ALERT

Biden Tax Plan

On May 28th, the White House released its fiscal year 2022 budget blueprint (the "Green Book"). As promised during President Biden's campaign and previewed in the American Jobs Plan and American Families Plan, the Green Book proposes significant tax increases targeting large corporations and high-income individuals to pay for trillions of dollars in new spending.

The tax experts at FTI Consulting have outlined below many of the higher profile tax changes that may affect you and your businesses.

Corporate Rate Increase: The proposal would increase the income tax rate for C corporations from 21 percent to 28 percent. The proposal would be effective for taxable years beginning after December 31, 2021. For taxable years beginning after January 1, 2021 and before January 1, 2022, the tax rate would be equal to 21 percent plus 7 percent times the portion of the taxable year that occurs in 2022. News outlets have recently reported that President Biden is willing to drop the proposal to raise the corporate income tax rate in order to facilitate an infrastructure deal.[1]

Individual Provisions

Top Tax Rate

— Top marginal individual income tax rate would increase to 39.6 percent. This rate would be applied to taxable income in excess of the 2017 top bracket threshold, adjusted for inflation. In taxable year 2022, the top marginal tax rate would apply to taxable income over $509,300 for married individuals filing a joint return, $452,700 for unmarried individuals (other than surviving spouses), $481,000 for head of household filers, and $254,650 for married individuals filing a separate return. After 2022, the thresholds would be indexed for inflation using the C-CPI-U, which is used for all current tax rate thresholds for the individual income tax.

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

Capital Gains Tax Rate

— Long-term capital gains and qualified dividends received by taxpayers with ***adjusted gross income*** of more than $1 million would be taxed at ordinary income tax rates, indexed for inflation after 2022. For example, a taxpayer with $900,000 in wages and $200,000 in preferential capital gain would have $100,000 of capital gain taxed at the current preferential capital gain rate and $100,000 taxed at ordinary income tax rates.

— This proposal would be effective for gains required to be recognized after the date of announcement, which is generally understood to mean April 2021 when President Biden announced the American Families Plan.

Like-Kind Exchanges

— The proposal would allow the deferral of gain up to an aggregate amount of $500,000 for each taxpayer ($1 million in the case of married individuals filing a joint return) each year for real property exchanges that are like-kind. Any gains from like-kind exchanges in excess of $500,000 (or $1 million in the case of married individuals filing a joint return) during a taxable year would be recognized by the taxpayer in the year the taxpayer transfers the real property subject to the exchange.

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

— The proposal raises the question whether a deferred like-kind exchange that was initiated in 2021 but not completed until 2022 would be subject to this new limitation. It is assumed that the enacted law would provide guidance on this question.

— The proposal does not address how taxpayers other than individuals, such as tiered partnerships and REITs would be impacted by the change in law.

Carried Interest

— It is not uncommon for partners to receive partnership interests in exchange for services. Typically, the partnership interest entitles the partner to share in future partnership profits referred to as “profits interests” or “carried interests”.

— If a partnership recognizes long-term capital gain, the partners, including partners who provide services, generally would recognize their shares of such gain on their tax returns as long-term capital gain.

— The proposal would tax as ordinary income a partner’s share of income on an “investment services partnership interest” (ISPI), regardless of the character of the income at the partnership level, if the partner’s taxable income (from all sources) exceeds $400,000. This income would also be subject to SECA (social security tax on self-employed taxpayers).

— Any gain recognized on the sale of an ISPI would be taxed as ordinary income, not as capital gain, if the partner is above the income threshold.

— Unlike the current Code section 1061 carried interest rules, which require a three year holding period to claim long-term capital gain treatment on carried interests, this new rule would apply regardless of how long the ISPI has been held or how long the partnership held its assets.

— In addition, treating a partner’s share of income as ordinary income (instead capital gain) could negatively impact certain partners who may have capital losses from other businesses or who are interested in deferring gain by investing in a Qualified Opportunity Fund.

— An ISPI is a profits interest in an investment partnership that is held by a person who provides services to the partnership. A partnership is an investment partnership if substantially all of its assets are investment-type assets (certain securities, real estate, interests in partnerships, commodities, cash or cash equivalents, or derivative contracts with respect to those assets), and over half of the partnership’s contributed capital is from passive investors.

— There are certain exceptions for service partners who have also invested capital in the investment partnership.

— "Invested capital" excludes proceeds from any loan or advance made or guaranteed by any partner or the partnership (or any person related to such persons).

— Also, there are anti-abuse rules that would prevent a service partner from avoiding the carried interest rules by holding a "disqualified interest" (such as convertible debt, an option or any derivative instrument) in the partnership.

— The proposal would replace Code section 1061 for taxpayers with taxable income (from all sources) in excess of $400,000 and would be effective for taxable years beginning after December 31, 2021.

— However, current Code section 1061 would continue to apply to those taxpayers below that taxable income threshold.

Estate and Gift Provisions

— ***A donor or deceased owner of an appreciated asset would realize a capital gain at the time of the transfer or death.*** The Green Book does not discuss what tax rate would apply to such "deemed" capital gain.

— For a donor, the amount of the gain realized would be the excess of the asset's fair market value on the date of the gift over the donor's basis in that asset.

— For a decedent, the amount of gain would be the excess of the asset's fair market value on the decedent's date of death over the decedent's basis in that asset.

— The use of capital losses and carry-forwards from transfers at death would be allowed against capital gains income and up to $3,000 of ordinary income on the decedent's final income tax return, and the tax imposed on gains deemed realized at death would be deductible on the estate tax return of the decedent's estate.

— For purposes of the imposition of this tax on appreciated assets, a transferred partial interest would be its proportional share of the fair market value of the entire property (no minority discounts etc.).

— The proposal would allow a $1 million per-person exclusion from recognition of unrealized capital gains on property transferred by gift or held at death.

  — Generally, the recipient's basis in property received would be the fair market value at the time of transfer.

  — However, the donee's basis in property received by gift during the donor's life would be the donor's basis in that property at the time of the gift to the extent that the unrealized gain on that property counted against the donor's $1 million exclusion from recognition. ***It appears that recipient's basis in property received from a decedent is not subject to this rule (i.e., would be the fair market value even though decedent utilized the $1 million exclusion).***

— Payment of tax on the appreciation of certain family-owned and -operated businesses would not be due until the interest in the business is sold or the business ceases to be family-owned and operated. Furthermore, the proposal would allow a 15-year fixed-rate payment plan for the tax on appreciated assets transferred at death, other than liquid assets such as publicly traded financial assets and other than businesses for which the deferral election is made.

— Certain exclusions would apply.

  — Transfers by a decedent to a U.S. spouse or to charity would carry over the basis of the decedent.

  — Capital gain would not be recognized until the surviving spouse disposes of the asset or dies, and appreciated property transferred to charity would not generate a taxable capital gain.

  — The exclusion under current law for capital gain on certain small business stock would also apply.

— The proposal would be effective for gains on property transferred by gift, and on property owned at death by decedents dying, after December 31, 2021, and on certain property owned by trusts, partnerships, and other non-corporate entities on January 1, 2022.

International Reforms

Base Erosion Anti-Abuse Tax (BEAT)

— Current law provides that U.S. corporations with average gross receipts in excess of $500 million that make certain deductible "base eroding" payments to non-U.S. related persons are subject to a minimum tax on "modified taxable income" (referred to as the "BEAT").

— The proposal would repeal the BEAT, replacing it with a new rule that disallows deductions to domestic corporations or branches by reference to low-taxed income of entities that are members of the same financial reporting group.

— Specifically, under the Stopping Harmful Inversions and Ending Low-Tax Developments (SHIELD) rule, a deduction (whether related or unrelated party deductions) would be disallowed to a domestic corporation or branch, in whole or in part, by reference to all gross payments that are made (or deemed made) to "low-taxed members," which is any financial reporting group member whose income is subject to (or deemed subject to) an effective tax rate that is below a designated minimum tax rate.

— The rule would apply to financial reporting groups with greater than $500 million in global annual revenues (as determined based on the group's consolidated financial statement).

— The proposal to repeal BEAT and replace with SHIELD would be effective for taxable years beginning after December 31, 2022.

Interest Limitation

— The proposal would add another limitation on interest expense deductions.

— A financial reporting group member's deduction for interest expense generally would be limited if the member has net interest expense for U.S. tax purposes and the member's net interest expense for financial reporting purposes (computed on a separate company basis) exceeds the member's proportionate share of the financial reporting group's net interest expense reported on the group's consolidated financial statements.

— A member's proportionate share of the financial reporting group's net interest expense would be determined based on the member's proportionate share of the group's earnings (computed by adding back net interest expense, tax expense, depreciation, depletion, and amortization) reflected in the financial reporting group's consolidated financial statements.

— A member of a financial reporting group that is subject to the proposal would continue to be subject to the application of Code section 163(j). ***Thus, the amount of interest expense disallowed for a taxable year of a taxpayer that is subject to both interest expense disallowance provisions would be determined based on whichever of the two provisions imposes the lower limitation.***

Global Intangible Low-Taxed Income (GILTI)

— The qualified business asset income exemption which reduces U.S. taxation of GILTI would be eliminated, so that the U.S. shareholder's entire net controlled foreign corporation tested income is subject to U.S. tax.

— The Code section 250 deduction for a global minimum tax inclusion would be reduced to 25 percent, resulting in a U.S. effective tax rate under the global minimum tax of 21 percent (based on the proposed U.S. corporate income tax rate of 28 percent).

— The "global averaging" method for calculating a U.S. shareholder's global minimum tax would be replaced with a "jurisdiction-by-jurisdiction" calculation. Under the new standard, a U.S. shareholder's global minimum tax inclusion and, by extension, residual U.S. tax on such inclusion, would be determined separately for each foreign jurisdiction in which its CFCs have operations. These changes mean that foreign taxes paid to higher-taxed jurisdictions will no longer reduce the residual U.S. tax paid on income earned in lower-taxed foreign jurisdictions.

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

Foreign Derived Intangible Income (FDII)

— Current law provides a deduction to domestic corporations on their foreign-derived intangible income. The deduction allowed is 37.5 percent of a domestic corporation's FDII for any taxable year beginning after December 31, 2017 and 21.875 percent for any taxable year beginning after December 31, 2025. A domestic corporation's FDII is the portion of its intangible income, determined on a formulaic basis, that is derived from exports.

— The proposal would repeal the deduction allowed for FDII. The resulting revenue will be used to encourage R&D.

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

Minimum Worldwide Tax Rate

— Impose a 15 percent minimum tax on worldwide book income for corporations with such income in excess of $2 billion.

— In particular, taxpayers would calculate book tentative minimum tax (BTMT) equal to 15 percent of worldwide pre-tax book income (calculated after subtracting book net operating loss deductions from book income), less General Business Credits (including R&D, clean energy and housing tax credits) and foreign tax credits. The book income tax equals the excess, if any, of tentative minimum tax over regular tax. Additionally, taxpayers would be allowed to claim a book tax credit (generated by a positive book tax liability) against regular tax in future years but this credit could not reduce tax liability below book tentative minimum tax in that year. It is worth noting that the BTMT would not be reduced by deductions such as bonus depreciation which would disproportionately impact capital intensive companies. However, given the high threshold of $2 billion, the impact of this proposal may be limited.

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

Onshoring Credit

— The proposal creates a new general business credit equal to 10 percent of the eligible expenses paid or incurred in connection with onshoring a U.S. trade or business. For this purpose, onshoring a U.S. trade or business means reducing or eliminating a trade or business (or line of business) currently conducted outside the United States and starting up, expanding, or otherwise moving the same trade or business to a location within the United States, to the extent that this action results in an increase in U.S. jobs.

— For purposes of the proposal, expenses paid or incurred in connection with onshoring or offshoring a U.S. trade or business are limited solely to expenses associated with the relocation of the trade or business and do not include capital expenditures or costs for severance pay and other assistance to displaced workers.

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

References: [1] https://www.wsj.com/articles/bidens-latest-infrastructure-offer-1-trillion-11622725783?mod=politics_lead_pos7
https://home.treasury.gov/policy-issues/tax-policy/revenue-proposals

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