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Senator Manchin Announces That He Will Not Support the Build Back Better Act ??? Where Things Stand Now

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Today, December 19, 2021, Senator Joe Manchin (D., W.Va.) said that he opposes the Build Back Better Act, which effectively prevents its passage. While there are no immediate prospects for the Build Back Better Act to become law, future tax acts tend to draw upon earlier proposals. With a view to future tax proposals, this blog summarizes the final draft that was released by the Senate Finance Committee on December 11, 2021 (the "Build Back Better Bill"), and compares it to the bill passed by the House of Representatives (the "House Bill") and the prior bill that was released by the House Ways and Means Committee in September 2021 (the "Prior House Bill"), which the House Bill was based on. In light of Senator Manchin's announcement, this blog refers to the bills in the past tense.

Summary of Significant Changes to Current Law in the Build Back Better Bill

Individual taxation

??? A 5% surtax would have been imposed on income in excess of $10 million ($5 million for a married individual filing a separate return) and a 3% additional surtax would have been imposed on income in excess of $25 million ($12.5 million for a married individual filing a separate return). The surtax would have also applied to non-grantor trusts but at significantly lower thresholds – the 5% surtax would apply to income in excess of $200,000 and the 3% surtax would apply to income in excess of $500,000. The individual income tax rates would have otherwise remained the same as under current law.

???The 3.8% net investment income tax would have been expanded to apply to the active trade or business income of taxpayers earning more than $400,000. As a result, active trade or business income allocated to a limited partner of a limited partnership or a shareholder of a subchapter S corporation would have been subject to the net investment income tax. Under current law, the tax applies only to certain portfolio and passive income. Under current law, a limited partner of a

limited partnership and a shareholder of a subchapter S corporation is otherwise not subject to self-employment taxes. The Build Back Better Act would not have had otherwise imposed self-employment taxes on S corporation shareholders or limited partners.

- The exemption of gains on the disposition of “qualified small business stock” would have been reduced from 100% to 50% for taxpayers earning more than $400,000/year, and all trusts and estates.
- “Excess business losses” in excess of $250,000 ($500,000 in the case of a joint return) would have been carried forward as business losses (thus remaining still subject to the limitation) and would not have been converted to net operating losses, and the excess business loss provision would have been made permanent. It currently is scheduled to expire in 2026.
- Losses recognized with respect to worthless partnership interests would have been treated as capital losses (rather than ordinary losses as is often the case under current law), and would have been taken when the event establishing worthlessness occurs (rather than at the end of the year under current law).
- The wash sale rules would have been expanded to cover commodities, foreign currencies, and digital assets, like cryptocurrency, as well as dispositions by parties related to the taxpayer.
- The constructive ownership rules would have been expanded to cover digital assets, like cryptocurrency.

Business taxation

- A corporate minimum tax of 15% would have been imposed on “book income” of certain large corporations. But the corporate income tax rates would have remained unchanged at 21%.
- 1% excise tax would have been imposed on the value of stock repurchased by a corporation.
- The interest expense deduction of a domestic corporation that is part of an “international financial reporting group” and whose average annual net interest expense exceeds $12 million over a three-year period would have been disallowed to the extent its net interest expenses for financial reporting purposes exceeds 110% of its proportionate share (determined based on its share of either the group’s EBITDA or adjusted basis of assets) of the net interest expense for financial reporting purposes of the group. The disallowed interest deduction could be carried forward for subsequent years.

- ???Losses recognized by a corporate shareholder in liquidation of its majority owned corporate subsidiary would have been deferred until substantially all of property received in the liquidation is disposed of by the shareholder.
- ???Corporations spinning off subsidiaries would have been limited in their ability to use debt of the subsidiary to receive tax-free cash.

International taxation

- ???A foreign person who owns 10% or more of the total vote or value of the stock of a corporate issuer (as opposed to 10% or more of total vote under current law) would have been ineligible for the portfolio interest exemption.
- ???The Build Back Better Bill would have substantially revise the various international tax rules enacted as part of the Tax Cuts and Jobs Act ("TCJA"), including "GILTI", "FDII" and "BEAT" regimes.
- ???Foreign tax credit limitation rules would have been applied on a country-by-country basis.
- ???Section 871(m), which imposes U.S. withholding tax on U.S.-dividend equivalent payments on swaps and forward contracts, would have been expanded to require withholding on swaps and forwards with respect to, or by reference to, interests in publicly traded partnerships.[1]

Proposals Not Included in the Build Back Better Bill

The Build Back Better Bill **would not have**:

- ???Increased individual and corporate income tax rates (other than the surtaxes);
- ???Changed the tax treatment of carried interests;
- ???Affected the "pass-through deduction" under section 199A;
- ???Affected "like kind" exchanges under section 1031;
- ???Increased the cap on social security tax withholding;
- ???Changed the $10,000 annual cap on state and local tax deductions;[2] or
- ???Treated death as a realization event.

Discussion

Individual Tax Changes

Surtax on individuals

The Build Back Better Bill would have added new section 1A, which would have imposed a tax equal to 5% of a taxpayer's "modified adjusted gross income" in excess of $10 million (or in excess of $5 million for a married individual filing a separate return). Modified adjusted gross income would have been adjusted gross income reduced by any reduction allowed for investment interest expenses. Modified adjusted gross income would not have been reduced by charitable deductions and credits would not have been allowed to offset this surtax. An additional 3% tax would have been imposed on a taxpayer's modified adjusted gross income over $25 million (or in excess of $12.5 mm for taxpayers filing as married filing separately). The surtaxes would also have applied to non-grantor trusts at significantly lower thresholds – the 5% surtax would apply to modified adjusted gross income in excess of $200,000 and the 3% additional surtax would have applied to modified adjusted gross income in excess of $500,000.

As a result, the top marginal federal income tax rate on modified adjusted gross income in excess of $25 million would have been 45% for ordinary income and 31.8% for capital gains (including the net investment income tax). Nevertheless, the Build Back Better Bill rate on capital gains would have remained meaningfully less than the 39.6% rate proposed by the Biden Administration.

The Build Back Better Bill did not include a change to the individual income tax rates, which was a major departure from the Prior House Bill. The Prior House Bill included a similar surtax on individual taxpayers, but the threshold was lower at $5 million for taxpayers that file joint returns and the surtax rate was 3%.

The surtax would have been effective for taxable years beginning after December 31, 2021.

Application of net investment income tax to active business income; increased threshold

The Build Back Better Bill would have expanded the 3.8% net investment income tax to apply to net income derived in an active trade or business of the taxpayer, rather than only to certain portfolio income and passive income of the taxpayer under current law.

As a result, the 3.8% net investment income tax would have been imposed on limited partners who traditionally have not been subject to self-employment tax on their distributive share of income, and S corporation shareholders who have not been subject to self-employment tax on more than a reasonable salary. This proposed change was generally consistent with the Biden administration's proposal to impose 3.8% Medicare tax (although the additional net investment income tax proposed in the Build Back Better Bill would not be used to fund Medicare).

The Build Back Better Bill also would have limited the 3.8% net investment income tax so that it applies only to taxpayers with taxable income greater than $400,000 (and $500,000 in the case of married individuals filing a joint return), rather than $250,000 under current law.

These changes were consistent with the proposals in the Prior House Bill and would have applied in taxable years beginning after 2021.

Limitation on "qualified small business stock" benefits

The Build Back Better Bill would have limited the exemption of eligible gain for disposition of "qualified small business stock" ("QSBS") to 50% for taxpayers with adjusted gross income of $400,000 or more, as well as all trusts and estates, and would have subjected the gain to the alternative minimum tax.

Very generally, under current law, non-corporate taxpayers are entitled to exclude from tax up to 100% of gain from the disposition of QSBS that has been held for more than 5 years.[3] In addition, gain from the sale of QSBS can potentially be deferred if proceeds are reinvested in other QSBS.

The same proposal was included in the House Bill and the Prior House Bill. The Prior House Bill contained a proposal to increase corporate tax rates, which together with the proposed changes to the QSBS rules, would have further limited desirability of investing in QSBS. The Build Back Better Bill, the House Bill and the Prior House Bill only addressed the rules applicable to exclusion of gain from the sale of QSBS, and did not alter the rules allowing for deferral of gains for proceeds invested in other QSBS. Although the benefits associated with ownership of QSBS would have remained significant, had the Build Back Better Bill passed, in light of the reduction in potential gain that would have been excluded, the Build Back Better Bill would have required a reevaluation of choice-of-entity decisions based on QSBS benefits.

The proposal would have been effective retroactively and apply to sales or exchanges of stock on or after September 13, 2021, which is the date that the Prior House Bill was released.

Excess business losses

Under current law, for taxable years that begin before January 1, 2027, non-corporate taxpayers may not deduct excess business loss (generally, net business deductions over business income) if the loss is in excess of $250,000 ($500,000 in the case of a joint return), indexed for inflation. The excess loss becomes a net operating loss in subsequent years and is available to offset 80% of taxable income each year. The Build Back Better Bill would have made this limitation permanent and would treat the losses carried forward to the next taxable year as deduction attributable to trades or businesses, which would have been subject to the excess business losses limitation under section 461(l). As a result, no more than $250,000/$500,000 in losses could be used in any year, and excess business losses would never have become net operating losses. Unlike deductions that are suspended under the passive activity rules and at-risk rules that become deductible upon a disposition of the interest in the relevant trade or business, the excess business losses continue to be limited after the sale of the relevant trade or business.

This proposal is consistent with the Prior House Bill and would have been retroactive and apply for taxable years beginning after December 31, 2020.

Worthless partnership interest and limitation on loss recognition in corporate liquidations

Under current law, if a partner's interest in a partnership becomes worthless, in the taxable year of worthlessness the partner may take an ordinary loss if the partner receives no consideration and a capital loss in all other cases. As a practical matter, this rule allows for an ordinary loss if the partner has no share of any liabilities of the partnership immediately prior to the claim of worthlessness, or a capital loss if the partner has a share of any partnership liability immediately prior to the claim of worthlessness (because relief of partnership liabilities is treated as consideration received in a sale). Under current law, if a security (not including an obligation issued by a partnership) that is held as a capital asset becomes worthless, the loss is treated as occurring on the last day of the taxable year in which the security became worthless.

Under the Build Back Better Bill, if a partnership interest becomes worthless, the resulting loss would have been treated as a capital loss (and not an ordinary loss). Also, in the case of a partnership interest or a security that becomes worthless, the loss would have been recognized at the time of the identifiable event establishing worthlessness (and not at the end of the taxable year). The proposal would also have expanded the scope of securities subject to worthless securities rules to included obligations (bond, debenture, note, or certificate, or other evidence of indebtedness, with interest coupons or in registered form) issued by partnerships. These proposals were also included in the Prior House Bill and would apply to taxable years beginning after December 31, 2021.

The Build Back Better Bill would also have deferred the loss that is recognized by one corporate member of a controlled group[4] when a subsidiary merges into it in a taxable transaction under section 331 until substantially all of the property received in the liquidation is disposed to a third-party. This proposal would effectively have eliminated taxpayers' ability to enter into *Granite Trust* transactions to recognize capital losses by liquidating an insolvent subsidiary.[5] A similar loss deferral rule would also have applied to dissolution of a corporation with worthless stock or issuance of debt in connection with which corporate stock becomes worthless. This proposal would have applied to liquidations occurring on or after the date of enactment.

Expansion of wash sale and constructive sale rules

The Build Back Better Bill would have expanded the application of wash sale rules and constructive sale rules to cryptocurrencies and other digital assets.

The Build Back Better Bill would also have expanded the wash sale rules to include transactions made by related parties. The wash sale rules disallow a loss from a sale or disposition of stock or securities if the taxpayer acquires or enters into a contract to acquire substantially similar stock or securities thirty days before or after the sale giving rise to the claimed loss. The basis of the acquired assets in the wash sale is increased to include the disallowed loss. Under the Build Back Better Bill, a wash sale would also have occurred when a "related party" to the taxpayer (other than a spouse) acquires the substantial similar stock or securities within the thirty day period.[6] More significantly, the disallowed loss in a wash sale triggered by a related party (other than a spouse) would have been permanently disallowed under the Build Back Better Bill. If the Build Back Better Bill had passed, it would have been challenging for certain taxpayers to comply with the related party provisions—and very difficult for the IRS to enforce it. Under the provision, if a parent were to sell stock at a loss and, within 30 days, her child were to purchase the same stock, the parent's loss would have been denied, even if neither parent nor child knew about each other's trades.

The Build Back Better Bill would have exempted from the wash sale rules foreign currency and commodity trades that were directly related to the taxpayer's business needs (other than the business of trading currency or commodities). This exception would not have applied to digital assets.

Finally, the Build Back Better Bill would have provided that an appreciated short sale, short swap, short forward, or futures contract is constructively sold under section 1259 when the taxpayer enters into a contract to acquire the reference property (and not when the taxpayer actually acquires the reference property, as current law provides).

The changes were the same as those proposed in the Prior House Bill. The proposal would have applied after 2021.

SALT deductions

The Build Back Better Bill has a "placeholder for compromise on deduction for state and local taxes". This is a key departure from the House Bill, which included an increase to the current annual $10,000 cap on SALT deductions to $80,000 until 2030, at which time the $10,000 annual limitation would apply again.

Business Tax Changes

Corporate alternative minimum tax

The Build Back Better Bill would impose a 15% minimum tax on "book income" of corporations with 3-year average book income in excess of $1 billion. A corporation's book income would have been calculated based on the corporation's audited financial statement (or if publicly traded, financial statement shown on SEC Form 10-K), but adjusted to take into account certain U.S. income tax principles.[7] Because this is a minimum tax, a corporation would have paid any excess amount of this minimum tax over its regular tax for the applicable tax year. This minimum tax would also have applied to a foreign-parented U.S. corporation if the U.S. corporation has an average annual book income of $100 million or above.

The Prior House Bill did not include this corporate minimum tax based on book income, but the Biden administration's tax reform proposals included a similar corporate minimum tax for large corporations. The Build Back Better Bill does not otherwise provide for an increase in corporate income tax rates.

The corporate minimum tax would have been effective for tax years beginning after December 31, 2022.__

Limitation on business interest expense deductions

The Build Back Better Bill would have introduced an additional interest deduction limitation for a U.S. corporate member of an international group that has disproportionate interest expense as compared to the other members of the group. New section 163(n) would generally have limited the interest deduction of a U.S. corporation that is part of an "international financial reporting group" and has net interest expense that exceeds $12 million (over a three-year period) if the ratio of its net interest expense to its EBITDA (or if an election is made, the aggregated bases of its assets)[8] exceeds by 110% of the similar ratio for the group.

Proposed section 163(n) was similar to what was included in the Prior House Bill, as well as a proposal that was included in the Senate and House bill for TCJA that was ultimately dropped in the conference agreement between the Senate and the House. This limitation appears to target base erosion interest payments that may not be captured under the BEAT regime (which is further discussed in detail below).

The Build Back Better Bill would also have revised section 163(j) to treat partnerships as aggregates for purposes of applying the business interest expense limitation. As a result, the section 163(j) limitation would have been applied at the partner level. Under current law, the limitation, which very generally limits business interest expense deduction to 30% of EBITDA, is applied at the partnership level. The interest deductions limited under section 163(j) or (n) (whichever imposes a lower limitation) would have continued to be allowed to be carried forward indefinitely (as opposed to 5 years under the Prior House Bill).

The proposals would have been effective for tax years beginning after December 31, 2022.

Limitation on using controlled corporation's debt in a spin-off transaction

The Build Back Better Bill would have limited the ability of a U.S. "distributing corporation" to effectively receive cash tax-free from a spun-off "controlled corporation" subsidiary. Under current law, a controlled corporation can issue debt securities to its parent distributing corporation that the distributing corporation can then use to redeem its own outstanding debt on a tax-free basis in connection with the spin-off of the controlled corporation. The Build Back Better Bill would have required the parent distributing corporation to recognize gain in this transaction to the extent that the amount of controlled corporation debt it transfers to its creditors exceeds (x) the aggregate basis of any assets it transfers to its controlled corporation in connection with the spin-off less (y) the total amount of liabilities the controlled corporation assumes from it and (z) any payments that the controlled corporation makes to it. This effectively would have treated the debt securities issued by a controlled corporation as same as any other property distributed by the controlled corporation (which is commonly called as "boot").

The proposal would have applied to reorganizations occurring on or after the date of enactment.

Excise tax on corporate stock buybacks

The Build Back Better Bill would have imposed a nondeductible 1% excise tax on publicly traded U.S. corporations engaging in stock buybacks. The tax was to be imposed on the value of the stock “repurchased” by the corporation during the tax year, reduced by value of stock issued by the corporation during the tax year (including those issued to the employees). The term “repurchase” is defined as a redemption within the meaning of section 317(b), which is a transaction in which a corporation acquires its stock from a shareholder in exchange for property. Repurchases that are (i) dividends for U.S. federal income tax purposes, (ii) part of tax-free reorganizations, (iii) made to contribute stock to an employee pension plan or ESOP, (iv) made by a dealer in securities in the ordinary course of business, or (v) made by a RIC or a REIT are not subject to the excise tax. Also, repurchases that are less than $1 million in a year are excluded.

It was unclear how the value of repurchased stock was to be determined in calculating the excise tax amount. The types of transactions that would have been covered under the proposed rule is also unclear. The term “repurchase” was very broad and it could have had applied to different types of transactions, such as redemption of redeemable preferred stocks or redemption of stock in a company’s acquisition transaction. The rule would also have had significant impact on de-SPAC transactions, which involve redemption rights for shareholders of the SPAC. The Treasury would also have been provided with a broad authority to issue regulations to cover economically similar transactions.

The proposal would have applied to repurchases of stock after December 31, 2021.

International Tax Changes

Portfolio interest exemption

Under current law, a foreign person that owns 10% or more of the total voting power of a corporate issuer of debt is not eligible for the "portfolio interest" exemption, which provides for exemption from withholding on interest paid on certain debt. Current law does not prohibit "de-control structures" under which the sponsor of a fund will typically invest a small percentage of the capital of a U.S. blocker in exchange for large percentage of its voting stock, thereby ensuring that no foreign investor will own 10% of the voting power of the U.S. blocker and permitting those foreign investors who own more than 10% of the value of the U.S. blocker to take the position that they may avoid U.S. withholding tax on interest received from the U.S. blocker. The Build Back Better Bill would have revised this exception so that any person who owns 10% or more of the total vote or value of the stock of a corporate issuer would have been ineligible for the portfolio interest exemption. This change would have prevented the de-control structures.

This proposal, which was also included in the Prior House Bill, would have applied to obligations issued after the date of enactment (i.e., all existing obligations would have been grandfathered). However, if a grandfathered obligation was "significantly modified" for U.S. federal income tax purposes, it might have lost its grandfathered status. Also, any subsequent draws on existing facilities that are made after the date of enactment would not have been grandfathered.

GILTI

The "global intangible low-taxed income" ("GILTI") regime generally imposes a 10.5% minimum tax on 10-percent U.S. corporate shareholders of "controlled foreign corporations" ("CFCs") based on the CFC's "active" income in excess of a threshold equal to 10% of the CFC's tax basis in certain depreciable tangible property (such basis, "qualified business asset investment", or "QBAI"). GILTI is not determined on a country-by-country basis, and, therefore, under current law a U.S. multinational corporation may be able to avoid the GILTI tax with respect to its subsidiaries operating in low-tax rate countries by "blending" income earned in the low tax-rate countries with income from high-tax rate countries. Taxpayers are allowed 80% of the deemed paid foreign tax credit with respect to GILTI.

The Build Back Better Bill would have imposed GILTI on a country-by-country basis to prevent blending of income from a low tax-rate country with income from a high-tax rate country. This general approach would have been largely consistent with the prior proposals made by the Biden administration and the Senate Finance Committee.[9]

The Build Back Better Bill would have determined net CFC tested income and losses and QBAI on a country-by-country basis. The Build Back Better Bill would have achieved this by using a "CFC taxable unit" – net CFC tested income and loss would have been determined separately for each country in which CFC taxable unit is a tax resident. The Build Back Better Bill would have allowed a taxpayer to carryover country-specific net CFC tested loss to succeeding tax year to offset net CFC tested income of the same country. In addition, taxpayers would no longer have been able to offset net CFC tested income from one jurisdiction with net CFC tested losses from another jurisdiction. These proposed changes on determining net CFC tested income on a country-by-country basis were consistent with the Prior House Bill's proposals.

The Build Back Better Bill would also have (i) reduced the exclusion amount from 10% to 5% of QBAI, (ii) increased the effective tax rate on GILTI for corporate taxpayers from 10.5% to 15%,[10] and (iii) helpfully reduced the "haircut" for deemed paid foreign tax credit for GILTI from 20% to 5% (i.e., 95% of GILTI amount would have been creditable as deemed paid credit).

The GILTI proposals would generally have been effective for taxable years beginning after December 31, 2022.

FDII

The "foreign-derived intangible income" ("FDII") regime encourages U.S. multinational groups to keep intellectual property in the U.S. by providing a lower 13.125% effective tax rate for certain foreign sales and provision of certain services provided to unrelated foreign parties in excess of 10% of the taxpayer's QBAI. The lower effective tax rate is achieved by 37.5% deduction allowed for FDII under section 250.

The Build Back Better Bill would have reduced the section 250 deduction for FDII from 37.5% to 24.8%, which would have had the effect of increasing the effective rate for FDII from 13.125% to 15.8%.[11] The Build Back Better Bill further provided that if a section 250 deduction actually exceeded the taxable income of the taxpayer, the deduction would have increased the net operating loss amount for the taxable year and could be used in subsequent years to offset up to 80% of taxable income.

This proposal generally would have been effective for taxable years beginning after December 31, 2021.

BEAT/SHIELD

The "base erosion and anti-abuse tax" ("BEAT") generally provides for an add-on minimum tax, currently at 10%, on certain deductible payments that are made by very large U.S. corporations (generally, with at least $500 mm of average annual gross receipts) whose "base erosion percentage" (generally, the ratio of deductions for certain payments made to related foreign parties over all allowable deductions) is 3% or higher (or 2% for groups that include banks and securities dealers).

The Build Back Better Bill would have expanded the BEAT regime. The proposal would have increased the BEAT tax rate gradually from 10% up to 18% by the taxable year starting after December 31, 2024. The proposal would also have substantially revised the formula for calculating "modified taxable income", which generally appeared to have increased the income amount that would have been subject to the BEAT regime. Finally, the Build Back Better Bill would have eliminated the 3%/2% de minimis exception. These proposals were generally consistent with the BEAT proposals in the Prior House Bill, but with different tax rates.

The Build Back Better Bill did not include the Biden administration's "Stopping Harmful Inversions and Ending Low-Tax Developments" ("SHIELD"), which had been proposed to replace the BEAT regime.

Changes to Subpart F regime

The Build Back Better Bill would have significantly changed the subpart F regime. The Build Back Better Bill would have helpfully reinstated section 958(b)(4) retroactively. Section 958(b)(4) had prevented "downward" attribution of ownership of foreign person to a related U.S. person for purposes of applying subpart F regime. Section 958(b)(4) was repealed in the TCJA, which allowed stock owned by a foreign person to be attributed downward to a U.S. person for purposes of determining a foreign corporation's CFC status.

To address the situation that had prompted the repeal of downward attribution, the Build Back Better Bill would have introduced a new section to apply the GILTI and subpart F regimes to a foreign corporation that would have been a CFC if the downward attribution rule had applied, but only if the U.S. shareholder held at least 50% of vote or value of the foreign corporation's stock. This regime would have been effective for taxable years beginning after the date of the enactment.

The Build Back Better Bill would also have allowed a U.S. shareholder of a foreign corporation to elect to treat the foreign corporation as a CFC, which may have permitted a taxpayer to exclude foreign-source dividends received from the foreign corporation under the Build Back Better Bill's amended section 245A (which is discussed below). The Build Back Better Bill also would have limited the scope of foreign base company sales and services income, which is includible as subpart F income, to sales and services provided to U.S. residents and pass-through entities and branches in the United States, which effectively would have subjected foreign base company sales and services income for non-U.S. sales and services to the GILTI regime. The Build Back Better Bill also would have amended section 951(a) so that a United States shareholder that receives a dividend from a CFC would have been subject to tax on its pro rata share of the CFC's subpart F income (generally negating any deduction under section 245A with respect to the dividend), regardless of whether the shareholder held shares in the CFC on the last day of the taxable year. Current law requires a United States shareholder to include Subpart F income only if it owned shares of the CFC on the last day of the taxable year.

Foreign tax credits

The Build Back Better Bill would have imposed the foreign tax credit limitation on a country-by-country basis. Currently, foreign tax credits are calculated on an aggregate global basis and divided into baskets for active income, passive income, GILTI income, and foreign branch income. The revised rules would have calculated foreign tax credit limitations based on a country-by-country "taxable unit", which is consistent with the "CFC taxable unit" used under the Build Back Better Bill's GILTI rules. Together with the proposed amendments to the GILTI regime, this revision to the foreign tax credit limitation rules would have sought to prohibit taxpayers from using foreign tax credits from taxes paid in a high-tax jurisdiction against taxable income from a low-tax jurisdiction.

The Build Back Better Bill would have made a number of other changes to the foreign tax credit rules, including and repealing the carryback period (which, under current law, is 1 year, but retaining the current 10-year carryforward period for excess foreign tax credit limitation).

This proposal would have been generally effective for taxable years beginning after December 31, 2022.

Dividends from foreign corporations

The Build Back Better Bill would have amended section 245A so that the foreign portions of dividends received only from a CFC (rather than any specified 10-percent owned foreign corporation) would have qualified for the participation exemption (and not have been subject to U.S. federal income tax) under section 245A.[12] Currently, section 245A allows foreign-source dividends from any specified 10-percent owned foreign corporation (a broader concept than CFC) to be exempt from U.S. tax under section 245A. Although the provision appeared to narrow the scope of section 245A, as noted above, the Build Back Better Bill would have permitted a taxpayer and a foreign corporation to make an election to treat the foreign corporation as a CFC, in which case the benefits of section 245A would have been available to all dividends paid by the electing foreign corporation (even if U.S. shareholders own less than 10%). This provision was consistent with the proposal in the Prior House Bill and would have been effective for distributions made after the date of the enactment.

Anti-inversion rules

The Senate Finance Committee's Build Back Better Bill would have significantly expanded the anti-inversion rules. Generally, under current law, a foreign acquirer of an inverted U.S. corporation – typically, an existing U.S. corporation that is acquired by a foreign acquirer and whose shareholders continue own the U.S. corporation indirectly through their ownership in the foreign acquirer – is treated as a U.S. corporation for U.S. federal income tax purposes, if the continuing ownership stake of the shareholders of the inverted U.S. corporation is 80% or more. If the continuing ownership stake of the shareholders of the inverted U.S. corporation is between 60% and 80%, certain rules designed to prevent "earnings stripping" – or deductible payments by the U.S. corporation to its foreign parent – apply.

The Build Back Better Bill would have lowered the 80% threshold in treating a foreign acquirer of an inverted U.S. corporation as a U.S. corporation for U.S. federal income tax purposes to 65%. The Build Back Better Bill would also have lowered the 60% threshold in applying the earnings stripping rules to 50%. Finally, the Build Back Better Bill would have expanded the scope of the anti-inversion rules to cover acquisitions of substantially all of the assets constituting (i) a trade or business of a U.S. corporation or partnership, or (ii) a U.S. trade or business of a non-U.S. partnership.

This provision was not included in the House Bill, but it did reflect some elements of an anti-inversion rule proposal by the Biden administration, such as the lowering of the 80% threshold to treat a foreign acquirer as a U.S. corporation for U.S. federal income tax purposes and the expansion of the scope of the rules to cover certain asset acquisitions. This proposal would have applied for taxable years ending after December 31, 2021.

[1] Unless otherwise noted, all section references are to the Internal Revenue Code of 1986, as amended.

[2] The House Bill contained a provision that would raise the $10,000 cap to $80,000 for 2021 through 2030.

[3] The amount of gain eligible to be taken into account for these purposes by any taxpayer and any corporation is subject to a cap generally equal to the greater of (i) $10 million cumulative exclusions of gain with respect to that corporation and (ii) 10 times the taxpayer's aggregate adjusted tax bases of QSBS of the corporation disposed of in that year.

[4] Generally, corporations connected through stock ownership of more than 50%. Section 267(f).

[5] In a *Granite Trust* transaction, a corporate parent that owns a depreciated subsidiary reduces its ownership in the subsidiary to below 80% before liquidating the subsidiary so that the liquidation is taxable and any built-in loss of the parent in the subsidiary's stock would have been recognized.

[6] A related party for this purpose includes (i) the taxpayer's spouse, dependent, (ii) any corporation, partnership, trust or estate that is controlled by the taxpayer, and (iii) the taxpayer's retirement account and certain other tax-advantaged investment accounts for which the taxpayer is the beneficiary or the fiduciary.

[7] For example, if a corporation owned foreign corporations that are "controlled foreign corporations" for U.S. federal income tax purposes, the corporation would have had to take into account its pro rata share of such foreign corporation's book income. Also, prior year's net operating losses (calculated for book purposes) could have been used to reduce the book income, but could have only offset 80% of the book income for the subsequent year.

[8] The election to use the aggregated bases of assets in lieu of EBITDA was added in the Senate Finance draft of the Bill.

[9] The Senate Finance Committee's prior proposal (which included a draft legislation and a section-by-section explanation) provided for a mandatory exclusion of high-taxed income. This approach was different than the Build Back Better Bill, but the general approach of disallowing "blending" of income between high-tax jurisdiction and low-tax jurisdiction was the same.

[10] This would have been achieved by reducing the deduction provided to corporate taxpayers under section 250 from the current 50% level to 28.5%. The Build Back Better Bill would have not change the tax rate to be applied to a non-corporate taxpayer's GILTI amount. This was a lower rate than what was proposed in the Prior House Bill (37.5%), but the effective tax rate under the Prior House Bill was higher due to the increased income tax rates.

[11] The FDII deduction was higher under the Prior House Bill (at 21.875%), with the effective tax rate of 20.7% (taking into account the increased corporate rate). The Senate Finance Committee's prior proposal also stated that the FDII deduction would have been reduced, but did not commit to a specific percentage.

[12] The Build Back Better Bill would have also amended section 1059 so that if a corporation received dividend from a CFC that was attributable to earnings and profits of the foreign corporation before it was a CFC or before it was owned by the corporation, the non-taxed portion of that dividend would have reduced the basis of the CFC's stock, regardless of whether the corporation had held the CFC's stock for 2 years or less. Therefore, CFC's dividends that are exempt from tax under section 245A could have been subject to the proposed expanded section 1059.

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