NAM Summary:
Select Revenue Provisions in the Build Back Better Act
November 5, 2021

On Thursday, Oct. 28, President Biden announced a negotiated framework for the Build Back Better Act (the budget reconciliation bill), including the tax increases designed to pay for the package. The framework was considered by the House Rules Committee on Wednesday, Nov. 3.

Thanks to sustained advocacy by the NAM and our members, the agreement differs in several key aspects from the House Ways & Means package released in September. Most notably, the proposal does not include increases in either the corporate tax rate or the top individual income tax rate.

This document summarizes the key revenue provisions in the Build Back Better framework that are important to manufacturers. For more information, please see the White House announcement, the section-by-section summary, and the legislative text.

Overview

- According to the White House, the revenue provisions in the BBB would increase taxes by over $1 trillion. The changes under consideration would impact corporations, businesses with international operations and pass-throughs.

- **Corporate:** No changes to the corporate tax rate, but significant tax changes affecting manufacturers.
    - New 15% corporate alternative minimum tax in the form of a tax on financial statement income that applies to large corporations ("book tax").
    - New limitation on the ability to deduct interest on business loans.
    - New excise tax on stock buybacks.
    - Delay in effective date for R&D amortization.

- **International:** Changes to a variety of provisions affecting globally engaged manufacturers.
    - GILTI (global minimum tax): higher tax rate, more complex calculation, more foreign income subject to the tax.
    - FDII (tax incentive for U.S. IP): reduced benefit.
    - BEAT (minimum tax targeting related party payments): higher tax burden.

- **Pass-Throughs:** Preserves current law for the pass-through deduction and for individual and capital gains tax rates, but pass-through businesses paying tax at the individual rate will face several new surtaxes.
    - 3.8% net investment income tax applied to business income greater than $400,000 (single)/$500,000 (married).
    - New 5% surtax on individuals with adjusted gross incomes over $10 million, plus an additional 3% surtax on adjusted gross incomes over $25 million.
    - Increases the deduction for state and local taxes to $36,250(single)/$72,500 (married) through 2031.

Corporate Provisions

Corporate Alternative Minimum Tax ("Book Tax")

BBB Framework: New corporate alternative minimum tax in the form of a tax on financial statement income ("book tax"). Applies to corporations with a three-year average adjusted financial statement income exceeding $1 billion. Foreign-parented corporations with global income of $1 billion and U.S. income of $100 million would be subject to the tax. Certain adjustments are permitted in determining income (e.g., conforming covered period to taxable year, disregarding federal or foreign taxes). The corporation will have a book tax liability if its book tax liability is greater than its regular tax liability.

General business tax credits and foreign credits are allowed. Financial statement losses can be carried forwarded indefinitely for taxable years ending after December 31, 2019 but cannot exceed 80% of income. A tax credit for prior year book taxes can be applied against regular tax liability provided that the regular tax liability is greater than the book tax liability.

Effective Date: Taxable years beginning after Dec. 31, 2022.

NAM Advocacy: The NAM sent a letter of opposition to Senate Finance and House Ways & Means, published an article about the proposal on NAM.org and issued a press statement.

163(n) Interest Expense Limitation

Current Law: The tax deduction for interest on business loans is limited by section 163(j) to 30% of a business's earnings before interest, tax, depreciation, and amortization (EBITDA). Starting in 2022, the deduction will be further limited—to 30% of a business's earnings before interest and tax (EBIT).

BBB Framework: The proposed section 163(n) would impose new limits on the deductibility of interest by capping interest deductions for domestic corporations that are part of an international group. A domestic corporation's interest deductions would be limited to an "allowable percentage" (based on its share of the group's net interest expense) of 110% of the group's net interest expense. Businesses would be forced to apply the stricter of the current 163(j) and proposed 163(n) limitations. (Note that the Ways & Means bill's proposed section 163(o), which would limit carryforward of unused interest deductions, was not included in the BBB framework.)

Effective Date: Taxable years beginning after Dec. 31, 2022. (The Ways & Means provision would have taken effect in taxable years beginning after Dec. 31, 2021)

NAM Advocacy: The NAM has conducted significant outreach on interest deductibility, including a letter to Senate Finance and House Ways & Means on 163(j), 163(n) and 163(o).

Excise Tax on Stock Buybacks

Current Law: Shareholders are taxed on buybacks to the extent the repurchase price exceeds the investor's basis (or to the extent of a corporation's earnings and profits for dividend-equivalent redemptions), but corporations do not pay additional taxes for distributing capital to shareholders.

BBB Framework: The BBB would impose an excise tax equal to 1% of the fair market value of a corporation's stock repurchased in a taxable year. The amount of repurchases subject to tax can be reduced by new issuances of stock and certain transactions are exempted from the provision.

Effective Date: Applies to share repurchases after Dec. 31, 2021.

NAM Advocacy: The NAM sent a letter of opposition to Senate Finance and House Ways & Means.

R&D Amortization

Current Law: Starting in 2022, businesses will be required to amortize or deduct their R&D expenses over a period of years instead of being able to deduct them immediately as is currently the case.

BBB Framework: Provides for a four-year delay of R&D amortization (through the end of 2025).

NAM Advocacy: The NAM has been spearheading a years-long effort through the R&D Coalition to ensure that the tax code continues to support innovation.

International Provisions

GILTI (Global Intangible Low-Taxed Income)

Current Law: A global minimum tax regime (called Global Intangible Low-Taxed Income, or GILTI) imposes a minimum 13.125% tax on foreign earnings—foreign earnings taxed below that rate in the local jurisdiction are subject to GILTI. The minimum tax is applied on a worldwide basis. There is a 10% deduction for qualified business asset investment (QBAI) meant to approximate a routine return generated by tangible assets such as factories. There is a limitation of GILTI foreign tax credits to only 80% of foreign taxes paid (i.e., a 20% "haircut") and the denial of carryforwards of excess GILTI foreign tax credits.

BBB Framework: The GILTI statutory tax rate increases to 15%; however, with the foreign tax credit "haircut" the effective rate is 15.8%. GILTI would also be applied on a country-by-country basis. Further, the QBAI deduction is reduced from 10% to 5% (making more foreign earnings subject to GILTI). (*Note*: The QBAI deduction does not apply to territories.). GILTI foreign tax credit "haircut" relief is provided by reducing the 20% haircut to 5%. Finally, country-specific CFC losses can be carried over to the following taxable year.

Effective Date: Taxable years of foreign corporations beginning after Dec. 31, 2022, and taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

NAM Advocacy: The NAM published an economic analysis illustrating the harmful impact of President Biden's proposed changes to GILTI on U.S. jobs (e.g. 21% rate (or 26.5% when accounting for foreign tax credit haircut)), conducted significant outreach and weighed in against the Ways and Means Committee's (16.5% or 17.45 with foreign tax credit haircut) and Finance Committee's GILTI proposals. Bottom line, the NAM effectively pushed back against the worst of the proposed changes but BBB framework changes would still tilt the playing field against globally engaged manufacturers.

FDII (Foreign-Derived Intangible Income)

Current Law: The foreign-derived intangible income provision is intended to incentivize companies to develop and maintain intellectual property in the United States, as well as return IP and related jobs back home, by providing a deduction that results in a lower tax rate (currently 13.125%) for performing activities and servicing foreign markets from the U.S.

BBB Framework: Reduces the Section 250 deduction, which effectively increases the FDII rate to 15.8% from 13.125%.

Effective Date: Taxable years beginning after Dec. 31, 2022 (a transition rule is provided for taxable years that include but do not end on Dec. 31, 2022).

NAM Advocacy: The NAM has highlighted the importance of supporting IP in the U.S. and conducted significant outreach pushing back against the Administration's proposal to eliminate FDII, the Finance Committee's proposed harmful changes, and the Ways & Means proposal to reduce the FDII benefit.

BEAT (Base Erosion Anti-Abuse Tax)

Current Law: The base erosion anti-abuse tax provision functions as a minimum tax (currently 10%) that applies to corporations with gross receipts greater than $500 million and "base erosion" payments (i.e., deductions for royalties, services, depreciation) to related foreign corporations greater than 3% of total deductions.

BBB Framework:

Increases the BEAT rate as follows:

- 10% in taxable years beginning after Dec. 31, 2021, and before Jan. 1, 2023;
- 12.5% in taxable years beginning after Dec. 31, 2022, and before Jan. 1, 2024;
- 15% in any taxable year beginning after Dec. 31, 2023, and before Jan. 1, 2025; and
- 18% in any taxable year beginning after Dec. 31, 2024.

The bill also amends the BEAT by:

- Allowing for the full value of tax credits (e.g., R&D tax credit);
- Targeting the cost of goods sold exception (i.e., amounts paid to a foreign related party that are required to be capitalized in inventory and for inventory which exceed the costs of the property to the foreign related party); and
- Exempting payments from the BEAT tax if the effective foreign tax rate is not lower than the BEAT tax rate.
- Once subject to BEAT, a taxpayer remains subject to BEAT for the next 10 calendar years (applicable taxpayer rule).

Effective Date: Except for the increased BEAT rates, the BEAT provisions are effective for taxable years beginning after Dec. 31, 2021.

NAM Advocacy: The NAM conducted significant outreach opposing the proposed higher BEAT rates and the targeting of the cost of goods sold exception, including comments submitted to the Finance Committee.

Foreign Tax Credit

Current Law: Excess foreign tax credits can be carried over for 10 years or carried back one year.

BBB Framework: Repeals the one-year carryback. Five-year carryforward for GILTI (for taxes paid or accrued in taxable years beginning after December 31, 2022 and before December 31, 2030). Foreign branch income basket repealed. Foreign tax credit calculated on a per country basis.

Effective Date: Taxable years beginning after Dec. 31, 2022.

Pass-Through Entity Provisions

Net Investment Income Tax/Self-Employed Contributions Act Surtax

Current Law: A 3.8% surtax applies to net investment income (e.g., interest, dividends, royalties, rents, etc.) for taxpayers with income greater than $250,000 (married)/$200,000 (single). Additionally, a 0.9% Medicare surtax applies to self-employment income for taxpayers with income greater than $250,000 (married)/$200,000 (single).

BBB Framework: Extends the NIIT to income derived in the ordinary course of trade or business for taxpayers with incomes greater than $500,000 (married)/$400,000 (single), as well as for trusts and estates.

Effective Date: Taxable years beginning after Dec. 31, 2021.

Surcharge on High Income Individuals, Trusts and Estates

Current Law: Top individual income tax rate of 37% ($628,300 married/$523,600 single)

BBB Framework: Adds a surcharge equal to 5% of a taxpayer's adjusted gross income in excess of $10 million, plus an additional 3% surtax on adjusted gross income in excess of $25 million. Also applies the surcharges to income above $200,000/$500,000 in an estate or trust.

Effective Date: Taxable years beginning after Dec. 31, 2021.

Deduction for State and Local Taxes

Current Law: Deduction for state and local taxes capped at $10,000

BBB Framework: Temporarily increases the deduction for state and local taxes to $40,000(single)/$80,000 (married).

Effective Date: Taxable years beginning after Dec. 31, 2020 and before January 1, 2031.

Limitations on Excess Business Losses of Noncorporate Taxpayers

Current Law: The amount of business losses that can be deducted by noncorporate taxpayers is limited to $262,000 for individuals and $524,000 for joint filers; this limit is set to expire after 2026.

BBB Framework: Limitation is permanently extended.

Effective Date: Taxable years beginning after Dec. 31, 2021.

Other Issues

<u>Qualified Small Business Stock Limitation</u>

Current Law: Generally, investors' gains from the sale of a "qualified small business stock" (defined as shares of a business with less than $50 million in gross assets) benefit from a 50% exclusion from capital gains taxation if the stock is held for at least five years. Depending on when the shares were purchased, investors may qualify for a 75% or 100% exclusion.

BBB Framework: The BBB framework would prevent individuals with income above $400,000 from benefiting from the 75% and 100% exclusions.

Effective Date: Would apply to sales and exchanges after Sept. 13, 2021.

<u>Orphan Drug Tax Credit</u>

Current Law: The Orphan Drug Tax Credit provides a 25% credit for clinical testing expenditures related to the development of treatments for rare diseases.

BBB Framework: The BBB framework would limit the Orphan Drug Tax Credit by disallowing the credit for all but the first approved orphan use of a new drug.

Effective Date: Taxable years beginning after Dec. 31, 2021.

<u>R&D Payroll Tax Credit</u>

Current Law: Certain pre-revenue businesses can claim up to $250,000 of their eligible R&D Credit amount against their payroll tax liability in the absence of income tax obligations.

BBB Framework: Doubles the allowable credit amount to $500,000.

Effective Date: Taxable years beginning after Dec. 31, 2021.

<u>IRS Enforcement</u>

Provides nearly $80 billion in additional funding for the IRS, which cannot be used to increase taxes on taxpayers with income under $400,000.

<u>Nicotine Excise Tax</u>

BBB Framework: Would create a new excise tax on "taxable nicotine," which is defined any nicotine (other than nicotine used in currently listed tobacco products or certain products approved by the FDA) that has been extracted, concentrated, or synthesized. The amount of tax is the greater of (i) the dollar amount specified for small cigarettes or (ii) $50.33, per 1,810 milligrams of nicotine.

Effective Date: Calendar quarters beginning 180 days after date of enactment.

<u>Deduction for Union Dues</u>

BBB Framework: Would create a new above-the-line deduction for up to $250 in union dues paid by an employee.

Effective Date: Taxable years beginning after Dec. 31, 2021 and before January 1, 2026.

Temporary Deduction for Employee Uniforms

BBB Framework: Would create a new above-the-line deduction for up to $250 for employee uniforms or work clothing.

Effective Date: Taxable years beginning after Dec. 31, 2021. This provision expires on December 31, 2024.

Amended Returns for Couples Married Before *U.S. v. Windsor*

Current Law: In *U.S. v. Windsor* the Supreme Court overturned the Defense of Marriage Act, which prevented the federal government from recognizing same-sex marriages. After the *Windsor* decision, the IRS released guidance allowing taxpayers to amend prior years' returns back to 2010 in order to update their marital status and claim related tax benefits.

BBB Framework: Would extend the ability to amend returns back to the year of a couple's marriage (i.e., as early as 2004 for some couples).

Effective Date: Date of enactment.