tax lens to their current and future ESG goals, prioritizing investments and activities that reduce potential exposure to environmental taxes and pricing mechanisms and/or generate tax credits or other public incentives to help defray the cost of investment.

As 2022 begins, MNEs need to deal with ESG issues in the area of tax transparency. The finalized EU directive on public country-by-country (CbCR) tax reporting entered into force in December 2021 and will be implemented by 2023. Companies that are subject to the EU regulations must publish their total revenue, taxable profits, tax paid, and number of employees on a country-by-country basis.

*Action item:* MNEs should be prepared to engage in the public debate over the "fair share" of taxes to be paid by businesses with factual and accurate information on the total level and composition of tax contributions paid. Income taxes are a limited part of the overall tax contribution to society resulting from economic investment and job creation by business enterprises. A key goal should be to demonstrate how a company's tax strategy aligns with its business strategy of creating economic value benefitting all of the company's stakeholders, including employees and customers, as well as educating the public on the company's total tax contribution to the communities in which it operates.

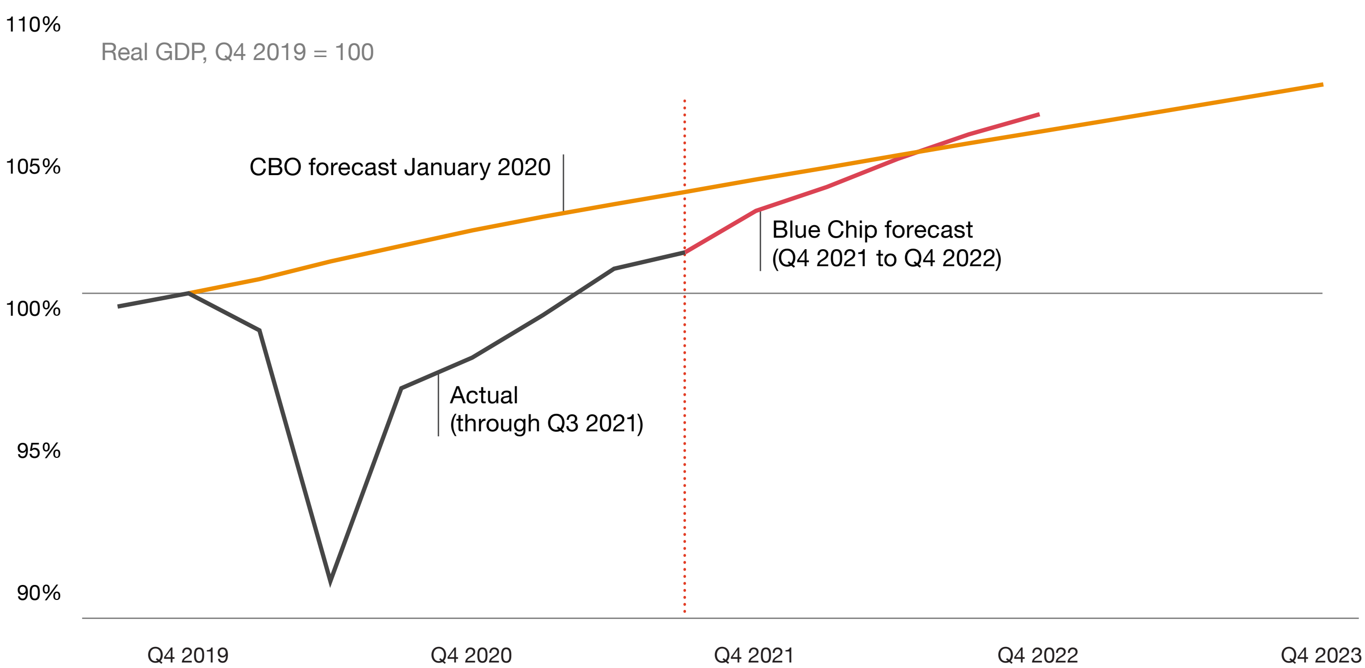
## Economic outlook

Concerns over the outlook for US and global economic growth have remained high as countries have sought to deal with the effect of the pandemic, supply chain disruptions, and other political and social sources of disruption. These concerns and political disagreements over the direction of US economic policy are expected to influence both legislative activity in the current Congress and the outcome of the 2022 midterm elections.

### GDP growth

The economic outlook for 2022 is for strong but moderating growth as the economy continues to rebound from the challenges of the pandemic. Private forecasters project real gross domestic product (GDP) in 2022 will expand at a 3% to 4% rate. Real GDP in 2021, aided by significant federal government fiscal support, is estimated to have grown by 5.7%. The strong continuing growth following the recession in early 2020 is forecast to lift real GDP by the third quarter of 2022 above the level projected by the CBO in January 2020, prior to the pandemic.

**Figure 2: Real GDP is forecast to exceed pre-pandemic trend by the third quarter of 2022**

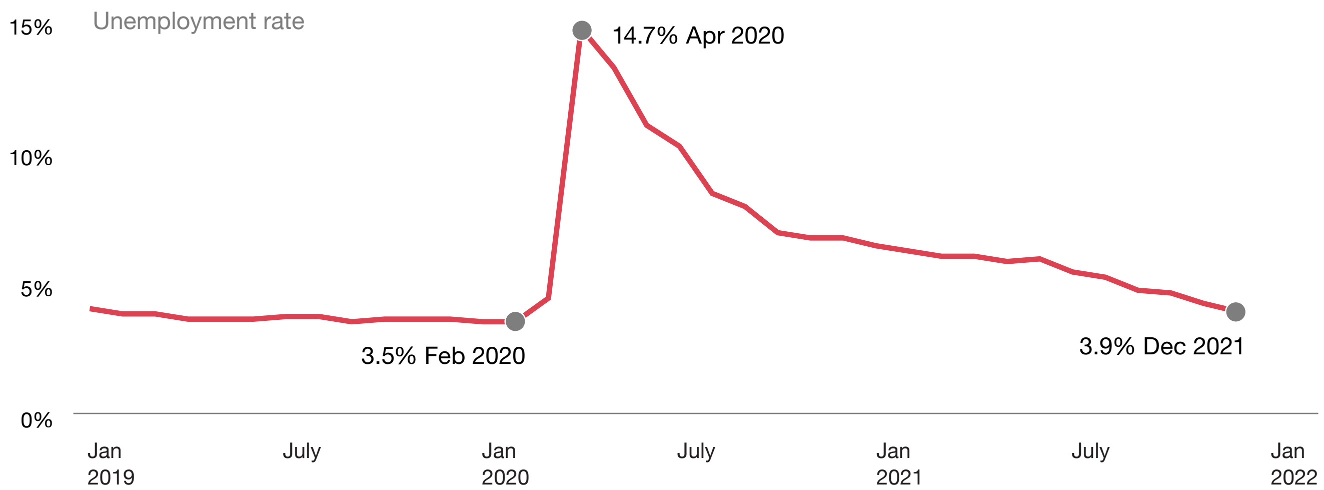



Source: Calculations from BEA (Dec. 22, 2021), CBO, and Blue Chip Economic Indicators, Jan. 10, 2022.

## Employment trends

Employers added 6.4 million jobs in 2021, but ended the year with 3.6 million fewer workers on their payrolls than in February 2020. The unemployment rate was 3.9% in December, down from 6.7% at the end of 2020 and nearing the 50-year lows reached in late 2019 and early 2020. Strong demand for workers is expected to continue to reduce unemployment and draw into the labor force individuals who are not presently seeking work.

**Figure 3: Unemployment rate has declined faster than expected by most forecasters**



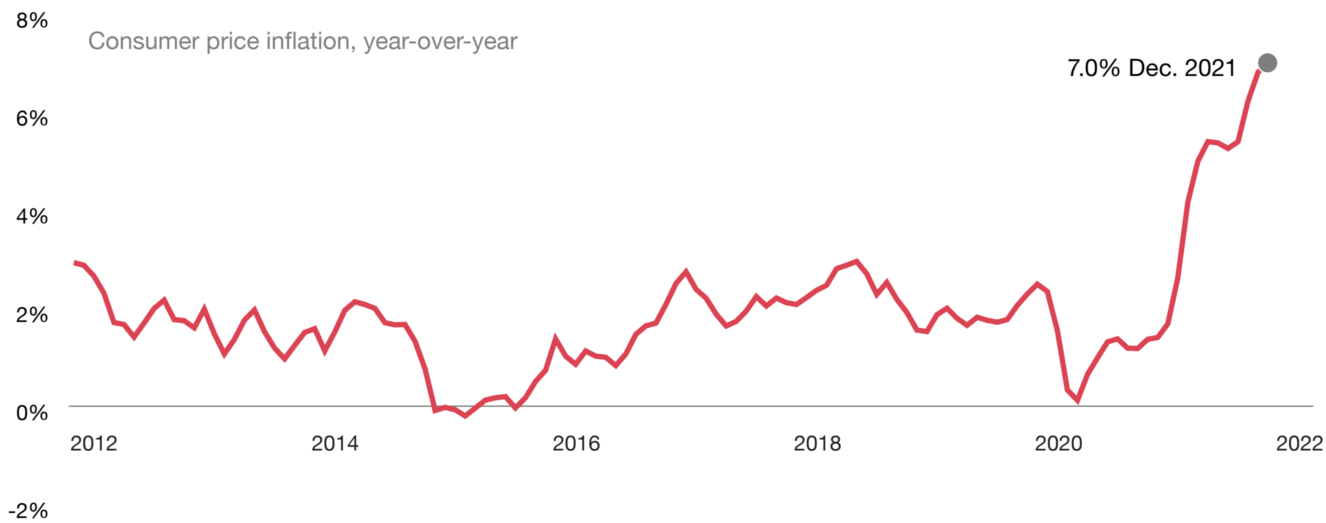

Source: Department of Labor, January 7, 2022.

Aggregate payrolls of private sector employers increased by 9.9% in 2021. Average hourly earnings increased over the last three months of 2021 at an annual rate of 6.2% in nominal terms. Nominal wage growth, however, lagged behind accelerating inflation, resulting in a decline in real average hourly earnings.

## Inflation effect

Inflation was the unwelcome economic indicator of 2021. As measured by the consumer price index (CPI), inflation for the 12 months ending in December was 7.0%, the highest since 1982.

**Figure 4: Inflation is at a 40-year high**




Source: Bureau of Labor Statistics, January 12, 2022.

The Federal Reserve's preferred measure of inflation—the personal consumption expenditures (PCE) price index—increased at a rate of 5.7% for the 12 months ending in November. Core PCE prices, which remove more volatile food and energy prices, rose by 4.7% over the same period.

Inflation is projected to moderate in 2022 as supply constraints are expected to ease and as the substantial fiscal support added by the federal government in 2020 and 2021 wanes. *The Blue Chip* economists' January forecast is for CPI to increase at a 3% to 4% annual rate over the first half of the year before settling to around 2.5% in the second half of 2022.

In response to inflation substantially exceeding the Federal Reserve's 2% percent target and unemployment easing, the Federal Reserve has indicated that it expects to begin to increase interest rates in 2022. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents released in December show that a majority anticipate raising the federal funds rate by 0.75 percentage points in 2022.

Recent private sector forecasts are for interest rate hikes to begin in March, and to increase by a full percentage point over the course of the year. The Federal Reserve—which announced it intends to stop adding to its balance sheet by March—also is expected to consider policies that would reduce its asset holdings as it seeks to return to a more neutral monetary stance.

The Federal Reserve's goals are to tamp down inflationary pressures and expectations of future inflation while maintaining maximum sustainable employment. The pandemic has created challenges for the Federal Reserve due to persistent supply bottlenecks increasing inflationary pressures, declines in labor force participation rates making it difficult to gauge how far the economy is from full employment, and the uncertainties facing the economy from the unknown duration of COVID-19.

**Figure 5: 2022 Congressional legislative schedule**

| | |
|---|---|
| Senate convenes | January 3 |
| House convenes | January 10 |
| Martin Luther King Jr. Day | January 17 |
| House and Senate recess | January 24–31 |
| President's Day recess (House) | February 10–25 |
| President's Day recess (Senate) | February 21–25 |
| President's State of the Union Address | March 1 |
| House recess | March 21–25 |
| Spring recess (House) | April 8–25 |
| Spring recess (Senate) | April 11–22 |
| House recess | May 2–9 |
| Memorial Day recess (House) | May 20–June 6 |
| Memorial Day recess (Senate) | May 30–June 3 |
| Juneteenth | June 20 |
| Independence Day recess (House) | June 27–July 11 |
| Independence Day recess (Senate) | June 27–July 8 |
| August recess (House) | August 1–September 12 |
| August recess (Senate) | August 8–September 5 |
| Rosh Hashanah | September 26 |
| House recess | October 3–November 11 |
| Senate recess | October 3–10 |
| Senate recess | October 24–November 8 |
| Election Day | November 8 |
| Veterans Day | November 11 |
| Thanksgiving recess (House and Senate) | November 21–25 |
| Target adjournment date (House) | December 15 |
| Target adjournment date (Senate) | December 21 |

# Balance of power

## House of Representatives

With the second session of the 117th Congress underway, Democrats continue to hold a slim majority in the House of Representatives. The House presently is composed of 222 Democrats and 212 Republicans, with one open seat that had been held by a Republican. A special election will be held later this year to fill the seat of Rep. Devin Nunes (R-CA), who resigned from Congress on January 3.

A slim majority means House Speaker Nancy Pelosi (D-CA) faces the ongoing challenge of uniting Democrats behind key priorities, since nearly unanimous support among Democrats will be required to pass legislation that lacks bipartisan support. Assuming all current House members are present and vote along party lines, Democrats can afford to lose only four votes to pass legislation with a simple majority of 218.

## Senate

In the Senate, there are 50 Democrats (including the two Independents who caucus with Democrats) and 50 Republicans. Democrats control the evenly divided Senate due to Vice President Kamala Harris (D) holding the tie-breaking vote.

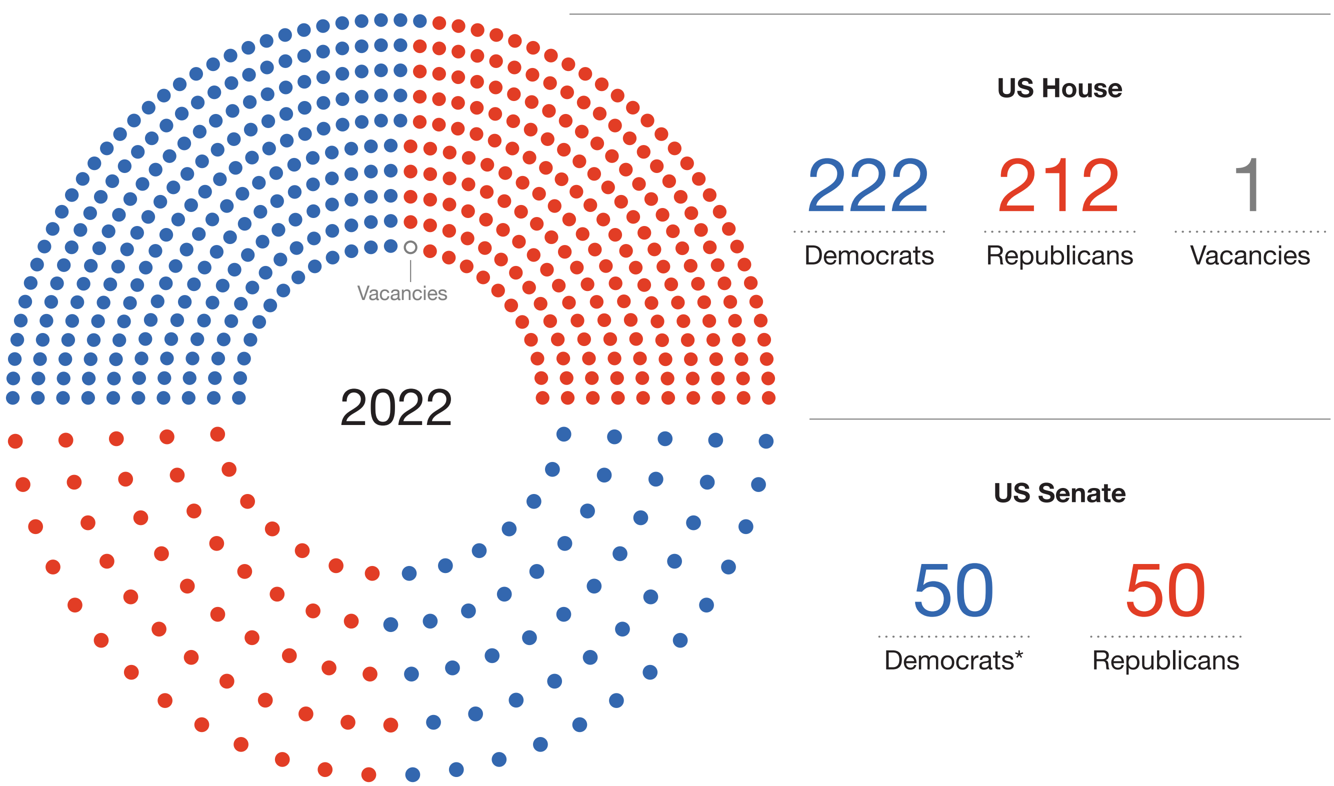
The Senate continues to operate under an organizing resolution (S. Res. 27) negotiated last year by Majority Leader Chuck Schumer (D-NY) and Minority Leader Mitch McConnell (R-KY) for governing the 50-50 Senate. Under the ‘power-sharing agreement,’ committee memberships are divided equally between the two parties and the senior Democrat is designated as the chair. In the event a bill or nomination fails in committee on a tie vote, the organizing resolution provides for up to four hours of debate on discharging the matter from committee.

Senate procedures in effect generally require 60 votes to limit debate on legislation and bring about a vote on final passage. A Senate rule modification adopted in 2017 lowered the threshold for approving US Supreme Court nominations to a simple majority (usually 51 votes), which brought the requirement in line with a 2013 rule change that adopted a simple majority threshold for executive branch and non-Supreme Court judicial nominations.

Budget reconciliation procedures provide a pathway for the Senate to pass certain legislative proposals with a simple majority. Because Democrats hold a de facto 51-50 Senate majority, they potentially can use the budget reconciliation process in seeking to advance proposals with only Democratic votes as long as they secure the support of all 50 Democratic Senators. Various limitations apply to legislation considered under reconciliation procedures.

Some Democrats have advocated changing Senate rules to modify or eliminate the legislative filibuster entirely or to allow particular bills to advance with a simple majority. An effort to change filibuster rules to allow for action on voting rights legislation was rejected on January 19 by a vote of 52 to 48. In December 2021, the House and Senate approved (with more than 60 votes in the Senate) a measure creating a one-time, fast-track process that allowed the Senate to pass a measure to increase the debt limit outside the budget reconciliation process with a simple majority vote.

**Figure 6: 2022 Congressional balance of power**




As of January 27, 2022

* Includes two Independents: Senators Bernie Sanders (I-VT) and Angus King (I-ME)

## House and Senate tax committees

Rep. Richard Neal (D-MA) continues as chairman of the House Ways and Means Committee, and Rep. Kevin Brady (R-TX) remains the Ranking Republican Member. There currently are 25 Democrats and 18 Republicans on the committee; Rep. Greg Murphy (R-NC) recently was appointed to fill the Ways and Means Republican seat that had become open after Rep. Nunes resigned on January 3.

The Senate Finance Committee is led by Chairman Ron Wyden (D-OR), and Senator Mike Crapo (R-ID) serves as the Ranking Republican Member. The Finance Committee is evenly divided with 14 Democrats and 14 Republicans.

## Administration

The President has the power to veto legislation passed by Congress, with a two-thirds majority of both the House and Senate required for a veto override. With Democratic majorities in both the House and the Senate, President Biden did not veto any bills during his first year in office. The presidential veto is not expected to be an important factor in 2022.

The continued difficulty of passing legislation through a closely divided Congress could mean that regulatory and administrative actions take on additional importance this year. Treasury and the IRS are expected to issue significant guidance implementing tax provisions in the COVID relief and infrastructure laws that were enacted in 2021 as well as under any tax legislation enacted in 2022. At the same time that the pace of regulatory activity is increasing, Treasury and the IRS also may need to administer other emergency and temporary relief provisions.

Janet Yellen continues to serve as Treasury Secretary and Lily Batchelder is Treasury Assistant Secretary for Tax Policy.

Current IRS Commissioner Charles Rettig was appointed to a fixed term that ends November 12, 2022. The position of IRS Chief Counsel is vacant; Principal Deputy Chief Counsel and Deputy Chief Counsel (Technical) William M. Paul had been serving as Acting Chief Counsel, but his term as acting chief counsel expired on November 17, 2021. Until a chief tax counsel is nominated, the duties of this position are being shared by Mr. Paul and IRS Deputy Chief Counsel (Operations) Drita Tonuzi for matters under their respective jurisdictions.

President Biden's economic team includes Brian Deese, who is Director of the National Economic Council. Shalanda Young, who currently is serving as Acting Director of the Office of Management and Budget (OMB), has been nominated by President Biden to serve as OMB Director. Cecilia Rouse is Chair of the Council of Economic Advisers.

Gary Gensler is chair of the Securities and Exchange Commission (SEC), and Rohit Chopra is director of the Consumer Financial Protection Bureau (CFPB).

At the Federal Reserve, President Biden has nominated Chair Jerome Powell, whose term expires in February 2022, to serve a second term. President Biden also has nominated Dr. Lael Brainard, who has served on the board of governors since 2014, to serve as Vice Chair. Additional recent

Fed nominations include Sarah Bloom Raskin (formerly a governor from 2010-2014) to serve as vice chair for supervision, and economists Lisa Cook and Philip Jefferson to fill two vacant seats on the board of governors.

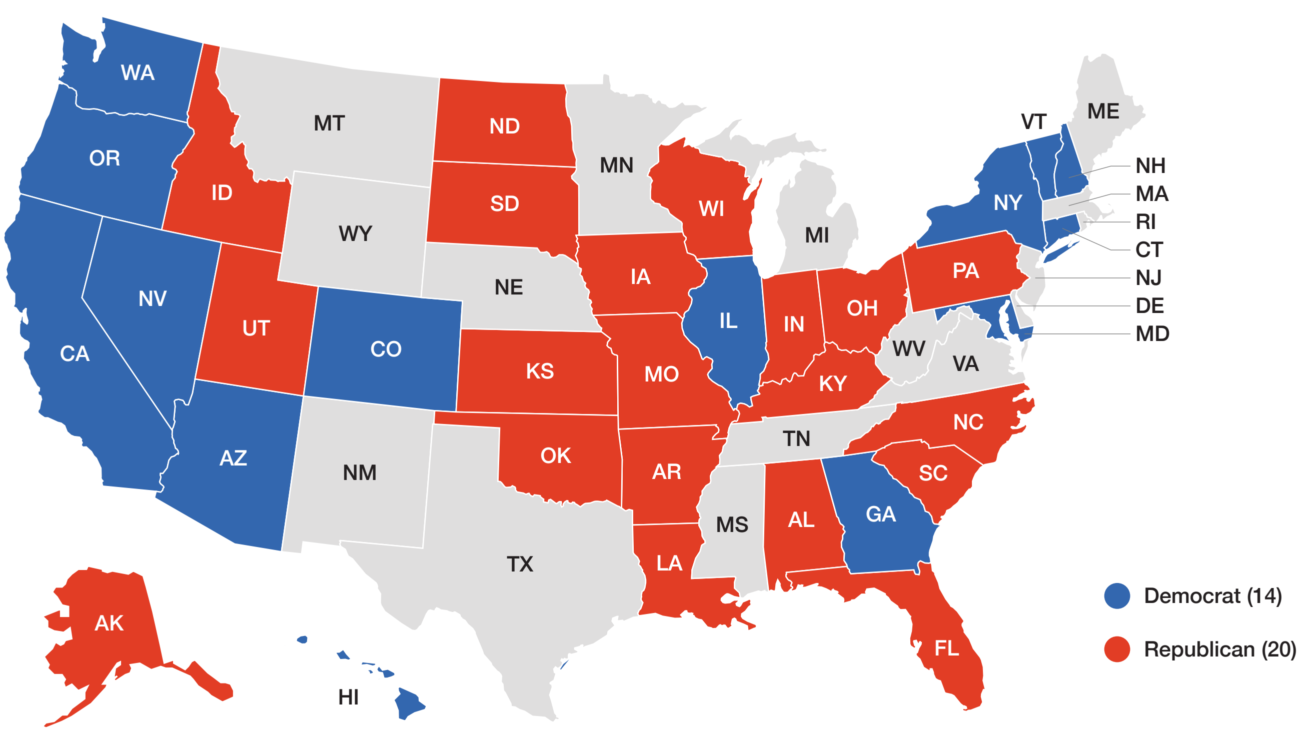
A listing of key policymakers is provided in Appendix A.

## 2022 midterm elections

All 435 seats in the House are up for election every two years. Republicans would need to achieve a net gain of only five seats in the 2022 midterm elections to regain control of the House. The outlook for 2022 House races is complicated by the reapportionment of House seats to reflect the 2020 census report. As a result, Texas will gain two Congressional seats while Colorado, Florida, Montana, North Carolina, and Oregon each will gain one seat. The states that will lose one seat are California, Illinois, Michigan, New York, Ohio, Pennsylvania, and West Virginia.

Roughly one-third of all Senate seats are subject to election every two years. In 2022, 34 Senate seats are up for election, of which 20 currently are held by Republicans and 14 currently are held by Democrats, as shown in Figure 7. Two of the Senate seats up for election in 2022—Mark Kelly (AZ) and Raphael Warnock (GA)—are held by Democrats who won special elections in 2020 for seats that had been held by Republicans. In addition, two Republican-held Senate seats up for election—Pat Toomey (PA) and Ron Johnson (WI)—are in states Joe Biden won in the 2020 presidential election. Senator Alex Padilla (D-CA), who was appointed to take the seat of Kamala Harris when she became Vice President, also will be up for election in 2022.

**Figure 7: Senate 2022 map**




Source: US Senate

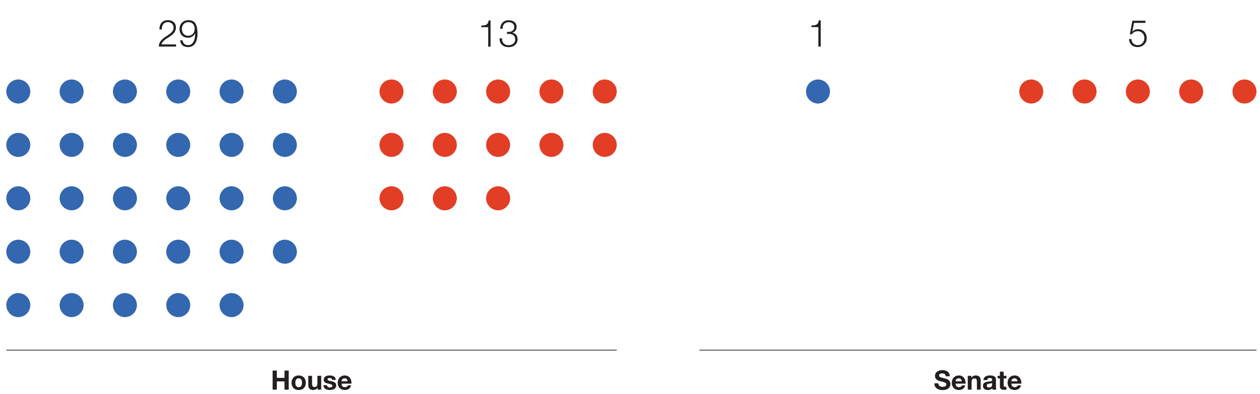
As of this writing, 29 House Democrats and 13 House Republicans have announced they will not seek re-election this year, as shown in Figure 8. Ways and Means Committee members that have announced they will not seek re-election include Ranking Member Brady, Stephanie Murphy (D-FL), Ron Kind (D-WI), Tom Suozzi (D-NY), and Tom Reed (R-NY).

One Democratic Senator and five Republican Senators so far have announced they will not run for re-election in 2022. Among the Senators not seeking re-election are Finance Committee members Richard Burr (R-NC), Rob Portman (R-OH), and Pat Toomey (R-PA). Other Senators not seeking re-election are Senators Roy Blunt (R-MO), Patrick Leahy (D-VT), and Richard Shelby (R-AL).

Senate Finance Committee members currently expected to run for re-election are Democrats Michael Bennet (CO), Catherine Cortez Masto (NV), Maggie Hassan (NH), and Ron Wyden (OR), and Republicans Mike Crapo (ID), Charles Grassley (IA), James Lankford (OK), Tim Scott (SC), John Thune (SD), and Todd Young (IN). A listing of all Senators whose seats are subject to election in 2022 is included in Appendix B.

*Observation:* If Republicans were to win control of the House or Senate in the next Congress as a result of the 2022 midterm elections, there would be a significant change in the current composition of one or both of the tax committees as the ratio of Democrats to Republicans would be subject to change. In any case, the retirement of Ways and Means Ranking Republican Brady means that House Republicans will need to name a new GOP member to serve as the top Republican on the House tax panel. No change currently is expected in the other leadership positions on the two tax committees.

**Figure 8: Incumbents not seeking re-election in 2022**



# US tax policy

## Overview

The top 2022 tax policy priority for President Biden and most Democrats in Congress is the ongoing effort to enact some version of the House-passed Build Back Better legislation. The need to secure the support of all 50 Democratic Senators—and the support in particular of Senators Manchin and Sinema—remains the primary obstacle to enacting significant corporate, international, and individual tax changes this year as part of that bill.

*Observation:* If Senate Democrats can reach an agreement on spending proposals for a revamped version of the House-passed bill, it is likely that they also will be able to resolve any remaining issues on tax provisions. It is also likely that any reconciliation bill that can gain the support of all 50 Senate Democrats will be accepted by House Democrats and cleared for signing by President Biden.

President Biden and Congressional Democrats achieved enactment of two major bills in 2021 that included some significant tax provisions (see list of tax provisions in Appendix C):

- The $1.9 trillion American Rescue Plan Act (ARPA) was enacted in early March 2021 with only Democratic votes by using budget reconciliation procedures. The legislation provided additional federal spending and targeted tax relief provisions in response to the COVID-19 pandemic. Key ARPA revenue-raising tax provisions included repealing the election for US affiliated groups to allocate interest expense on a worldwide basis and expanding the scope of the $1 million limitation on deducting compensation in the case of public corporations.

- The $1.2 trillion Infrastructure Investment and Jobs Act (the Infrastructure Act) was enacted in November 2021 with bipartisan support in the House and Senate. In addition to extending existing federal fuel excise taxes, other revenue-raising provisions include a new cryptocurrency information reporting requirement and the reinstatement of Superfund excise taxes on chemicals. The infrastructure legislation also expanded tax-exempt bond authority, which was a reversal of some of the 2017 tax reform act's tightening of the exclusion for contributions in aid of construction (CIAC).

## The ongoing evolution of President Biden's tax proposals

Soon after enactment of the ARPA, President Biden in March 2021 proposed a $2.3 trillion "American Jobs Plan," an infrastructure and climate change initiative that would have been funded by tax increase proposals. These included raising the US corporate income tax rate from 21% to 28%, imposing a 15% alternative minimum tax on global book income, and making various changes to US international tax rules.

In addition, the President in April 2021 proposed a $1.8 trillion "American Families Plan" that called for spending $1 trillion on education, childcare, paid family and medical leave, and nutrition programs, as well as $800 billion in targeted tax cuts. The cost of the plan was to have been offset by tax increase proposals that included raising the top individual income tax rate from 37% to 39.6%, taxing capital gain and dividend income at ordinary rates for individuals with incomes above $1 million, eliminating step-up in basis at death above certain income levels, broadening application of the 3.8% net investment tax, ending the "carried interest loophole," extending permanently the current limitation on certain excess business losses, and eliminating like-kind exchange tax treatment for certain real estate gains above $500,000. The American Families Plan also called for increasing funding for IRS enforcement efforts by $80 billion over 10 years.

After months of negotiations between a group of Senate Democrats and Republicans, the Senate voted 69 to 30 on August 10, 2021, to approve a compromise Infrastructure Investment and Jobs Act. This bill set aside President Biden's corporate and international tax increase proposals and adopted instead a limited number of revenue-raising provisions, as noted above. Over the objections of six progressive Democrats and 200 Republicans, the House voted 228 to 206 to approve the Senate-passed infrastructure bill without change on November 5, 2021, and President Biden signed the legislation on November 15, 2021.

Many of the corporate and individual tax rate increase proposals that originally were proposed in early 2021 by President Biden have been blocked or have been subjected to significant change by members of his own party.

For example, House Ways and Means Committee Democrats approved a bill that proposed to increase the corporate rate to 26.5%, instead of the 28% corporate rate proposed by President Biden. Ways and Means Democrats also approved international tax proposals that in many ways are less taxpayer unfavorable than the proposals that had been proposed by the Biden administration or some Senate Democrats. While agreeing with President Biden to increase the top ordinary income tax rate to 39.6%, Ways and Means Democrats rejected the president's proposals to tax the capital gains income of high-income individuals at the same rates as ordinary income and to eliminate step-up in basis at death.

Subsequently, Democrats in the full House acted to block even the more limited proposals to increase the US corporate income tax rate and individual tax rates for ordinary and capital gains income that had initially gained the support of Ways and Means Democrats. Additional Ways and Means proposals that were dropped include provisions related to carried interest, the Section 199A 20% deduction for pass-through income, and the estate tax and grantor trusts. In their place, House Democrats adopted several alternative revenue-raising proposals.

*Observation:* These actions were taken in large part in response to objections from Senator Sinema but also in response to concerns raised by certain moderate House Democrats who did not want to support legislative proposals that could not be passed in the Senate.

## The Build Back Better bill

### Corporate and individual tax proposals

During House action on what became known as the Build Back Better bill, new corporate and individual tax increase provisions that were adopted by the House include:

- a 15% corporate alternative minimum tax based on adjusted financial statement book income,
- a 1% excise tax on corporate stock repurchases, and
- a 5% surcharge on an individual's modified AGI in excess of $10 million and an additional 3% surcharge (total of 8%) on a taxpayer's modified AGI in excess of $25 million.

Some corporate and individual tax increase proposals that had been proposed by President Biden or the Ways and Means Committee were retained, with modifications in certain cases. These provisions in the House-passed bill include measures that would:

- expand the net investment income tax,
- impose new limits on high-income taxpayers with large retirement account balances,
- impose new limits on qualified small business stock exclusions,
- modify wash sale rules to address cryptocurrency and other issues,
- make permanent, with modifications, a temporary current-law limitation on excess business losses, and
- reinstate additional Superfund excise taxes (principally on crude oil).

### International provisions

President Biden has had greater success in securing Democratic support for significant international tax changes. While the administration's initial proposals have been moderated, the House-passed bill includes significant changes to provisions dealing with global intangible low-taxed income (GILTI), foreign-derived intangible income (FDII), foreign tax credit rules, the base erosion and anti-abuse tax (BEAT), and subpart F income. The House-passed bill also includes significant new limits on the interest deductions of international financial reporting groups.

While President Biden originally proposed to increase the GILTI rate to 21%, the House-passed bill would increase the current nominal GILTI rate from 10.5% to 15% (taking into account limitations on the ability to claim foreign tax credits on GILTI, the relevant GILTI rate would increase from 13.125% under current law to approximately 15.8% under the House-passed bill). Notably, the House-passed bill brings GILTI closer in some respects to the OECD's proposed rules, parts of which are more liberal than current-law GILTI. At the same time, the House adopted the president's proposal to apply the higher GILTI rate on a per-country basis instead of the current global basis. Congressional Democrats also opted to tighten the current-law BEAT provision instead of adopting the administration's proposal to replace BEAT with a new set of rules referred to as SHIELD (Stopping Harmful Inversions and Ending Low-Tax Developments).

*Observation:* The House-passed bill's provision to increase the GILTI rate to 15% (15.8% after the limitations on foreign tax credits) on a per-country basis, which is proposed to be effective in 2023, is intended to comport with the OECD's Pillar Two proposal. Some in Congress have expressed concern that the United States is proceeding faster than other countries to change its international tax rules, and have proposed that changes to the US GILTI rules should not be effective until at least 2024, if not some even later date.

### SALT cap relief

The House adopted additional provisions not proposed by President Biden or the Ways and Means Committee to secure the support of all but one House Democrat. For example, the House added a measure to the legislation that would increase the limitation on the itemized deduction for state and local taxes from $10,000 to $80,000 ($40,000 for an estate, trust, or married individual filing a separate return) through 2030, retroactive to 2021, with the current-law $10,000/$5,000 caps reinstated for one year through 2031. Under the 2017 tax reform act, the current-law SALT cap is set to expire at the end of 2025, along with all other individual and pass-through tax provisions enacted as part of that legislation.

*Observation:* There continues to be opposition from some Senate Democrats to the level of SALT cap relief included in the House-passed bill. Senators Bernie Sanders (I-VT) and Robert Menendez (D-NJ) have been discussing with Finance Chairman Wyden and other Senate Democrats various options to limit the ability of higher-income individuals to benefit from a change to the current SALT deduction cap. It remains unclear how and at what level of income this goal may be achieved as part of a compromise acceptable to all Democratic Senators as well as House Democrats.

### Research expensing

The House-passed bill includes some taxpayer-favorable provisions that were not proposed by President Biden. The most significant is a measure that would extend expensing (i.e., current deduction) of research and experimental costs under Section 174 through the end of 2025.

*Observation:* The 2017 tax reform act included changes to Section 174 expensing and Section 163(j) interest limitations that went into effect as scheduled after December 31, 2021. As discussed below, Congress could provide temporary Section 174 relief as part of action on the Build Back Better bill or in another legislative vehicle.

## Capitalizing R&E and increased interest disallowance rules have become effective

Prior to the 2017 tax reform act, Section 174 allowed taxpayers to currently deduct "research or experimental" (R&E) expenditures. Taxpayers alternatively could elect to treat R&E as deferred expenses that were deducted ratably over at least 60 months or as capital expenditures that were amortizable over a useful life, if determinable. Taxpayers choosing to deduct R&E expenditures also could annually elect under Section 59(e) to recover the costs over a 10-year period.

Similarly, Rev. Proc. 2000-50 provided that software development costs could be deducted currently, capitalized and amortized over five years, or capitalized and amortized over three years (with or without bonus depreciation).

The 2017 Act amended Section 174, effective for amounts paid or incurred in tax years beginning after December 31, 2021, to eliminate these options and require taxpayers to charge their R&E expenditures and software development costs (collectively, R&E expenditures) to a capital account. Capitalized costs are required to be amortized over five years (15 years for expenditures attributable to foreign research).

Legislation currently is under consideration in the Senate that would reinstate on a temporary basis the previous Section 174 treatment of R&E expenditures. The House-passed "Build Back Better" reconciliation bill would defer for four years the effective date of the 2017 capitalization and amortization requirement. If enacted, taxpayers with R&E expenses paid or incurred in tax years beginning before 2026 would continue to have the earlier options.

*Observation:* Allowing taxpayers to currently deduct R&E expenditures has broad bipartisan support as an incentive to invest in research activities, in recognition of the potential economic benefits that result from these activities. There are freestanding bills in both the House and Senate to repeal the change to Section 174 that would require capitalization.

A change to the Section 163(j) interest deduction limitation also has gone into effect in 2022. For tax years beginning after 2021, taxable income no longer is adjusted for depreciation, amortization, and depletion in arriving at adjusted taxable income (ATI). Excluding these adjustments results in lower ATI and potentially a greater interest disallowance. The House-passed Build Back Better bill does not propose to delay or eliminate this change to the computation of ATI.

*For consideration:* With the delay in Senate action on the Build Back Better bill, the changes to Section 174 and Section 163(j) have become effective for tax years beginning in 2022. Taxpayers should consider the effect of these changes on their first quarter 2022 financial reporting and estimated tax payments and on cash taxes, R&E credits, Section 861 allocation and apportionment of R&E expenditures, state income taxes, and other tax matters.

## Climate change provisions and other business and individual tax incentives

The House-passed bill features numerous incentives for clean energy and certain types of business investment. The bill also extends and expands various incentives for electric vehicles, renewable energy and reducing carbon emissions.

New or modified tax credits include:

- advanced manufacturing investment credit
- advanced manufacturing production credit
- clean electricity production and investment credits (as well as an increased clean energy investment credit for facilities connected to low-income communities)
- clean fuel production credit.

In addition to expanding the refundability of certain credits, taxpayers could elect the direct payment of some credits.

## IRS funding

The House-passed bill would appropriate approximately $79 billion in funds for the IRS for taxpayer services, enforcement, operations support, and business systems modernization. The provision also provides $15 million for the IRS to prepare and deliver a report to Congress on the cost of developing and running a free direct efile tax return system. These appropriated funds, which would be available to the IRS until September 30, 2031, could not be used to increase taxes on any taxpayer with taxable income below $400,000.

*Observation:* The proposed increases in funding would allow the IRS to increase the size of its workforce, greatly expanding its ability in the future to conduct examinations of large corporations, partnerships, and high-net worth individuals.

## Senate proposed changes to the House-passed bill

Senate Finance Committee Democrats have proposed amendments to some tax, trade, and healthcare provisions in the House-passed bill, as well as certain new proposals, such as a provision that would tighten current-law Section 7874 anti-inversion rules. Democrats on other Senate committees have proposed additional changes to the House-passed bill.

Assuming the support of Senator Manchin and all other Senate Democrats can be secured for a revised package of proposals, a substitute version of the House-passed bill is expected to be offered for floor debate and further amendments. Legislation considered in the Senate under budget reconciliation instructions is subject to limits on the overall time for debate and can be passed by a simple majority (allowing the Vice President to cast a tie-breaking vote), instead of the 60-vote supermajority required for most legislation.

### Effective dates

Potential Senate revisions could include revisiting the now retroactive effective dates of certain provisions, like the new 1% excise tax on corporate stock repurchases and new income tax surcharges that would apply for certain higher-income individuals, that are currently proposed to be effective at the start of 2022 (or at the start of 2021 in the case of the proposed SALT cap relief provision). The effective dates of some provisions that are proposed to be effective in 2023 or later also could be reconsidered.

*Observation:* Congressional Democrats may consider it appropriate to enact some tax provisions on a retroactive basis, based on the theory that taxpayers have been given fair warning of the proposed changes. At the same time, as discussed above, some in Congress have called for the effective dates of certain still prospective provisions—like proposed changes to US GILTI rules that are set to take effect in 2023—to be delayed further for policy reasons.

For a listing of key tax provisions and proposed effective dates in the House-passed bill and Finance Democrats' proposed changes, see Appendix D.

## Tax accounting implications

In general under US GAAP, ASC 740, Accounting for Income Taxes, requires that the effects of a change in tax law or rates be recognized in the period that includes the enactment date. For US federal tax purposes, the enactment date is most often the date the President signs the bill into law. From a state and local income tax perspective, companies would need to analyze how each jurisdiction adopts or otherwise conforms to the Internal Revenue Code (e.g., adoption of the Code as of a specific date, 'rolling conformity' that adopts federal amendments automatically, or other approaches).

The total effect of changes in tax laws or rates on current and deferred tax balances are recorded as a component of the income tax provision related to continuing operations for the period in which the law is enacted, even if the assets and liabilities relate to other components of the financial statements, such as discontinued operations, a prior business combination, or items of accumulated other comprehensive income. These effects may include, but are not limited to, changes to assessments surrounding the realizability of existing deferred tax assets (e.g., foreign tax credit or interest limitation carryovers). Importantly, companies should further consider which elements of the existing draft legislation relate to taxes based upon income (and thus included within the scope of the ASC 740 income tax accounting model), as opposed to non-income based taxes (which would be accounted for outside of the income tax accounting model, e.g., excise taxes).

To the extent that an enactment date occurs within an interim accounting period, companies would need to determine what impacts of the federal amendments are recognized through the annual effective tax rate and what should be recorded discretely in the period of the enacted change in tax law.

## Other possible legislation

### Retirement savings incentives

There have been ongoing discussions by leaders of the House Ways and Means Committee and the Senate Finance Committee on efforts to advance retirement savings incentives legislation. Finance Committee members Ben Cardin (D-MD) and Rob Portman (R-OH) also have long worked together in this area.

Key areas of focus include:

- Expanding automatic enrollment in retirement plans,
- Increasing the required distribution age to 75,
- Offering individuals 60 and older more flexibility to set aside savings as they approach retirement,
- Creating a new financial incentive for small businesses to offer retirement plans, and
- Increasing and modernizing the existing federal tax credit for contributions to a retirement plan or individual retirement account.

*Observation:* While retirement savings incentives generally have garnered bipartisan support in the House and Senate, it is unclear whether there will be a legislative vehicle on which such proposals can advance this year. The announced retirements of Ways and Means Ranking Member Brady and Senator Portman could spur additional efforts to act on this issue before the end of the current Congress.

### Tax extenders

The House-passed Build Back Better legislation includes provisions to extend a number of temporary business and individual tax provisions that have expired at the end of 2021 as well as some healthcare premium assistance provisions that are set to expire at the end of 2022. The House-passed bill also would extend and expand several renewable energy tax provisions that expired at the end of 2021 as well as biodiesel and renewable diesel energy tax provisions that are set to expire at the end of 2022.

Two temporary measures that are scheduled to expire at the end of 2022 and are not included in the House-passed bill are the following provisions:

- Allowance of full deduction for business meals provided by a restaurant.
- Railroad track maintenance credit (expiration of 50% rate).

*Observation:* If Senate Democrats are unable to reach an agreement on a revised version of the House-passed reconciliation bill, Congress could consider renewing some of the temporary provisions that expired at the end of 2021 and those that are set to expire at the end of 2022 as part of an “extenders package” that could be added to some other legislation later this year.

## Tax regulations

The Treasury Department will be responsible for a significant amount of regulatory guidance this year if the Congress enacts some version of the tax reconciliation bill now under Senate consideration. In particular, the current proposals to create a new 15% corporate alternative minimum tax based on adjusted financial statement book income and make sweeping changes to US international tax rules will require a considerable amount of new guidance.

Additional guidance will be needed for other legislation enacted during the current Congress, such as the new cryptocurrency information reporting requirements that were enacted as part of the 2021 Infrastructure Investment and Jobs Act. Other regulatory projects also are under consideration as part of the IRS priority guidance plan.

*Observation:* Biden administration efforts to advance the president's agenda through regulatory guidance are expected to increase significantly if there is a change of party control of the House or Senate following the 2022 midterm elections. Given the challenge that President Biden has had advancing some of his proposals through a Democratic-controlled Congress, the ability to pursue some policy goals through the regulatory process also may have appeal for some in the administration this year.

Recent significant regulatory guidance projects include the release on December 28, 2021 by Treasury and the IRS of final regulations addressing various aspects of the foreign tax credit (FTC) regime. The 2021 final regulations were published in the Federal Register on January 4, 2022, and represent the third set of final regulations that have been issued with respect to the core provisions of the US foreign tax credit regime following the 2017 tax reform act.

The 2021 final regulations provide guidance in the following areas:

- the disallowance of a credit or deduction for foreign income taxes with respect to dividends eligible for a dividends-received deduction under Section 245A;
- the allocation and apportionment of foreign income taxes, interest expense, and certain deductions of life insurance companies;
- the definition of a foreign income tax and a tax in lieu of an income tax, including a new attribution requirement (previously the "jurisdictional nexus" requirement);
- the definition of foreign branch category income; and
- the time at which foreign taxes accrue and can be claimed as a credit.

## Federal budget outlook

The Biden administration and other recent administrations have not made addressing federal budget deficits a high priority. This has been true especially in the past few years when the focus has been on responding to the COVID-19 pandemic and its effects on public health and the economy.

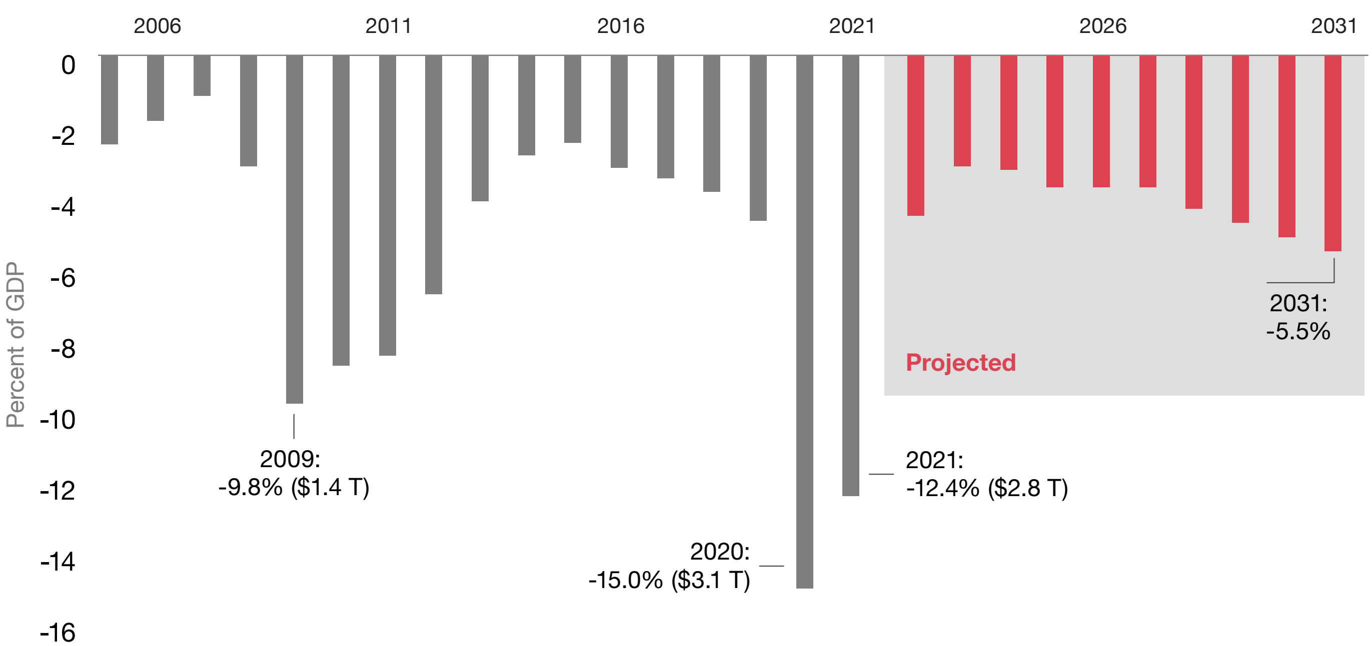
*Observation:* Projections of increased federal budget deficits and questions about the long-term solvency of Social Security and government health programs are expected to gain increased attention in advance of the 2022 midterm elections. Focus on federal budget deficits traditionally has increased when one party controls the White House and a different party controls the House or Senate.

### CBO projections

CBO is expected to release updated budget projections later this winter. In its projections last July, CBO forecast a federal budget deficit for fiscal year (FY) 2022 of $1.1 trillion (4.5% of GDP), adjusted to remove certain calendar-timing effects between fiscal years. The FY 2021 deficit was $2.8 trillion (12.4 percent of GDP). Deficits in FY 2020 and 2021—the two largest deficits as a percentage of GDP since 1945—were driven by pandemic-related spending and economic assistance and, for 2020, a contraction in GDP.

**Figure 9: Federal budget deficit is projected to decline for several years and then increase thereafter**

Projection assumes no deficit-increasing legislation is enacted over the next 10 years




Source: Projections from CBO July 2021.

Deficits are projected to decline to approximately 3% of GDP in FY 2023 and 2024, before beginning to rise for the remainder of the decade primarily due to growth in mandatory spending on Social Security and government health programs and interest on federal government debt. By 2031, deficits are projected to rise to 5.5% of GDP. With deficits exceeding the nominal growth rate of the economy, government debt held by the public is projected to increase from about 100% of GDP at the end of FY 2021 to 106% of GDP by 2031.

### Factors influencing deficits

These projections assume a current-law baseline. Deficits would be higher if future legislation increased government spending or reduced taxes, including possible extensions of expiring tax provisions, such as temporary provisions enacted in the 2017 tax reform legislation or the 2021 American Rescue Plan Act.

Deficits also may be higher or lower if tax receipts or spending differ from projected levels for reasons other than legislative changes. For FY 2021, tax receipts were $204 billion higher than CBO projected in July, with stronger individual income, corporate income, and other tax receipts offsetting lower than expected payroll taxes. On the spending side, higher than anticipated interest rates could increase interest payments on the federal debt more rapidly than forecast.

CBO's long-run budget forecasts, extending out 30 years, have not been updated since March 2021, prior to the enactment of the American Rescue Plan Act. Under CBO's extended baseline, deficits will rise steadily, reaching 13.3% of GDP in 2051. Government debt held by the public is projected to increase to more than 200% of GDP in 2051.

# Global tax policy

## OECD/Inclusive Framework

In October 2021, G20 leaders endorsed the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (Inclusive Framework) political agreement on a two-pillar plan to address the tax challenges arising from the digitalization of the economy. The plan, agreed to by 137 of the 141 members of the Inclusive Framework, provides for the reallocation of some (residual) profits of multinational enterprises to “market” countries (Pillar One) and a global minimum tax at an effective rate of 15% (Pillar Two). The agreement calls for the implementation of the rules by the beginning of 2023.

While reaching a political agreement is an important milestone, numerous technical issues need to be finalized across both pillars before implementation—making the timeline extremely ambitious. Many unknowns remain, but in 2022 companies should prepare for countries implementing the agreement through proposed domestic legislation for Pillar Two and a multilateral convention (MLC) for Pillar One (as well as tax authorities incorporating some of these concepts into audits, even before the relevant effective dates).

**Figure 10: OECD official timeline**

| | | |
|---|---|---|
| Oct 2021 | G20 Finance Ministers & Leaders political endorsement | |
| Dec 2021 | EU Draft Directive for Pillar Two | Pillar Two GloBE model rules |
| First half 2022 | Pillar One consultations on rolling basis as issues rolled out | Pillar Two Consultation in Feb once Commentary released |
| Mid-late 2022 | MLC for Pillar One: development and open for signature with signing ceremony in mid-2022 | Pillar Two STTR model provision and MLI language to be developed |
| Mid-late 2022 | Implementation Framework for GloBE rules to be developed by the end of 2022… or early 2023 | Amount B model rules to be finalized by the end of 2022 |
| 2023 | Pillar One MLC ratification and entry into force and effect | Pillars One & Two expected implementation in the EU |
| 2024 | Implementation of some IF countries with slower processes | UTPR to come into effect |

Interim period where signatory countries will not introduce any newly enacted DSTs

## Pillar One

Under “Amount A” of Pillar One, a formulaic share of a portion of the consolidated profit of MNEs will be allocated to markets (i.e., where sales arise). Amount A will apply to MNEs with profitability above 10% (profit before tax/revenue) and global turnover above EUR 20bn. The profit to be reallocated to markets will be calculated as 25% of the profit before tax in excess of 10% of revenue. Two sectors remain carved out from Amount A: extractive industries and regulated financial services. Amount A is expected to affect approximately 100 of the world’s largest companies; it is estimated that approximately 50% of those are US MNEs.

*Observation:* Key issues remain concerning the design and operation of Amount A, including: the identification of surrendering entities; the safe harbor for marketing and distribution activities; detailed sourcing rules; and mandatory and binding dispute prevention and resolution mechanisms. The opportunity for stakeholder input on these (and other) issues is expected in early 2022 through a series of public consultations.

Amount A will be implemented through an MLC that will be developed and opened for signature by mid-2022, with a goal of Amount A coming into effect in 2023. The MLC will be developed to introduce a multilateral framework for all jurisdictions that join, regardless of whether a tax treaty currently exists between those jurisdictions. Where a tax treaty exists between parties to the MLC, that tax treaty will remain in force and continue to govern cross-border taxation outside Amount A. The MLC will commit its signatories to remove all Digital Services Taxes (DSTs) and other relevant similar measures with respect to all companies (even those not in scope of Amount A), and to commit not to introduce such measures in the future.

The October 2021 agreement notes that work on “Amount B” of Pillar One—a fixed rate of return on in-country baseline marketing and distribution activities intended to approximate results determined under the arm’s-length principle—will be completed in 2022, with a particular focus on the needs of low-capacity countries. There is a planned public consultation for Amount B in mid-2022.

## Pillar Two

Under Pillar Two, the Inclusive Framework agreed to enact a jurisdictional-level minimum tax system with a minimum effective tax rate (ETR) of 15%. Companies with global turnover above EUR 750m will be within the scope of Pillar Two, with headquarter jurisdictions retaining the option to apply the rules to smaller, domestic MNEs.

The Pillar Two Model Rules were released on December 20, 2021, just days before the release of a draft EU Directive on minimum taxes (discussed below). The Model Rules cover the income inclusion rule (IIR) and undertaxed payments rule (UTPR), collectively referred to as “GloBE.” The Inclusive Framework also is developing the model provision for a “subject to tax rule” (STTR) together with a multilateral instrument for its implementation, to be released later in 2022. Generally, the goal is for Pillar Two to be brought into law in 2022, to be effective in 2023, with the UTPR to come into effect in 2024.

The Model Rules are final, and are intended to be implemented as part of a common approach. This means that Inclusive Framework member jurisdictions are not required to adopt the GloBE rules, but must accept their application by other Inclusive Framework members. Notably, the Model Rules do not specifically address co-existence with the US Global Intangible Low-Taxed Income (GILTI) rules in either their current form or as they might be amended. The OECD is expected to release explanatory Commentary to the Model Rules in early 2022, followed by the development of, and public consultation on, an implementation framework focused on administrative, compliance, and coordination issues (including safe harbors and conditions for US GILTI coexistence).

The UK and Ireland are among the first countries to launch a public consultation on how the Pillar Two Model Rules should be translated into their respective domestic legislation.

*Observation:* The OECD's timetable for implementing both Pillars remains highly ambitious. However, companies should prepare for the likelihood that the Inclusive Framework's technical work will be implemented in the foreseeable future. In the short term, there is still time to make an impact. There will be opportunities for stakeholder engagement in 2022, and companies should stay (or become) involved in the process.

*Action item:* To provide feedback, tax leaders should engage with the C-suite to identify primary areas of concern and collaborate with other stakeholders, such as sectoral and broader trade groups, including Business at OECD (BIAC) and the US Council for International Business (USCIB). In particular, companies should examine whether they are in scope, and what consequences could result from their global digital footprint. It is important to model out how these measures will affect overall ETRs and how they will intersect with US rules, such as the foreign tax credit (particularly bearing in mind the recently released FTC regulations). For US-headquartered groups, or intermediate holding companies in the United States, the question of whether the US GILTI regime is a "compliant Pillar Two regime" remains unanswered; without such protection, subsidiaries of US-owned businesses could be subject to the UTPR.

## Role of US Treasury and Congress

### *Biden proposal on scope of Pillar One*

US engagement in the OECD negotiations on the digital tax project shifted gears following the transition to the Biden administration in 2021. Former Treasury Secretary Steven Mnuchin's proposal to make Pillar One a safe harbor for US companies (the US "safe-harbor regime" proposal), which was unacceptable to other governments, was replaced with Secretary Yellen's push for a dramatic change in direction on the scope of Amount A.

In April 2021, the new administration outlined its proposal to scrap the requirement that only "consumer-facing businesses" (CFB) and "automated digital services" (ADS) industries and activities be in scope of Amount A. Instead, Amount A would apply to the largest and most profitable MNE groups, regardless of industry classification or business model (i.e., a comprehensive scope determined by quantitative criteria). The intent behind US Treasury's proposal was to minimize subjective scoping discrimination and achieve administrability by shrinking the number of companies in scope of Amount A to no more than 100 MNEs.

*Observation:* This proposal, which was agreed by the Inclusive Framework, offered a simpler, but not necessarily more-principled approach. While it solved some problems, like the impasse created by the previous administration's safe harbor proposal, it created others, like bringing new industries and transactions unaffected by DSTs into scope.

## Tax treaty process may pose challenges for US implementation of Pillar One

While there is some debate on this issue, there seems to be a growing consensus that Pillar One can only be implemented effectively by treaty, not just by domestic legislation. Under the US Constitution, ratification of a treaty requires a two-thirds majority in the Senate. As discussed below in more detail, the Senate in recent years has faced significant obstacles in agreeing to ratify tax treaties. A lack of consensus among policymakers on positions taken by the Treasury Department on the OECD's proposals is expected to increase the difficulty of acting on tax treaties related to Pillar One.

*Observation:* The prospects for securing sufficient levels of bipartisan Senate support to ratify the expected treaty related to Pillar One appear uncertain at this time. A number of Republican Senators have expressed public opposition to the Treasury Department's current approach to both Pillar One and Pillar Two.

*Observation:* A comprehensive scope of Amount A calls for a rethink of the Pillar One rules and how they apply to various industries and transactions that were not covered by the CFB and ADS scope, which may be complex in some instances. Part of the reason for a CFB scope was that consumer-facing businesses, for commercial reasons, are best placed to know their end customers—which, in particular, simplified the approach to Amount A revenue sourcing. A comprehensive scope demands a more comprehensive approach to revenue sourcing (e.g., for business-to-business sale of goods or services) and other key building blocks of Pillar One. Stakeholder input on the final design of the Pillar One rules in light of the comprehensive scope will be critical to ensure the rules are administrable, minimize compliance costs, and produce results consistent with intended policy objectives.

***Effect on Pillar Two of Biden GILTI proposals***

On Pillar Two, proposed changes to the US tax code played a significant role in the OECD negotiations. For example, the publication of President Biden's tax plan in April 2021 had the effect of moving the discussion on the Pillar Two rate from 12.5% to 21% (so as to match the proposed increased GILTI rate), before it landed initially on a rate of "at least 15%" in July and eventually on a rate of 15% as part of the Inclusive Framework's October 2021 agreement.

In addition, the Biden administration proposal to move the application of the GILTI regime from a global blending system to a country-by-country system has had an effect on the Pillar Two blending rule, which already followed a jurisdictional blending model. Following the publication of the Biden plans to move GILTI to a country-by-country basis, the OECD proposal moved towards making jurisdictional blending of ETRs a "super factor" for a minimum tax regime to be treated as a qualified IIR under the GloBE rules.

*Observation:* Many observers have suggested that Treasury's support for Pillar Two is being driven to a significant degree by the Biden administration's desire to raise the US GILTI rate. The administration's support for a country-by-country approach also reflects the longstanding policy preferences of key Democrats in Congress, including Senate Finance Committee Chairman Wyden.

The House-passed Build Back Better legislation seeks to align proposed changes to the US GILTI regime more closely with Pillar Two, including applying it on a country-by-country basis and ensuring the US effective statutory rate on foreign-source income is at least 15%. However, the uncertain outlook for Senate action on the Build Back Better legislation has raised questions about whether US tax changes will be enacted in a form that is considered compliant with Pillar Two.

## What happens if US tax rules are deemed to be noncompliant with Pillar Two?

While the outlook for US tax legislation may be uncertain, key officials in the European Union and other jurisdictions have signaled an intent to proceed with efforts to implement Pillar Two by enacting their own domestic legislation. Companies in scope of Pillar Two should model scenarios that take into account the interaction between the UTPR and both the current-law US GILTI regime and the proposed revisions to the US GILTI regime. Recent US foreign tax credit guidance calls into question whether UTPR-type payments to foreign jurisdictions would be considered creditable for the purpose of claiming US foreign tax credits.

**Scenario A:** Under a scenario in which the current-law US GILTI regime (with its 10.5% rate and global netting provisions) remains in effect, foreign jurisdictions may apply the UTPR in a broad manner that could affect most US MNEs with operations in those jurisdictions.

**Scenario B:** Under a scenario where the United States enacts changes to its GILTI regime that are intended to comply with Pillar Two, foreign jurisdictions still could apply the UTPR in more limited circumstances in the case of US MNEs that benefit from the use of general business credits (e.g., R&D and clean energy credits) that produce an ETR on income earned in the United States that is lower than 15% for Pillar Two purposes (even though in excess of 15% for US tax purposes).

## EU implementation

Shortly after the Inclusive Framework's release of the Pillar Two Model Rules, the European Commission (EC) published its proposal for a Council Directive "on ensuring a global minimum level of taxation for multinational groups in the Union" (Draft Directive). The Draft Directive largely mirrors the OECD model rules but differs in some notable respects. In particular, the Draft Directive includes an extension of the IIR to "large-scale" purely domestic groups and allows EU Member States to exercise the option to apply a domestic top-up tax to low-taxed domestic subsidiaries (this will allow the top-up tax due by the subsidiaries of the multinational group to be charged locally–within the respective Member State–and not at the level of the parent entity).

While the OECD Model Rules do not specifically address the US GILTI regime at a time when legislative changes are being considered in the United States, the EC Draft Directive rules out the possibility that the current GILTI rules would be considered compliant with Pillar Two. Under the proposed EC rules, blending of income only would be allowed for entities within the same jurisdiction.

The timeline for EU action on Pillar Two seeks to meet the OECD's ambitious target dates for implementation. EC officials have outlined a plan to have a high-level agreement at the EU level by June 2022, and individual member states transposing the Directive into their own national laws, so as to be effective by January 2023.

The timetable envisaged by the EC raises an issue with regard to the OECD process of issuing guidance for the implementation of Pillar Two. The OECD explanatory Commentary is not scheduled to be released before February 2022; the final implementation guidance is not expected to be available until the end of 2022 and could be delayed until early 2023. In light of this uncertain timetable for OECD guidance, there can be no assurance that the ongoing OECD work and the Draft Directive (and EU Member States laws) will fully converge.

*Observation:* If there is a lack of synchronicity between the OECD and EU timelines, the EU could implement laws without the OECD guidance being issued, causing a potential lack of consistency. This could result in companies having to grapple with parallel implementation of the rules by the EU and other jurisdictions that fail to synchronize with the OECD timeline.

## Unilateral Measures/DSTs

A key impetus of the global negotiations on the OECD's digital tax project was to preclude uncoordinated unilateral measures (e.g., DSTs) from being imposed by different jurisdictions. The October 8 Inclusive Framework agreement formalized this resolution.

The agreement noted that the Pillar One MLC will remove existing DSTs and "relevant similar measures" for all companies, presumably including those that are not in scope of Pillar One. It also commits parties not to introduce any new DSTs or other relevant similar measures. Specifically, the agreement requires the parties not to impose any newly enacted DSTs (or other such measures) from October 8, 2021 until the earlier of December 31, 2023 or the coming into force of the MLC.

In keeping with this objective, in late 2021 a Joint Statement was issued between the United States and Austria, France, Italy, Spain, and the United Kingdom ("Unilateral Measures Compromise") where the latter agreed to withdraw their DST rules for all companies once Pillar One takes effect. The same countries also agreed that DST liabilities accrued and collected in their jurisdictions in the period beginning on January 1, 2022 and ending on the date the MLC implementing Pillar One comes into force on December 31, 2023 (the Interim Period) would be credited against the tax liability arising from the introduction of Amount A under Pillar One. In return, the United States agreed to terminate proposed trade actions, including for periods before October 8, and not to impose any new trade actions, until the end of the Interim Period with respect to the existing DSTs imposed by the countries participating in the joint statement. The United States struck similar agreements with Turkey and India.

*Observation:* The timeline remains unclear for withdrawal of existing DSTs (and other such measures), as does the future of DSTs beyond 2023, particularly for those jurisdictions that do not sign up to the MLC or for companies that are not within the scope of Amount A. Further, while these agreements may bring some relief to companies in scope of Pillar One, most companies nevertheless need to be prepared to pay DSTs in jurisdictions that have not yet withdrawn them and those that did not sign onto the October 8 Inclusive Framework agreement (e.g., Nigeria and Kenya).

## Other EU activities

The implementation of the global minimum tax in the EU is accompanied by several other significant corporate tax changes that are expected to move forward in 2022.

- **Public country-by-country reporting:** On November 11, 2021, after several years of considering the proposal, the EU parliament passed the EU Accounting Directive (the 'Directive') requiring public country-by-country reporting (pCbCR). The new rules apply to multinational groups or standalone undertakings with a total consolidated revenue of at least EUR 750m, over a period of two consecutive financial years, whether headquartered within the European Union or not. Companies will need to disclose publicly the corporate income tax they pay in each EU Member State plus in each of the countries that are either on the EU list of non-cooperative jurisdictions for tax purposes (the 'EU's blacklist'), or listed for two consecutive years on the list of jurisdictions that do not yet comply with all international tax standards but have committed to reform (the 'EU's grey list'). EU Member States now have a maximum of 18 months to transpose the Directive into domestic legislation. If transposition does not occur ahead of the mandated timeline, businesses can expect that the additional disclosure requirements will become applicable in mid-2024, that they will apply to accounting periods beginning after that date, and that disclosure will first be required in the latter part of 2025 (or, more likely, 2026 for those with a December 31 accounting year-end).

- **Public ETR proposal:** In 2022, the EU is expected to release a legislative proposal for the publication of ETRs paid by large companies, based on the methodology under discussion in Pillar Two of the OECD negotiations. The proposal aims to improve public transparency around the real ETR experienced by large EU companies.

- **EU "shell entities" directive:** On December 22, 2021, in tandem with its global minimum tax proposal, the EC proposed a shell company directive, also known as "ATAD 3," to target EU shell entities that are deemed to have minimal substance. The proposal would be transposed into national law by July 1, 2023 and come into effect in January 2024.

*Observation:* This proposal could have significant ramifications beyond the usual understanding of what constitutes a "shell" entity. Under the proposal, if an undertaking is deemed to be a shell entity, benefits of tax treaties and EU Directives may be denied, resulting in an increased withholding tax burden as well as potential penalties.

- **DAC 7 and focus on digital platforms transparency:** The latest Directive on Administrative Cooperation (DAC 7) aims to enhance tax transparency through automatic exchange of information between EU Member States on potential "aggressive tax planning" and circumvention of Common Reporting Standard (CRS) reporting and Ultimate Beneficial Owner (UBO) identification schemes. Additional regulations intend to strengthen transparency obligations in tax matters in broader areas. In this regard, the Council of the EU adopted on March 22, 2021 the proposal for DAC 7 in order to extend the EU tax transparency rules to digital platforms. Member States have until December 31, 2022, to implement DAC 7.

## Other international developments

As global tax revisions progress, particular countries are considering changes to incentivize investment or protect their tax base. In late December, the Irish government opened a consultation on options for replacing its worldwide corporate tax regime with a limited territorial system that would offer a participation exemption for dividends and gains on foreign direct investments.

As part of its post-pandemic recovery efforts, the UK responded with the Finance Act 2021, which in addition to introducing innovation incentives, raised its tax rate from 19% to 25% in the main rate of corporation tax. This change will take effect in April 2023.

In January, the UK launched a public consultation on implementing the Pillar Two Model rules. The consultation sets out a proposal for a UK domestic minimum top-up tax (DMT), which would be closely based on the GloBE rules, but rather than allowing a foreign jurisdiction to charge top-up taxes in relation to any low-taxed profits of a group's entities in the UK, the UK would instead impose that top-up tax. If pursued, the UK DMT would take effect no earlier than April 1, 2024.

The Mexican Congress on October 26 approved several changes to different tax laws as part of the proposed 2022 budget. Significant changes include a number of strong measures aimed at tax evasion and avoidance.

*Observation:* Given the broad nature of the changes introduced, multinationals with operations in these countries should analyze and model the effect of these new provisions.

## Tax treaties

There has been limited movement on US tax treaties in recent years. The challenge of securing Senate action on tax treaties has been the primary impediment to implementing new agreements. US tax treaties traditionally have been considered in the Senate under unanimous consent procedures, which permit ratification of treaties without requiring significant Senate floor time for debate and formal vote, but that changed with Senator Rand Paul's (R-KY) election in 2010. Senator Paul has consistently objected to expediting the consideration of tax treaties due to privacy concerns related to tax information exchange provisions, which have been expanded in recent years as part of a global effort to prevent tax evasion.

Despite these procedural challenges, Senate leadership in July 2019 filed a cloture motion that resulted in the Senate's ratification of four long-pending protocols to US tax treaties with Spain, Switzerland, Japan, and Luxembourg. Further Senate consideration of long-pending tax treaties with Chile, Hungary, and Poland, however, was delayed because of reservations requested by the Treasury regarding the interaction of treaties and the BEAT provision.

The Biden administration may seek to reopen tax treaty negotiations with Chile, Hungary, and Poland unless agreement is reached on a reservation. If the Senate approves the treaties with a reservation, the treaty partner will have the option of accepting the treaty with the reservation or requesting another round of negotiations.

Treasury officials have commented in public forums that work is underway to update the existing treaty network, including efforts to open negotiations with Croatia, the only EU member country with which the United States does not have an existing tax treaty. Previous comments from Treasury officials indicate that negotiations may be resumed with Vietnam, Norway, Romania, Colombia, and the Netherlands. As noted above, the United States also may need to address the OECD Pillar One proposals as part of the negotiations with other countries on future tax treaties.

# Trade policy

The effects of a global pandemic, increased tensions in US-China relations, and sometimes strained ties with long-standing allies and partners continue to loom over a wide range of trade and investment issues.

US Trade Representative (USTR) Katherine Tai has stated that the United States will continue consulting and coordinating with allies and partners to ensure that "the terms of competition are fair, work collectively to set the rules of the road for trade and technology in the 21st century, and strengthen the global market for our workers and businesses." The USTR plans to accelerate this progress and to maintain conversations with allies and partners about how the United States and its allies and partners can work together to find solutions and present a unified front to address the effect of China's nonmarket practices.

*Observation:* Protectionist policies are continuing to receive support across the political spectrum around the world. Global tensions and national security interests are leading the United States and other jurisdictions—including Australia, Canada, China, the EU, Japan, and the United Kingdom—to increase the breadth and depth of protectionist policies. Countries are exploring how to protect homegrown technological advancement and companies from foreign investment and the potential loss of critical intellectual property.

## Trade legislation

### US Innovation and Competition Act

President Biden and Congressional leaders are working on a bipartisan basis to enact legislation—the US Innovation and Competition Act (S. 1260), which is also known as USICA—that seeks to boost US semiconductor production, scientific research, development of artificial intelligence, and space exploration to address growing economic, technological, and military competition from China. USICA also includes various national security measures aimed at cyberattacks, foreign infiltration of domestic supply chains, and foreign exploitation of US intellectual property.

The legislation, which was passed by the Senate on June 8, 2021, integrates several China-related bills, including the CHIPS for America Act, which is designed to preserve a competitive edge over China through the appropriation of billions of dollars for various US manufacturing and infrastructure initiatives.

House Speaker Pelosi has indicated that the House may hold a floor vote in early February on its version of USICA. As noted above, House leaders have indicated that rather than resolving differences beforehand, they intend to pass their version of the legislation and then seek to resolve the differences between the two versions of the bill.

Key provisions of USICA as passed by the Senate would:

- Require the Biden Administration to impose economic sanctions on Chinese entities that knowingly undermine US cybersecurity or engage in theft of trade secrets;
- Strengthen the Committee on Foreign Investment in the United States (CFIUS) review of deals with limited ties to the United States;
- Authorize $1.5 billion for the Countering Chinese Influence Fund and require the United States to develop strategies to counter Chinese influence in various specific regions throughout the world;
- Amend the Uyghur Human Rights Policy Act of 2020 to require imposition of sanctions against individuals deemed responsible for serious human rights violations in Xinjiang;
- Authorize the Secretary of State to determine that an alien is inadmissible if the alien enters the United States to steal emerging technologies on behalf of an adversarial foreign government;
- Prohibit the use of TikTok on federal government devices;
- Establish ‘Buy American’ procurement preferences for all public infrastructure spending; and
- Address a wide range of trade issues, including provisions on the generalized system of preferences and miscellaneous tariff relief.

## Presidential trade and tariff authority

President Biden and Congress last year did not act to renew trade promotion authority (TPA) legislation before it expired on July 1, 2021. TPA provided US presidents with authority to negotiate comprehensive reciprocal free trade agreements with major trading partners, which then were considered in Congress under an expedited process.

Under TPA procedures, trade agreements were limited to debate (i.e., no filibuster) and an up-or-down vote (i.e., no amendments allowed) when all debate time expired. Also known as 'fast track' trade negotiating authority, TPA was subject to certain conditions, including Congressional consultation and access to information during all phases of trade negotiations.

## Harmonized Tariff Schedule (HTS)

The US International Trade Commission (USITC) publishes and maintains the HTS and provides technical information on its structure and modification. Only the Bureau of Customs and Border Protection (CBP) is authorized to interpret the HTS, to issue legally binding rulings or advice on the tariff classification of imports and their treatment upon entry into the United States, and to administer the US customs laws.

A December 23, 2021, presidential proclamation updates the HTS to reflect changes in several US trade agreements with other countries, including the Dominican Republic-Central America-United States Free Trade Agreement, the United States-Peru Trade Promotion Agreement, the United States-Korea Free Trade Agreement, the United States-Colombia Trade Promotion Agreement, the United States-Panama Trade Promotion Agreement, the United States-Mexico-Canada Agreement (USMCA), the United States-Israel Free Trade Agreement, and the United States-Singapore Free Trade Agreement.

The proclamation also updates the HTS to reflect increased duties on imports from China resulting from the USTR determination that China's acts, policies, and practices related to technology transfer, intellectual property, and innovation are actionable under section 301(b) of the Trade Act. These changes to the HTS will take effect January 27, 2022.

The presidential proclamation terminates, effective January 1, 2022, the designation of Ethiopia, the Republic of Guinea, and the Republic of Mali as beneficiary sub-Saharan African countries for purposes of section 506A(a)(1) of the Trade Act, as added by section 111(a) of the African Growth and Opportunity Act (AGOA), because the president has determined that these countries are not making continual progress in meeting the requirements described in section 506A(a)(1) of the Trade Act.

## Other trade legislation

Senators Sherrod Brown (D-OH) and Rob Portman (R-OH) in April 2021 introduced the Leveling the Playing Field 2.0 Act to strengthen US trade remedy laws as effective tools to challenge unfair trade practices and protect American workers. The legislation would establish the new concept of "successive investigations" to improve the effectiveness of the US trade remedy system in responding to repeat offenders, helping to level the playing field for American workers. Representatives Terri Sewell (D-AL) and Bill Johnson (R-OH) introduced companion legislation in the House.

## Trade relations

### US-China relations

President Biden and Chinese President Xi set a pragmatic tone at their November 15, 2021, virtual summit but the meeting did not yield significant changes in US-China relations. The summit was a strong indicator that both countries want to avoid the tense relationship seen in recent years, but did not alleviate concerns about long-term US-China relations (including how US relations with Russia affect US-China relations) or clarify whether the United States and China will reignite trade tensions or hinder commerce between US and Chinese companies.

*Observation:* The absence of a joint statement by the two leaders or substantive outcome suggests that the presidents found little common ground beyond avoiding public disagreements. It appears that the leaders are agreeing to cooperate on win-win issues, while leaving more complex problems that challenge the US-China relationship unresolved for now. For China, these issues include greater access to the US market and technology, and recognition of China's power, and for the United States, they include greater access for US firms in China, combating intellectual property theft, and limiting China's power.

The USTR on October 4, 2021, described the Biden Administration's approach to the US-China bilateral trade relationship as "a comprehensive, thoughtful USTR-led, whole-of-government review of the bilateral trade relationship" with the objective of not escalating trade tensions with China.

The USTR announced that the United States will restart talks with China as to its compliance with the conditions of Phase One of a multibillion-dollar trade agreement signed by former President Donald Trump and Chinese Vice Premier Liu He on January 15, 2020. Phase One called for certain actions by China, including structural reforms and other changes to China's economic and trade regime regarding intellectual property, technology transfer, agriculture, financial services, and currency and foreign exchange practices. The agreement also included a commitment by China to increase purchases of US agricultural goods, energy, and manufactured goods by $200 billion through December 31, 2021.

The USTR also announced that the United States will reopen a process to allow US firms to seek exemptions from tariffs on certain Chinese imports—a step which may suggest a US intent to keep the current tariff framework in place. While pursuing Phase One enforcement, the United States restarted its targeted tariff exclusions process to mitigate the effects of certain tariffs imposed by former President Trump under section 301 of the Trade Act of 1974. The Phase One agreement was reached after multiple rounds of tariff increases by both the United States and China and left in place the 25% and 7.5% tariffs on approximately $250 billion and $120 billion, respectively, of Chinese imports.

In addition, the USTR announced that the United States plans to address various issues not covered in the Phase One agreement, specifically related to China's "state-centered and non-market trade practices including Beijing's non-market policies and practices that distort competition by propping up state-owned enterprises, limiting market access, and other coercive and predatory practices in trade and technology…and the theft of US intellectual property."

President Biden on December 23, 2021, signed the Uyghur Forced Labor Prevention Act, which effectively bans imports of all goods from the Xinjiang Autonomous Uyghur Region of China on the 'rebuttable presumption' that they are made with forced labor, unless an importer can prove otherwise. The law also creates new reporting requirements and declares that it is the policy of the United States to coordinate with Canada and Mexico on this issue. The enactment continues the relatively recent trend toward using section 307 of the Tariff Act of 1930 on a region-wide basis and for humanitarian purposes. Section 307 prohibits importing any product that was mined, produced, or manufactured wholly or in part by forced labor, including forced or indentured child labor.

### United States-Mexico-Canada Agreement (USMCA)

The USTR on January 4, 2022, announced that "the United States has prevailed in the first dispute settlement panel proceeding ever brought under the USMCA. A USMCA panel agreed with the United States that Canada is breaching its USMCA commitments by reserving most of the in-quota quantity in its dairy tariff-rate quotas (TRQs) for the exclusive use of Canadian processors." The USITC has estimated that implementation of the USMCA would increase US dairy exports to Canada by $227 million.

The Mexican government on January 6, 2022, requested a USMCA panel to resolve its dispute with the United States regarding the rules of origin for automotive parts. Mexico claims that the United States is improperly interpreting stricter regional content rules under the agreement, which raised required regional content to 75% of a vehicle's value or components from the 62.5% threshold under the prior North American Free Trade Agreement. Mexico is arguing that the United States is taking an unduly strict approach by not allowing "various methodologies" to calculate content as contained in the USMCA annex. A USTR spokesman stated, "We are reviewing Mexico's request to establish a panel and remain confident that the US interpretation of the automotive rules of origin is consistent with the USMCA."

Senate Finance Committee Chairman Wyden and Ranking Member Crapo on January 12, 2022, sent a letter to the USTR raising issues with respect to Canada and Mexico's compliance with the USMCA treaty obligations. Among the concerns are Canada's continued efforts to impose its proposed DST, which would potentially violate the USMCA. The Senators urged the USTR to utilize remedial measures under the USMCA if Canada proceeds with these measures.

### North American foreign trade zones (FTZs)

The USTR has requested a study of North American FTZs "to understand the impact of FTZs and programs on employment and the competitiveness of goods produced in FTZs in the United States." The USTR believes that the USITC "can be helpful to us in understanding the operation of US FTZs and similar programs in Canada and Mexico, and whether and how policies and practices with respect to those respective FTZs and programs impact employment and the competitiveness of goods produced in FTZs in the United States."

The USTR seeks data with respect to (1) economic activity in FTZs in the United States, Canada, and Mexico since 2016; (2) current FTZ policies and practices in the three countries; and (3) to the extent practicable, an analysis of current FTZ policies and practices in the three countries on the cost competitiveness of products of firms operating in these FTZs.

## US-European Union (EU) trade

The USTR announced in an October 21, 2021, release that—in response to the United States reaching an agreement with Austria, France, Italy, Spain, and the United Kingdom regarding the treatment of DSTs during the interim period prior to full implementation of Pillar One of the OECD agreement—the United States will terminate the currently suspended additional 25% tariffs on certain goods from those countries that had been adopted following conclusion of the DST Section 301 investigations. These tariffs otherwise would have taken effect at the end of November 2021.

During a joint appearance with EU President Ursula von der Leyen on October 31, 2021, President Biden announced that the United States and EU reached an agreement that will end the trade dispute between the two regions that began in 2018, when former President Trump imposed section 232 tariffs on aluminum and steel imports from the EU, after which the EU imposed retaliatory tariffs on certain imports of US retail products. Under the agreement, US tariffs on steel and aluminum imports will remain at 25% and 10%, respectively, but certain amounts of aluminum and steel "entirely produced" in the EU may be imported into the United States free of tariffs for two years.

*Observation:* Recent proposals in the EU and the United States to impose border adjustments on certain imports from heavy carbon emitters, while in the early stages and likely to face challenges, represent new initiatives to address climate change—the use of established trade mechanisms. This proposed new form of border levy could have a considerable effect on international trade due to the prominence of the EU and the United States in global supply chains. These efforts have attracted the attention of countries such as China and Russia that could be affected considerably by such adjustments.

Mechanisms such as the EU's 'cap-and-trade' Emissions Trading Scheme (ETS) have been in place for many years. The EU and the United States now are considering new proposals generally known as carbon border taxes or border adjustments—levies on imports based on the amount of carbon emissions resulting from production of the product in question. These measures, at least in the case of the EU proposal, are aimed in part at reducing 'carbon leakage'—the relocation by businesses from countries that have enacted measures to reduce carbon emissions to other countries with looser standards. They also are viewed as a means of incentivizing or penalizing countries deemed to be insufficiently addressing the issue of climate change.

The European Commission, as part of its 'Fit for 55' package (named for the goal of reducing EU greenhouse gas emissions by 55% by 2030 compared with 1990 levels), has proposed a Carbon Border Adjustment Mechanism (CBAM). The proposed CBAM would be a levy on the importation of certain specified goods (cement, electricity, fertilizers, iron and steel, and aluminum) into the EU. A reporting system will apply beginning in 2023 for covered products, and importers will start paying a financial adjustment in 2026.

## US-UK trade agreement

The United States and the United Kingdom formally launched trade negotiations in March 2020 and completed five rounds of talks working toward a comprehensive US-UK Free Trade Agreement (US-UK FTA). After a promising start, US-UK trade negotiations have slowed as both countries continue to focus on higher domestic and international priorities.

# State tax policy

States saw a dramatic improvement in their fiscal outlooks as they progressed through the 2021 legislative sessions, enacting the largest spending increases since fiscal year 2007. When they closed the books on fiscal year 2021, 46 states reported year-end balances at least 10% above their total general fund spending.

With actual tax revenues generally continuing to exceed projections, states this year may shy away from significant tax increases. At the same time, states may not enact major tax cuts, given continued uncertainty around COVID, inflation, and the end of federal budget assistance.

*Observation:* Further, states generally avoid making significant tax changes in an election year, and this year there will be 36 gubernatorial races plus legislative races in 46 states. Given these factors, states may be more likely to consider spending priorities and targeted tax policies to spur economic development and help struggling individuals and businesses.

## Corporate and individual focus on tax rates

### Tax increases

Income tax rate increase and ‘wealth tax’ proposals garnered significant attention in the states in 2021, including multiple proposals in California and New York. New York ultimately enacted temporary corporate and individual income tax rate increases, while Connecticut extended its corporate surcharge through 2022. Further, Washington enacted a 7% tax on long-term capital gains; that legislation is being challenged in court.

### Tax cuts

Spurred by improving economic conditions, however, over a dozen states enacted corporate and individual income tax rate cuts. This is despite the American Rescue Plan Act requirement that Treasury recoup fiscal recovery funds disbursed to the states to the extent they are used to either directly or indirectly offset a reduction in net tax revenue. The Treasury released its final rule implementing these provisions on January 6, 2022; its interim guidance (largely unchanged in the final rule) is subject to multiple lawsuits.

While many of the state income tax cuts enacted in 2021 were modest, North Carolina enacted legislation to eliminate its corporate income tax by phasing out the existing 2.5% rate beginning in 2025. This phase-down of the corporate tax is a continuation of an effort begun in 2013 to reduce the then-6.9% North Carolina corporate tax rate.

Will other states move to follow suit in 2022? Mississippi Governor Tate Reeves (R) has renewed his call for eliminating the individual income tax, seeking to compete with neighboring Tennessee, as would a Georgia legislative proposal. However, both corporate and individual income tax rate cuts could be deferred in many states in favor of more targeted tax policies.

For example, Indiana Governor Eric Holcomb (R) has advanced a 2022 legislative agenda that includes personal property tax relief for new equipment, enhancing economic development incentive programs, and funding education, training, and workforce development, as compared to recently introduced legislative proposals that would drop individual income tax or sales tax rates.

### Ballot measures

Beyond the legislative arena, another area of focus on tax rates will be at the ballot box. In California, multiple initiatives seek to raise corporate and individual income tax rates, in addition to a new legislatively proposed ballot measure that would raise individual income taxes as well as institute a payroll tax and gross receipts tax to fund single-payer healthcare.

Meanwhile, in Massachusetts, a ‘Fair Share Amendment’ is slated to appear on the November 2022 ballot that would impose an additional 4% tax on personal incomes over $1 million. Arizona voters may be voting on a measure to repeal a personal income ‘flat tax’ enacted last year in response to a 2020 initiative that imposed a 3.5% surcharge, although legislators may advance an alternative tax structure this year.

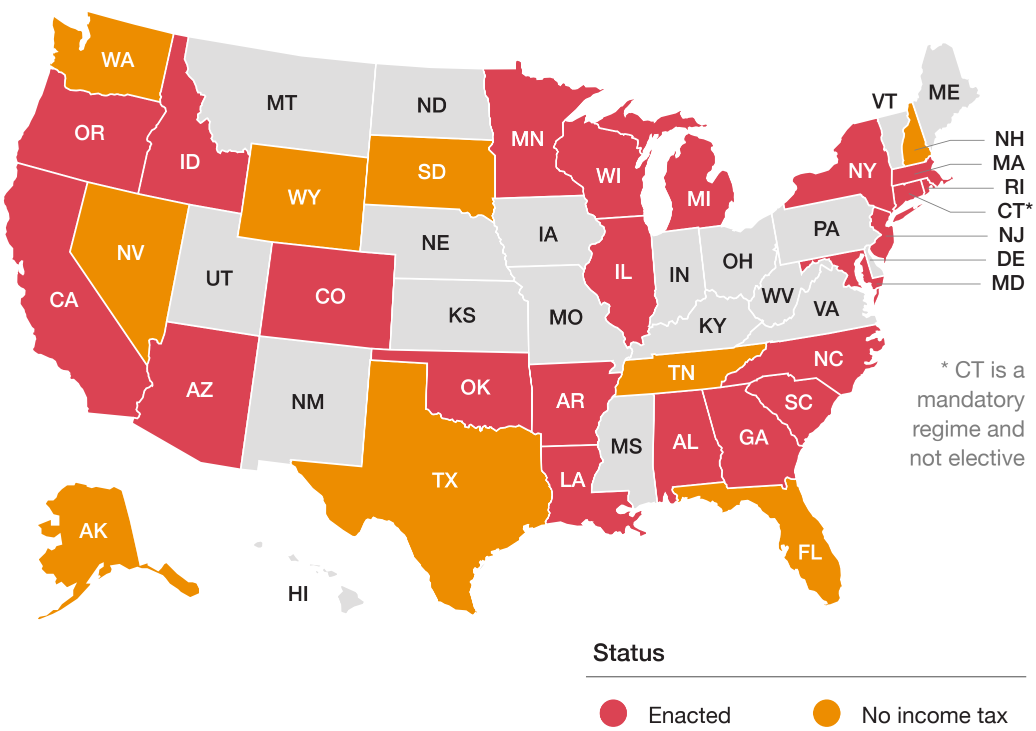
## State reactions to federal tax policies

Multiple states in 2021 enacted legislation continuing to modify state conformity to the 2017 tax reform act and the CARES Act. For example, Alabama enacted legislation decoupling from GILTI, and Kansas enacted legislation decoupling from both GILTI and Section 163(j). By contrast, California considered (but did not pass) legislation that would have included 40% of deemed repatriation and levied a 50% tax on GILTI.

Another federal tax policy that has garnered significant attention from state policymakers is the $10,000 limitation on the federal income tax individual itemized deduction for state and local taxes enacted as part of the 2017 Act.

While Congress may revise the current cap as part of action on Build Back Better legislation, as discussed above, 22 states have enacted “workarounds” to this deduction limitation for passthrough entity business owners by levying a state tax at the entity level and allowing a deduction or credit at the individual owner or partner level. All of these 22 states, except Connecticut, have made the passthrough entity tax optional.

**Figure 11: State passthrough entity tax legislation**




| Effective date | |
|---|---|
| Alabama | 1/1/2021 |
| Arizona | 1/1/2022 |
| Arkansas | 1/1/2022 |
| California | 1/1/2021 |
| Colorado | 1/1/2022 |
| Connecticut | 1/1/2018 |
| Georgia | 1/1/2022 |
| Idaho | 1/1/2021 |
| Illinois | 1/1/2021 |
| Louisiana | 1/1/2019 |
| Maryland | 1/1/2020 |
| Massachusetts | 1/1/2021 |
| Michigan | 1/1/2021 |
| Minnesota | 1/1/2021 |
| New Jersey | 1/1/2020 |
| New York | 1/1/2021 |
| North Carolina | 1/1/2022 |
| Oklahoma | 1/1/2019 |
| Oregon | 1/1/2022 |
| Rhode Island | 1/1/2019 |
| South Carolina | 1/1/2021 |
| Wisconsin | 2018 & 2019 |

## Corporate tax apportionment and remote work

States continue to be active on the issue of corporate tax apportionment, as Alabama and West Virginia adopted single sales factor apportionment and Montana adopted a double-weighted sales factor during 2021. Alabama repealed its "throwback rule," which required sales of tangible property into states where the taxpayer is not taxable to be "thrown back" into the apportionment numerator of the state where the sale originated. West Virginia also adopted market-based sourcing and repealed its "throwout rule" under which receipts from sale of tangible personal property made into states in which the taxpayer is not taxed are excluded from the apportionment denominator. These trends, which reflect an intent to incentivize in-state business activity and location decisions, are likely to continue in 2022. West Virginia specifically adopted its changes as a means of attracting businesses dealing with COVID-19 disruptions.

*Observation:* Another trend spurred by COVID-19 disruptions is an increase in remote work. States have taken varying approaches to nexus and withholding obligations resulting from alternative work arrangements during the pandemic. While the US Supreme Court declined to hear a challenge by New Hampshire to Massachusetts' approach to taxing remote work, a New York appeal is currently pending that seeks to overturn the state's 'convenience of the employer' test for taxing out-of-state days worked.

## Indirect tax focus on digital taxation

Maryland in 2021 enacted a first-in-the-nation tax on digital advertising gross revenue, while also broadly expanding its sales and use tax base to 'digital products' including many digital services and software access. These actions reflected legislative trends across the country.

More than a dozen states in the past two years have proposed digital advertising gross revenue taxes, taxes on consumer data usage or sales, or sales and use taxes targeted at digital advertising services. While no state ultimately followed Maryland's action in this respect, Connecticut came close during its budget process to enacting a digital advertising gross revenue tax, and New York has proposed an 'excise tax' on 'commercial data collectors' measured by the number of New York consumers whose data is collected.

Litigation pending in federal and state courts seeking to bar implementation of the Maryland digital advertising gross revenue tax, as well as an international commitment to move away from DSTs upon implementation of Pillar One, may slow consideration of DSTs at the state level in 2022.

In the meantime, the Multistate Tax Commission (MTC) has established a working group "to advise on the drafting of a white paper" to address state taxation of digital products. It appears the group's efforts will focus on sales and use taxes and an "analysis of the ways that digital products might be defined, categorized, exempted and sourced." This project may signal a continued interest in states expanding their sales and use tax bases to digital products and software access, and further state proposals along these lines are likely in 2022.

*Observation:* As states continue to consider taxation of the digital economy, taxpayers may expect increased controversy regarding existing tax base definitions and interpretations, sourcing, and rate determinations. The post-Wayfair environment has both encouraged states to tax digital goods and services and made compliance more complicated, especially with the universal adoption of marketplace facilitator collection requirements. Interpreting existing marketplace facilitator laws and addressing conflicts and gaps in these requirements will continue to be a major theme of state sales and use taxes in 2022.

Another area of focus in state indirect taxes in 2022 will be environmental tax measures, balancing credits and incentives with taxes on activity and products deemed harmful to the environment. These tax measures will be part of comprehensive regulatory plans to meet carbon neutrality goals set by many states (for example, New York's commitment adopted in 2019 to transition to a carbon-neutral economy by 2050). Excise taxes for both fuel and other products and services will continue to be a major focus of state tax policy, both in the environmental realm and in developing industries such as mobile gaming.

# Appendices

# Appendix A: Key policymakers

## Congressional leadership in the 117th Congress

| House Leadership | |
|---|---|
| Speaker of the House | Nancy Pelosi (D-CA) |
| Majority Leader | Steny H. Hoyer (D-MD) |
| Majority Whip | James E. Clyburn (D-SC) |
| Assistant Democratic Leader | Katherine Clark (D-MA) |
| Democratic Caucus Chair | Hakeem Jeffries (D-NY) |
| Democratic Caucus Vice Chair | Pete Aguilar (D-CA) |
| Democratic Congressional Campaign Committee Chair | Sean Patrick Maloney (D-NY) |

| | |
|---|---|
| Minority Leader | Kevin McCarthy (R-CA) |
| Minority Whip | Steve Scalise (R-LA) |
| Republican Conference Chair | Elise Stefanik (R-NY) |
| Republican Conference Vice Chair | Mike Johnson (R-LA) |
| Republican Policy Committee Chair | Gary Palmer (R-AL) |
| Republican Congressional Campaign Committee Chair | Tom Emmer (R-MN) |

**Senate Leadership**

| | |
|---|---|
| President of the Senate | Vice-President Kamala Harris (D) |
| President Pro Tempore | Patrick Leahy (D-VT) |
| Majority Leader and Democratic Conference Chair | Charles Schumer (D-NY) |
| Majority Whip | Dick Durbin (D-IL) |
| Assistant Majority Leader | Patty Murray (D-WA) |
| Democratic Policy and Communications Chair | Debbie Stabenow (D-MI) |
| Democratic Policy and Communications Vice-Chairs | Joe Manchin, III (D-WV), Cory Booker (D-NJ) |
| Democratic Conference Vice-Chairs | Elizabeth Warren (D-MA), Mark Warner (D-VA) |
| Democratic Conference Secretary | Tammy Baldwin (D-WI) |
| Democratic Senatorial Campaign Committee Chair | Gary Peters (D-MI) |
| Democratic Steering Committee Chair | Amy Klobuchar (D-MN) |
| Democratic Outreach Committee Chair | Bernie Sanders (I-VT) |
| Democratic Outreach Committee Vice-Chair | Catherine Cortez Masto (D-NV) |

| | |
|---|---|
| Minority Leader | Mitch McConnell (R-KY) |
| Minority Whip | John Thune (R-SD) |
| Republican Conference Chair | John Barrasso (R-WY) |
| Republican Conference Vice Chair | Joni Ernst (R-IA) |
| Republican Policy Committee Chair | Roy Blunt (R-MO) |
| Republican Senatorial Campaign Committee Chair | Rick Scott (R- FL) |

# House and Senate tax-writing committees

## House Ways and Means Committee

The Ways and Means Committee membership currently is composed of 25 Democrats and 18 Republicans.

**House Ways and Means Committee Members, 117th Congress**

| Democrats | Republicans |
|---|---|
| Richard Neal (D-MA), Chairman | Kevin Brady (R-TX)*, Ranking Minority Member |
| Lloyd Doggett (D-TX) | Vern Buchanan (R-FL) |
| Mike Thompson (D-CA) | Adrian Smith (R-NE) |
| John Larson (D-CT) | Tom Reed (R-NY)* |
| Earl Blumenauer (D-OR) | Mike Kelly (R-PA) |
| Ron Kind (D-WI)* | Jason Smith (R-MO) |
| Bill Pascrell Jr. (D-NJ) | Tom Rice (R-SC) |
| Danny Davis (D-IL) | David Schweikert (R-AZ) |
| Linda Sanchez (D-CA) | Jackie Walorski (R-IN) |
| Brian Higgins (D-NY) | Darin LaHood (R-IL) |
| Terri Sewell (D-AL) | Brad Wenstrup (R-OH) |
| Suzan DelBene (D-WA) | Jodey Arrington (R-TX) |
| Judy Chu (D-CA) | Drew Ferguson (R-GA) |
| Gwen Moore (D-WI) | Ron Estes (R-KS) |
| Dan Kildee (D-MI) | Lloyd Smucker (R-PA) |
| Brendan Boyle (D-PA) | Kevin Hern (R-OK) |
| Don Beyer (D-VA) | Carol Miller (R-WV) |
| Dwight Evans (D-PA) | Greg Murphy (R-NC) |
| Brad Schneider (D-IL) | |
| Tom Suozzi (D-NY)* | |
| Jimmy Panetta (D-CA) | |
| Stephanie Murphy (D-FL)* | |
| Jimmy Gomez (D-CA) | |
| Steven Horsford (D-NV) | |
| Stacey Plaskett (D-VI) | |

* Not running for re-election

### Senate Finance Committee

The Finance Committee membership currently is composed of 14 Democrats and 14 Republicans.

**Senate Finance Committee Members, 117th Congress**

| Democrats | Republicans |
|---|---|
| **Ron Wyden (D-OR), Chairman** | **Mike Crapo (R-ID), Ranking Minority Member** |
| Debbie Stabenow (D-MI) | **Charles Grassley (R-IA)** |
| Maria Cantwell (D-WA) | John Cornyn (R-TX) |
| Robert Menendez (D-NJ) | **John Thune (R-SD)** |
| Thomas Carper (D-DE) | **Richard Burr (R-NC)*** |
| Benjamin Cardin (D-MD) | **Rob Portman (R-OH)*** |
| Sherrod Brown (D-OH) | **Patrick J. Toomey (R-PA)*** |
| **Michael Bennet (D-CO)** | **Tim Scott (R-SC)** |
| Robert Casey, Jr. (D-PA) | Bill Cassidy (R-LA) |
| Mark Warner (D-VA) | **James Lankford (R-OK)** |
| Sheldon Whitehouse (D-RI) | Steve Daines (R-MT) |
| **Maggie Hassan (D-NH)** | **Todd Young (R-IN)** |
| **Catherine Cortez Masto (D-NV)** | Ben Sasse (R-NE) |
| Elizabeth Warren (D-MA) | John Barrasso (R-WY) |

* Not running for re-election
Senators subject to re-election in 2022 in **bold**

## Key Treasury and other Administration officials

| | |
|---|---|
| Treasury Secretary | Janet Yellen |
| Director, National Economic Council | Brian Deese |
| Director, Office of Management and Budget | Shalanda Young (Acting) |
| Chair, Council of Economic Advisers | Cecilia Rouse |
| Treasury Assistant Secretary for Tax Policy | Lily Batchelder |
| IRS Commissioner | Charles Rettig |
| IRS Chief Counsel | Vacant |

# Appendix B: Senators up for election in 2022

| Democrats | Republicans |
|---|---|
| **Bennet, Michael (D-CO)** | Blunt, Roy (R-MO)* |
| Blumenthal, Richard (D-CT) | Boozman, John (R-AR) |
| **Cortez Masto, Catherine (D-NV)** | **Burr, Richard (R-NC)*** |
| Duckworth, Tammy (D-IL) | **Crapo, Mike (R-ID)** |
| **Hassan, Maggie (D-NH)** | **Grassley, Charles (R-IA)** |
| Kelly, Mark (D-AZ) | Hoeven, John (R-ND) |
| Leahy, Patrick (D-VT)* | Johnson, Ron (R-WI) |
| Murray, Patty (D-WA) | Kennedy, John (R-LA) |
| Padilla, Alex (D-CA) | **Lankford, James (R-OK)** |
| Schatz, Brian (D-HI) | Lee, Mike (R-UT) |
| Schumer, Charles (D-NY) | Moran, Jerry (R-KS) |
| Van Hollen, Chris (D-MD) | Murkowski, Lisa (R-AK) |
| Warnock, Raphael (D-GA) | Paul, Rand (R-KY) |
| **Wyden, Ron (D-OR)** | **Portman, Rob (R-OH)*** |
| | Rubio, Marco (R-FL) |
| | **Scott, Tim (R-SC)** |
| | Shelby, Richard (R-AL)* |
| | **Thune, John (R-SD)** |
| | **Toomey, Patrick (R-PA)*** |
| | **Young, Todd (R-IN)** |

* Not running for re-election
Senate Finance Committee members shown in **bold**

# Appendix C: Summary of key tax provisions in recently enacted legislation

## American Rescue Plan Act

The $1.9 trillion American Rescue Plan Act (P.L. 117-2) was enacted March 11, 2021, to provide tax and non-tax COVID-19 relief and recovery for individuals and businesses.

| Key COVID-19 tax relief and recovery provisions | |
|---|---|
| Economic impact payments | Provided $1,400 one-time economic impact payments to eligible individuals; the payments phase out between $75,000 and $80,000 of adjusted gross income for individuals ($150,000 and $160,000 for joint filers). |
| Enhanced unemployment assistance | Provided $300 in additional weekly federal unemployment assistance benefits through 9/6/2021, plus a $10,200 tax exclusion for unemployment compensation income for tax year 2020 for households with incomes under $150,000. |
| Increased child tax credit | Increased the child tax credit from $2,000 to $3,000 (with a $3,600 credit for children under the age of six), and made the credit fully refundable and payable periodically. The enhanced child tax credit begins to phase out at AGI of $75,000 for single filers, $112,500 on head-of-household returns, and $150,000 on joint returns. These changes are effective only for 2021. |
| Employee retention tax credit | Extended the employee retention tax credit through December 31, 2021, and expanded the credit to allow the hardest-hit businesses to count all wages paid as qualifying wages, not just those wages paid to employees that are not providing services, and allowing certain start-up businesses to be eligible for the credit. NOTE: This credit was terminated early by the Infrastructure Investment and Jobs Act, as discussed below. |
| Tax-exempt loans and grants | Exempted Economic Injury Disaster Loan (EIDL) grants and Restaurant Revitalization Grants from tax and provided that such exclusions shall not result in a denial of deduction, reduction of tax attributes, or denial of increase in basis by reason of this exclusion from income. |
| Paid leave credits | Provided an extension and expansion of the paid sick and FMLA leave tax credits created in the Families First Coronavirus Response Act of 2020, and provided payroll tax credits for employers who voluntarily provide paid leave through the end of September 2021. |
| Tax-free student loan relief | Provided that all COVID-19 student loan relief is tax-free. |

| Key revenue-raising provisions | |
|---|---|
| Worldwide interest allocation election | Repealed the election for US affiliated groups to allocate interest expense on a worldwide basis, effective for tax years beginning in 2021. |
| Interest rate smoothing | Extended and supplemented interest rate smoothing for single-employer plans through 2025 with a phase-out after that, and increased the amortization period for shortfalls from seven years to 15 years for plan years beginning after 12/31/2019 (with option to elect to apply for the 2019 plan year). (Note: The legislation also includes relief for multi-employer pension plans.) |
| Section 162(m) limit expansion | Expanded the scope of the $1 million deduction limit for public corporations under Section 162(m) to include the five highest-paid employees of the corporation. The five employees are determined each year, and these employees are not subject to the 'once a covered employee, always a covered employee' treatment that continues to apply to the CEO, CFO, and three highest-paid executive officers. The provision is effective for tax years beginning after 12/31/2026. |
| Reporting transaction threshold | Lowered and modified the threshold below which a third-party settlement organization is not required to report payments to participants in its network. The provision seeks to address payments that are common in the ‘gig’ economy. For any calendar year beginning after 12/31/2021, a third-party settlement organization must report transactions with any participating payee that exceed a minimum threshold of $600 in aggregate payments, regardless of the aggregate number of such transactions. |
| Limit on excess business losses of non-corporate taxpayers | Extended for one year (through 12/31/2026) the $500,000 limitation on excess business losses of non-corporate taxpayers. |

## Infrastructure Investment and Jobs Act

The $1.2 trillion Infrastructure Investment and Jobs Act (P.L. 117-58) was enacted on November 15, 2021 (commonly known as the Infrastructure Act), and includes several tax-related provisions.

| Key tax provisions | |
|---|---|
| Superfund excise taxes | Reinstates, with modifications, Superfund taxes starting July 1, 2022, through December 31, 2031, on 42 specified "taxable chemicals" and on "taxable substances" produced from the 42 taxable chemicals. Reduces from 50% to 20% the threshold for the amount of taxable chemical by weight or value that must be present in a product before the product is considered a "taxable substance." The Act also effectively increases the tax levied on a taxable substance if the taxpayer fails on a timely basis to provide data to the IRS regarding the taxable substance, by raising the chemical's appraised value. |
| Highway taxes | Extends through 2028 the highway-related taxes that help finance the Highway Trust Fund. |
| Civil Nuclear Credit Program | Allocates $6 billion to the establishment of a Civil Nuclear Credit Program, which will provide tax credits to older nuclear power facilities that otherwise might close due to rising costs and decreasing electricity prices. Establishes a process for nuclear plant operators to apply for these credits through a bidding process. Credits would last for four years, and no new credits could be issued after the end of FY 2031. |
| Tax-free contributions to public utilities | Reverses, in part, the 2017 tax legislation's amendment to Section 118. Regulated public utilities set up as corporations may again receive tax-free contributions to fund the construction of drinking water or sewage disposal facilities. |
| Digital assets | Requires individuals and firms acting as "digital asset brokers" to report transaction information to the IRS for tax purposes, starting with tax year 2023. Also requires businesses to report any cryptocurrency payments worth more than $10,000 (similar to current requirements for cash transactions).<br><br>Defines "digital asset" as "any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology." Defines "broker" broadly as "any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person." |
| Tax-exempt bonds | Doubles from $15 billion to $30 billion the maximum amount of tax-exempt highway or surface freight transfer facility bonds that local or state governments can issue. Adds two new categories of private activity tax-exempt bonds: bonds funding carbon capture and direct air capture technologies projects and bonds funding broadband deployment in rural areas where a majority of households do not have access to broadband.<br><br>The Act also reduces the amount of the tax credit for carbon oxide sequestration when a project is funded by tax-exempt bonds by adding a new provision to Section 45Q(f). The amount of the limitation under the new provision is to be determined as of the end of a tax year. |

| Key tax provisions | |
|---|---|
| Employee Retention Tax Credit | Terminated three months early, retroactive to October 1, 2021, the Employee Retention Tax Credit, which had been scheduled to run through December 31, 2021, except for recovery startup businesses for which the expiration date remained December 31. The Act modified the eligibility requirements for recovery startup businesses, requiring that they started operations after February 15, 2020, and had annual gross receipts of less than $1 million. |
| Defined benefit plan 'smoothing rule' | Extends for five years the temporary provisions extended under the American Rescue Plan Act that were intended to stabilize pension funding percentages for defined benefit retirement plans. Maintains the current 10% range through 2030 (instead of 2025), then gradually widens the range until 2035, when it would return to a 60% range. |
| Procedural tax provisions | Makes minor changes to certain procedural sections of the Code to reflect recent experiences with extending tax deadlines for tax payments and for filing federal tax returns and Tax Court petitions.<br><br>For example, the Act modifies the Section 7508A automatic extension of certain deadlines for taxpayers affected by federally declared disasters, enacted as part of the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019, P.L. 116-94. The Act amends the definition of a disaster area in Section 7508A(d)(3) to mean "an area in which a major disaster for which the President provides financial assistance under section 408 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (42 U.S.C. 5174) occurs." Section 7508A previously referenced the definition in Section 165(i)(5)(B). |

# Appendix D: Summary of key tax provisions in the proposed Build Back Better Act (H.R. 5376)

The House on November 19 passed budget reconciliation legislation (H.R. 5376, the Build Back Better Act) that would make significant corporate and individual tax changes.

H.R. 5376 is pending further action by the Senate. Senate Finance Committee Democrats have proposed amendments to some provisions in the House-passed bill as well as certain new proposals; further proposed revisions to the legislation are expected. Effective dates could be changed.

| Key business provisions | House-passed bill | Proposed changes |
|---|---|---|
| Corporate profits minimum tax | 15% minimum tax on adjusted financial statement income of applicable corporations that report over $1 billion in profits to shareholders, effective for tax years beginning after 12/31/2022 | Use tax measures rather than book measures for income or expense related to defined benefit pension plans |
| Surtax on corporate stock repurchase | 1% excise tax on publicly traded US corporations for value of any stock repurchased by corporation during tax year, effective for repurchases of stock after 12/31/2021 | Modify for adjustment taken into account for stock issued “or provided” in certain circumstances |
| R&D expenses | Delay until 2026 a rule from the 2017 Act requiring capitalization of research expenditures to take effect in 2022 | No change |
| Superfund taxes | Reinstate Superfund excise taxes on petroleum products and chemicals, effective 7/1/2022 | Technical corrections |

| Key international provisions | House-passed bill | Proposed changes |
|---|---|---|
| Global intangible low-taxed income (GILTI) and foreign-derived intangible income (FDII) | Increase the current GILTI rate from 10.5% to 15.0% on per-country basis<br><br>Reduce the current FDII deduction from 37.5% to 24.8%<br><br>Reduce GILTI foreign tax credit haircut from 20% to 5% (results in a top GILTI rate of 15.8%)<br><br>Reduce GILTI tangible property exclusion (QBAI) from 10% to 5%<br><br>Changes for GILTI and FDII rates generally effective for tax years beginning after 12/31/2022 | No change |
| Base erosion and anti-abuse tax (BEAT) | Amend the BEAT rate to 10% for tax years beginning after 12/31/2021, and before 1/1/2023; 12.5% for tax years beginning after 12/31/2022, and before 1/1/2024; 15% for tax years beginning after 12/31/2023, and before 1/1/2025; and 18% for tax years beginning after 12/31/2024 | Change to the treatment of indirect costs associated with COGS |
| Interest deduction limitations | Limits the interest deduction of certain domestic corporations in proportion to their share of the total earnings of their international financial reporting group, effective for tax years beginning after 12/31/2022 | Add election to determine the limitation based on the adjusted basis of assets rather than EBITDA |
| Dividend received deduction (DRD) modifications | Limit availability of the Section 245A dividends received deduction to dividends from CFCs (dividends from specified 10%-owned foreign corporations no longer would be eligible), effective for distributions made after the enactment of the bill | Retain the current structure of Section 245A, such that it applies to dividends received from specified 10%-owned foreign corporations (rather than solely dividends received from CFCs); dividends received by a US shareholder directly from a 10/50 corporation would get a 65% DRD; dividends received by a CFC from a specified 10%-owned foreign corporation would qualify for the DRD under Section 245A if the US shareholder has an inclusion under Section 951a(1)(a) |
| Section 7874 anti-inversion rules | No provision | Lower the 80% threshold for treating an inverted corporation as a domestic corporation to 65%<br><br>Retain the current-law inversion gain regime but lower the threshold for that regime from 60% to 50%<br><br>Does not include a management and control test |

| Key individual provisions | House-passed bill | Proposed changes |
|---|---|---|
| Individual tax rate | New 5% surcharge of individual's modified AGI in excess of $10 million and additional 3% surcharge (total of 8%) on a taxpayer's modified AGI in excess of $25 million ($200,000 and $500,000 respectively for trusts), effective for tax years beginning after 12/31/2021 | Technical corrections and various modifications |
| Net investment income tax | Expand to include net income from passthrough businesses for high-income taxpayers, effective for tax years beginning after 12/31/2021 | Technical corrections |
| Excess non-corporate losses | Section 461(l) disallows a deduction for the amount of business losses in excess of $250,000 ($500,000 for joint filers), indexed for inflation, attributable to a trade or business in which the taxpayer actively participates. Under the 2017 tax reform, Section 461(l) expired after 2025, but would be extended beyond 2025. Also would no longer be an NOL but would remain subject to the limitation each year, effective for tax years beginning after 12/31/20 | Technical corrections |
| State and local taxes | Increase the limitation on the itemized deduction for state and local taxes from $10,000 to $80,000 ($40,000 for an estate, trust, or married individual filing a separate return) through 2030, with current $10,000/$5,000 caps reinstated for one year through 2031. The provision would be effective for tax years beginning after 2020.<br><br>Current limitation scheduled to expire in 2025 | Proposal to be determined |
| Qualified small business stock | Provides that the 75% and 100% exclusion rates and the elimination of the AMT preference item would not apply to taxpayers with adjusted gross income equal or exceeding $400,000, as well as for any trust or estate<br><br>Would apply to all sales or exchanges of qualified small business stock after 9/13/2021, subject to a binding contract exception | No change |
| Limitations on high-income taxpayers with large retirement account balances | Prohibits further IRA contributions for a tax year if the contributions would cause the total value of an individual's IRA and defined contribution retirement accounts as of the end of the prior tax year to exceed $10 million, also requires mandatory distributions, both effective for tax years beginning after 2028<br><br>Would apply to single taxpayers (or married filing separately) with income over $400,000, married taxpayers filing jointly with income over $450,000, and heads of households with income over $425,000 (all indexed for inflation)<br><br>Limits Roth IRA conversions for any qualified plans or IRA where any portion contains after-tax contributions, effective for tax years beginning after 2021 | No change |

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