The New Age of American Infrastructure

Tax Implications of U.S. Investment in Infrastructure

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Lessons of Biden’s First 100 days and the American Rescue Plan

- With losses in the Georgia Senate races, congressional Republicans are entirely shut out of process
- Democrats can achieve anything they can marshal the political will for
  - However, requires consensus from entire caucus
- The American Rescue Plan (“ARP”) showed President Biden can pass trillions in spending, but consider these factors:
  - Fifth such omnibus bill, first four done with bipartisan support
  - Public fully on board
  - No pay-fors, therefore no hard choices
- Infrastructure is a different ballgame

Build Back Better

- The effort around infrastructure is best understood as a fulfilment of President Biden's "Build Back Better" promise
  - Sweeping economic recovery and jobs program meant to seize a rare opportunity to enact generational reforms
  - Infrastructure will be part of the coming package(s) and the concept of infrastructure investment will be used to propel and ultimately sell it politically
- Current conversation is centered on priorities Democrats hope to enact this Congress, with precise structure and timing TBD

Topline Tax and Spending Components of Biden Agenda

- American Jobs Plan – traditional infrastructure paid for by corporate and international tax increase
  - Transportation and community infrastructure, R&D, manufacturing, workforce development, and eldercare
  - Cost: $2.25T
  - Offsets: $1.75T
- American Families Plan – “human” infrastructure paid for by tax increases on high income individuals, estates, investors
  - Education, family support, and workforce support (including paid leave)
  - Cost: $1.8T
  - Offsets: $1.5T (including $700B from “tax gap”)

Senate Republicans $568B Infrastructure Package

- Meant to serve as a counteroffer to American Jobs Plan
  - Emphasizes spending on "traditional" infrastructure —roads, ports, and airports — as well as water infrastructure and expanded broadband
  - Proposed revenue sources include repurposing federal funds and instituting user fees
- Key differences from the American Jobs Plan:
  - Includes $568B in spending versus $2T+
  - Does not have sweeping policy changes
  - Maintains key provisions of hTax Cuts and Jobs Act (TCJA), including a corporate tax rate of 21% (vs. Biden's proposal of 28%)
- Factors to consider:
  - Democrats broadly oppose the plan, in part because of substantially lower funding levels
  - Biden is working to reach bipartisan infrastructure agreement, but prospects are uncertain

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Will Democrats Use Reconciliation to Pass Infrastructure?

- Biden Administration approach to first 100 days has been informed by the experience of 2009-10
  - Must do what they can, while they can do it
  - Anything they hope to achieve beyond the status quo will have to be done on a partisan basis
- Therefore, budget reconciliation is the most obvious tool at the majority's disposal, barring significant changes to Senate rules

To answer the question: Yes, Democrats will almost certainly seek to use reconciliation again to enact their priorities, it's merely a question of size and scope

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Issues to Consider

- Despite its popularity in the abstract, infrastructure is deceptively tough
  - Hard to agree on a definition on what “infrastructure” means, let alone craft consensus policy
    - Current conversation ranges from roads, bridges, and multi-modal transport to climate, health, equity, “community infrastructure”…
  - It’s tricky to pay for
    - Chronic challenge of sustainable financing mechanisms, even for conventional infrastructure
    - Lack of offsets made ARP/COVID-19 package easier, but key Democratic Senators have indicated they intend to pay for (at least partially) future bills

Issues to Consider (continued)

- Reconciliation limits legislative range of motion, as we saw with ARP
  - Process built for amending spending and revenue levels; lends itself well to some things, such as tax overhauls, but is a poor fit for others that require changes in non-budgetary policy

Remember: Paper thin majorities require near absolute consensus of the majority

What Is Budget Reconciliation and Why Is It important?

- House of Representatives rules require a simple majority to pass legislation, but in the Senate, 60 votes are needed for most legislation
- Under current Senate rules and precedent, the minority can hold up (filibuster) bills if they don't support cloture (end the filibuster)
- Budget reconciliation provides a process to pass certain legislation by a simple majority
  - It is currently the primary tool for circumventing the 60-vote threshold

In short: budget reconciliation provides the Senate the ability to fast-track certain types of legislation with only 51 votes

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Reconciliation Basics

- Reconciliation may be used (at least) once each fiscal year
  - Congress used the FY 2021 budget resolution to enact COVID-19 relief in the American Rescue Plan (ARP) Act
  - The FY 2022 budget resolution is currently available, and they will have a third to use for FY 2023
  - Senate parliamentarian interpretation may give additional opportunities
- Budget reconciliation entails stricter rules in the Senate

Are There Limits on the Use of Reconciliation?

- The Budget Act prohibits the reconciliation package from containing "extraneous matters." In the Senate this can be enforced via a point of order under the "Byrd Rule"
  - Among other stipulations, matters are considered extraneous if they do not change outlays or revenues or the changes in outlays or revenue are "merely incidental" to goals of the provision
  - This subjective decision is made by the Senate parliamentarian
  - Byrd Rule also prohibits provisions with a fiscal impact outside of the 10-year budget window
  - If the parliamentarian rules that a matter is extraneous, this ruling can be overridden with 60 votes (under current rules)

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What Happens Now?

- Most activity remains in flux pending release of the President's budget (end of May?)
  - Will provide topline spending numbers for appropriators to begin the annual government funding process, as well as details on the American Jobs and American Families Plans
    - Treasury will release its Green Book at the same time
- The lone forcing mechanism for legislative action occurs at the end of September, when the current surface transportation authorization bill expires (though Congress could give itself more time)

What Happens Now? (continued)

- Government funding deadline and debt limit converging at end of September as well
  - One important factor: status of the Highway Trust Fund (HTF), whose revenue stream has been hit hard by the pandemic
  - There is bipartisan support for surface transportation reauthorization; in theory this could move via regular order but…

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What Are the Wild Cards and How Could They Affect Infrastructure Legislation?

- COVID-19
  - Trajectory of public health crisis
- Economic data (e.g. jobs numbers, GDP growth)
  - Trajectory of economic recovery
- Health/attendance of Congress
  - Razor-thin majorities in both chambers
- Midterm elections pressure
  - Window of action likely confined to 2021
    - Not going to do this in election year (especially tax increases)
    - One (or more) infrastructure packages?
  - What do members of Congress need?
    - E.g., SALT politics, tax treatment of family farms

Made in America Tax Plan: Revenue-Raising Proposals

- Increase the Corporate Tax Rate
- International Tax Regime: Repeal or reform rules regarding-
  - Global Intangible Low-Taxed Income (GILTI)
  - Deduction for Foreign-Derived Intangible Income (FDII)
  - Base Erosion Tax Avoidance (BEAT)
  - Engage in Multilateral Global Minimum Tax Negotiations
- Minimum Tax on Book Income
- Repeal Fossil Fuel Tax Incentives
- Increased IRS Enforcement Efforts

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Made in America Tax Plan: Background

- President Biden released $2.25 trillion American Jobs Plan on March 31, 2021
  - Broad definition of infrastructure

- Accompanying the American Jobs Plan was the "Made in America" tax plan
  - Designed to "fully [pay] for the investments in the American Jobs Plan over a 15-year period and [continue] to generate revenue on a permanent basis." (page 2)
  - Focuses entirely on corporate revenues (domestic and overseas operations)

- GOP seeks smaller, $568B plan that focuses on "traditional infrastructure" (Senate GOP Leader McConnell says GOP would support an $800B package)

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Made in America Tax Plan: Increase the Corporate Tax Rate

- President Biden has proposed raising the corporate tax rate to 28%
  - This increase is estimated to raise approximately $1 trillion over the next 15 years
  - In July 2013, President Obama offered to reduce the corporate tax rate to 28% (from 35%)

- Senator Joe Manchin (D-WV) indicated he would be willing to raise the corporate tax rate to 25% to help pay for infrastructure investments but would not support increasing the corporate rate to 28%

- Senator Bernie Sanders (I-VT) has introduced the "Corporate Tax Dodging Prevention Act"
  - Would raise the corporate rate back to the pre-TCJA level of 35% beginning in 2022
  - President Biden said that a 35% corporate rate is too high

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Made in America Tax Plan: Reforming Global Intangible Low-Taxed Income (GILTI) Regime

- President Biden has proposed multiple reforms to the GILTI regime created in the 2017 TCJA
  - Double the rate from 10.5% to 21% (by changing the allowable deduction amount from 50% to 25%)
  - Calculate the tax on a country-by-country basis (instead of an aggregate basis)
  - Eliminate the 10 percent exclusion on foreign qualified business asset investment (QBAI)

- The Senate Finance Committee (SFC) international framework includes many similar proposals
  - Increase the GILTI tax rate (by reducing deduction from anywhere between 0 and 40%)
  - Eliminate the 10% exclusion on foreign tangible assets
  - Changing the calculation of GILTI to either:
    - A country-by-country basis (per the Biden plan)
    - Low-tax and high-tax "buckets" whereby income subject to foreign effective tax rates greater than the GILTI rate would be exempt

- The "Corporate Tax Dodging Prevention Act" and the "No Tax Breaks for Outsourcing Act" call for strengthening the GILTI regime and country-by-country reporting

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Made in America Tax Plan: Reforming/ Eliminating Foreign-Derived Intangible Income (FDII) Deduction

- Provides a 37.5% deduction for a domestic corporation's foreign sales

- President Biden has proposed repealing the FDII deduction and use the savings to support $180 billion in research and development incentives

- The SFC international tax framework rebrands FDII as the "foreign derived innovation income" deduction
  - Provide a favorable tax rate to income attributable to "innovation spurring activities" in the U.S.
    - Research and development and worker training expenses
  - Equalize the effective tax rates for GILTI and FDII (currently GILTI is taxed at 10.5% and FDII at 13.125%)

- Senator Sanders' "Corporate Tax Dodging Prevention Act" would eliminate the FDII deduction

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Made in America Tax Plan: Reforming Base Erosion and Anti-Abuse Tax (BEAT)

- President Biden has proposed replacing the BEAT with a similar Stopping Harmful Inversions and Ending Low-tax Developments (SHIELD) regime
  - SHIELD would deny multinational corporations U.S. tax deductions for payments made to related parties in low-tax jurisdictions
    - Low-tax jurisdiction would be determined based on a globally agreed minimum tax rate or
    - The modified U.S. GILTI rate of 21%
  - SHIELD would also enhance corporate inversion rules - a foreign corporation would be treated as a U.S. taxpayer if:
    - Management and control remains in the U.S. or
    - The entity meets a reduced 50% continuing ownership threshold (current limits begin at 60%)

- SFC framework would bifurcate rates for regular tax liability and BEAT liability
  - The plan would create a second, higher rate for base erosion benefits (unspecified); regular income would remain subject to 10% rate
  - Would restore the full value of general business credits for the purpose of calculating BEAT

- Rep. Lloyd Doggett (D-TX) and Sen. Sheldon Whitehouse (D-RI) introduced the “Stop Tax Haven Abuse Act”
  - Reduce the gross receipts eligibility threshold from $500 million to $100 million
  - Include royalty payments in BEAT
  - Eliminate the 3% base erosion threshold to determine if a company is subject to BEAT

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Made in America Tax Plan: Engage in Multilateral Global Minimum Tax Negotiations

- "Under the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting, the United States and the international community are pursuing a comprehensive agreement on corporate minimum taxation, providing for minimum tax rules worldwide. Under the agreement, home countries of multinational corporations would apply a minimum tax when offshore affiliates are taxed below an agreed upon minimum tax rate." (Treasury Plan at p. 12)

- OECD believes there could be progress at G-20 meetings in July and October
  - Pillar one – nexus and profit allocation (as opposed to physical presence)
  - Pillar two - global minimum corporate tax

- Concern: Avoid the unfair targeting of U.S. digital firms which bear a larger burden of tax under the existing OECD framework – bipartisan Congressional opposition to this and other unilateral DSTs already enacted

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Made in America Tax Plan: Minimum Tax on Book Income

- Biden plan calls for a 15% tax on book income for corporations with net income of at least $2B
  - Large corporations would determine their regular tax liability and would pay the greater of the regular tax liability or 15% of its book income
  - It is estimated that only 180 companies would meet the $2 billion threshold
  - Corporations could reduce the book tax with general business credits (including R&D, clean energy and housing tax credits) and foreign tax credits
  - Any book tax paid by a corporation would result in a credit that could be used in future years
  - Treatment of NOLs unclear

- Senator Elizabeth Warren (D-MA) has said she will introduce her own book income tax proposal
  - It could resemble the Real Corporate Profits Tax she proposed during her presidential campaign – would apply a 7% tax on book income of companies that make more than $100 million

- The Tax Reform Act of 1986 briefly enacted a book income adjustment
  - From 1987 to 1989, the corporate alternative minimum tax was increased by 50% of a company's net adjusted book income in excess of its alternative minimum taxable income (functioning as a 10% tax on book income)

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Made in America Tax Plan: Eliminate Tax Preferences for Fossil Fuels

- The Biden proposal calls for the repeal of all tax preferences for the fossil fuel industry (with no specifics)
  - Estimated to raise $35 billion over the next decade – would pay for tax incentives for clean energy storage projects and transmission lines, extending the 48C tax credit, and a blender's credit for sustainable aviation fuels

- SFC Chairman Ron Wyden's "Clean Energy for America Act" would eliminate many of the same tax preferences

- The "Stop Tax Havens Abuse Act" would reintroduce subpart F rules for foreign related oil income and eliminate favorable foreign tax credits for payments to foreign countries.

- Senator Sanders' "End Polluter Welfare Act" would eliminate tax preferences for fossil fuels
  - Repeal the enhanced oil recovery credit, the marginal wells credit, percentage depletion, the advanced coal project credit, and preferential immediate expensing for various fossil fuel activities
  - Prevent fossil fuel activities from benefiting from broader tax incentives – FDII, research and development credits, like-kind exchange treatment, bonus depreciation, and the 20% deduction on pass-through income
  - Would terminate the credit for carbon sequestration and permanently increase the excise tax rate on coal

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Made in America Tax Plan: Increased IRS Enforcement Efforts

- The Biden Administration's "top line" appropriations numbers for fiscal year 2022 call for an IRS budget of $13.2 billion
  - Increase of 10.4% ($1.2 billion) over the 2021 enacted level
  - The agency would get an additional increase of $417 million for tax enforcement as part of a multi-year initiative to increase taxpayer compliance and revenues

- Over the next decade, the Biden Administration wants to provide an additional $80B in IRS funding – which is projected to generate $700B in net revenue (and allow enforcement staff to increase by 15% per year)

- Representative Peter DeFazio (D-OR) reintroduced the" IRS Enhancement and Tax Gap Reduction Act" this year, which would increase IRS funding levels and mandate minimum audit rates for high income corporations

- Senator Elizabeth Warren said that she will introduce legislation to provide mandatory funding for the IRS in order to improve the agency's hiring and enforcement efforts

The American Families Plan: Revenue-Raising Proposals

- Increase the Maximum Individual Income Tax Rate
- Increase the Maximum Capital Gains Tax Rate
- Repeal Step-up In Basis Rule
- Close The “Carried Interest Loophole”
- Curtail Section 1031 Like Kind Exchange Treatment For Real Property
- Make Permanent The TCJA Non-Corporate Business Loss Limitation Rules
- Enhance Reporting Requirements for Financial Institutions of Certain Activities
- Expansion of the Medicare Tax

The American Families Plan: Background

- On April 28, President Biden released $1.8 trillion American Families Plan (AFP)

- The AFP focuses on “human infrastructure” – four years of free education, direct support to children and families, and extend tax cuts for families with children and American workers

- The AFP would extend or make permanent the Child Tax Credit, the Earned Income Tax Credit, and the Child and Dependent Care Tax Credit

- To offset the AFP cost, President Biden proposed “a set of measures to make sure that the wealthiest Americans pay their share in taxes, while ensuring that no one making $400,000 per year or less will see their taxes go up. When combined with [the] American Jobs Plan, this legislation will be fully paid for over 15 years and will reduce deficits over the long term.” (AFP at p. 2)

The American Families Plan: Increase The Maximum Individual Income Tax Rate

- The Biden proposal would increase the top tax rate to its pre-TCJA level of 39.6%, up from the current 37% rate
  - In tax year 2021, the highest rate would apply to –
    - Single filers and heads of household with incomes in excess of $523,600
    - Joint filers with incomes in excess of $628,300
  - The last increase in the individual tax rate occurred in 1993 (when the top individual income tax rate was increased from 31% to 39.6%)

- The "SALT Act of 2021" introduced by Representative Bill Pascrell (D-NJ) would increase the top tax rate to 39.6% to offset the SALT cap repeal

The American Families Plan: Increase The Maximum Capital Gains Tax Rate

- The Biden proposal would increase the capital gains tax rate to 39.6% for taxpayers with more than $1 million in income
  - Rate would be 43.4% when considering the 3.8% NIIT
  - Provision would lose revenue if not coupled with the step-up basis repeal

- Senate Finance Chairman Ron Wyden (D-OR) is developing a mark-to-market framework that would tax unrealized capital gains on an annual basis
  - Would apply to taxpayers that meet an income ($1 million) or asset threshold ($10 million) for three consecutive years
  - Would provide a special lookback regime for non-tradable assets

- Senator Elizabeth Warren (D-MA) introduced the "Ultra-Millionaire Tax Act" earlier this year
  - Would apply a 2% rate on net worth above $50 million and a 3% rate on net worth above $1 billion

The American Families Plan: Repeal Step-up In Basis Rule

- The Biden plan would repeal the “step-up in basis” rule and tax gains in excess of $1 million at death
  - Assets with unrealized gain would be taxed; gain included in decedent’s final income tax return
  - When combined with the 40% estate tax rate, the effective tax rate is approximately 61%
  - Protections would apply to family-owned businesses and farms that are left to heirs
  - Gains on property donated to charity would not be taxed

- Sen. Chris Van Hollen (D-MD) introduced the “Sensible Taxation and Equity Promotion (STEP) Act”
  - Would eliminate the step-up retroactively for transfers made after December 31, 2020
  - Would exclude $1 million of unrealized gains and allow for the payment of the tax over 15 years

- Representative Bill Pascrell (D-NJ) introduced similar deemed realization legislation in the House
  - This bill is very similar to the Senate STEP Act
  - This legislation would affect transfers occurring after December 31, 2021

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The American Families Plan: Close The "Carried Interest Loophole"

- The Biden plan would end the rule that allows hedge fund managers to pay taxes on their income at the preferential capital gains tax rate of 20%
  - The proposal would equalize the capital gains tax rate and top income tax rate and calls for additional "structural changes" to permanently eliminate carried interest

- Representative Bill Pascrell (D-NJ) introduced the "Carried Interest Fairness Act of 2021"
  - Would remove the loophole by taxing carried interest at ordinary income rates and subject this income to employment taxes

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The American Families Plan: Curtail Section 1031 Like-Kind Exchange Treatment For Real Property

- The “like kind” exchange rule allows taxpayers to exchange qualifying real estate for other real estate of “like kind” without recognizing gain
  - The unrealized gain is deferred until the property received in the exchange is sold

- The Biden plan would eliminate the preferential deferral treatment for real property gains in excess of $500,000

- Like-kind exchanges were curtailed in the 2017 TCJA to apply only to real property
  - Note: The law’s limitation regarding the exchange of personal property applied to transactions completed after December 31, 2017 (with an exception if the property is disposed of or received in the exchange by December 31)

The American Families Plan: Make Permanent The TCJA Non-Corporate Business Loss Limitation Rules

- The plan would permanently extend the excess business loss limitation that was created in the Tax Cuts and Jobs Act (TCJA) under section 461(l)
  - The limitation is set to expire on December 31, 2026
  - This rule limits the amount of annual deductible losses to $500,000 for joint filers and $250,000 for single filers
  - The CARES Act temporarily repealed the limitation for years 2018 through 2020

- 120 Democratic members of Congress supported the "CARES Windfall for the Wealthiest Repeal Act" earlier this year
  - Would have reinstated the excess loss limitation that was temporarily repealed in the CARES Act
  - Would make the loss limitation permanent

The American Families Plan: Enhance IRS Reporting Requirements for Financial Institutions of Certain Activities

- The Biden plan would enhance IRS requirements for financial institutions
  - Require reporting for account flows on investment and business activity (similar to W-2 wages)
  - Provide additional funding for IRS enforcement
  - President Biden is seeking $80 billion in additional funding for the IRS (enforcement staffing, technology and bank reporting)
  - The proposals may generate up to $700 billion over the next decade (approximately 50% from the enhanced financial institution reporting requirements)

- Representative Peter DeFazio (D-OR) reintroduced the "IRS Enhancement and Tax Gap Reduction Act" this year, which would increase IRS funding levels and mandate minimum audit rates for high income corporations

- Senator Elizabeth Warren (D-MA) is working with Senate Finance Chairman Ron Wyden (D-OR) to draft legislation that would provide mandatory funding for the IRS to improve the agency's hiring and enforcement efforts

The American Families Plan: Expansion of The Medicare Tax

- Taxpayers pay a total of 2.9% in Medicare taxes (1.45% paid by workers and 1.45% paid by employers)

- An additional Medicare tax of 0.9% (increasing the total Medicare tax to 3.8%) is paid by taxpayers with the following income levels –
  - Single taxpayers: $200,000 and above
  - Joint filers: $250,000 and above

- The Biden plan provides the following:
  - “High-income workers and investors generally pay a 3.8% Medicare tax on their earnings, but the application is inconsistent across taxpayers due to holes in the law. The President’s tax reform would apply the taxes consistently to those making over $400,000, ensuring that all high-income Americans pay the same Medicare taxes.”

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Questions?

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