U.S. Insight: President Biden's Corporate Tax Changes Announced in Fiscal Year 2022 Budget Plan

The Treasury Department recently released a General Explanation of the Administration's Fiscal Year 2022 Revenue Proposals (the "Green Book") containing significant modifications to corporate and individual taxation. In this Client Alert, we share our first impressions of the corporate tax proposals in the Green Book, which includes new tax changes and adds further details to various proposals in the President's Made in America tax plan ("Biden's Tax Plan"). For previous coverage of the Biden's Tax Plan see here. At this point, it remains highly uncertain which, if any of the Green Book proposals will eventually be enacted into law and in what form, as Congress will be the ultimate drafter of any new legislation.

The more noteworthy corporate tax proposals in the Green Book are:

Corporate Tax Rate Increase to 28 percent

The Green Book reaffirms previously announced proposals by President Biden to increase the corporate federal income tax rate 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.

Large Corporation Minimum Tax on Book Earnings

The Green Book proposes a new 15 percent minimum tax on book income of large corporations with worldwide pre-tax book income of at least $2 billion. The Green Book explains that the book tentative minimum tax ("BTMT") would be based on world-wide pre-tax book income calculated after subtracting book net operating loss deductions from book income, along with other general book business credits (including research, clean energy and housing tax credits) and foreign tax credits. The book income tax imposed under this new regime would be equal to the excess, if any, of the BTMT over regular tax. Additionally, the proposed BTMT would allow taxpayers to claim a book tax credit (generated by a positive book tax liability) against regular tax in future years to the extent the credit would not reduce tax liability below the BTMT determined for that year. The link to financial statement treatment would significantly expand reliance on third-party accounting standards to determine federal income tax liability, a notable shift from previous standards and contrary to the corporate minimum tax regime that was repealed under the 2017 Tax Cuts and Jobs Act ("TCJA"). The proposal would be effective for taxable years beginning after December 31, 2021.

Global Minimum Tax Enhancements (GILTI)

Under current law, a "U.S. shareholder" (generally, a 10 percent shareholder) of a controlled foreign corporation (a "CFC") is subject to taxation with respect to its allocable share of "global intangible low-taxed income" ("GILTI") of the CFC. GILTI is generally calculated based on the income of the CFC reduced by a deemed 10 percent return on tangible assets (referred to as "qualified business asset income" or "QBAI").

U.S. corporate shareholders who are subject to GILTI inclusions are generally entitled to a 50 percent deduction which brings the effective federal income tax rate on GILTI inclusions to 10.5 percent based on the current 21 percent corporate federal income tax rate. In addition, the U.S. shareholder is generally entitled to a foreign tax credit with respect to 80 percent of the foreign income tax attributable to the GILTI inclusion.

GILTI inclusions that are subject to foreign tax at a rate that is equal to at least 90 percent of the U.S. corporate income tax rate (*i.e.*, 18.9 percent based on the current 21 percent rate) are excluded from the GILTI tax. For purposes of determining the effective foreign tax rate imposed on the potential GILTI inclusion, all GILTI inclusions are combined.

The proposed changes to the GILTI regime, as outlined by the Green Book, would make the GILTI tax bite significantly more severe. Under the proposal, the QBAI reduction would be repealed. Thus, essentially all of the income of a CFC would be subject to the GILTI tax. In addition, the 50 percent deduction available to corporate shareholders would be reduced to 25 percent. Combined with the proposed increase in the corporate tax rate to 28 percent, the net effect would be that the effective GILTI tax rate is increased to 21 percent, subject to potential credit for 80 percent of the underlying foreign taxes allocable to the GILTI inclusion. In addition, the "high-tax exception" ("HTE") for income that is subject to foreign taxation at a rate equal to at least 90 percent of the U.S. rate would be repealed.

Moreover, the GILTI and the availability of foreign tax credits would be calculated on a country-by-country basis, effectively eliminating the ability to blend income and offset U.S. tax on foreign income earned in one jurisdiction with losses and foreign tax credits from other foreign jurisdictions.

The Green Book also makes reference to the efforts by the Organization for Economic Co-operation and Development ("OECD") to enact a global minimum tax, known as "Pillar II". The Green Book contemplates that, to the extent Pillar II is adopted, a foreign-owned U.S. corporation that is subject to GILTI tax would receive a credit against the GILTI tax for Pillar II taxes imposed on the foreign owner of the U.S. corporation with respect to the GILTI inclusion of the U.S. corporation.

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

FDII Deduction Repeal

The Green Book repeals the deduction for FDII for tax years beginning after December 31, 2021. The tax revenue from repeal of the FDII deduction would be used to directly incentivize research and development in the United States, although the Green Book provides no details on how that would be achieved.

BEAT Replacement with Stopping Harmful Inversions and Ending Low-Tax Developments (“SHIELD”)

The Green Book proposes to replace the Base Erosion and Anti-Abuse Tax (“BEAT”) with the Stopping Harmful Inversions and Ending Low-Tax Developments (“SHIELD”) rule. Because, under current law, BEAT (i) does not generally apply to payments for cost of goods sold (“COGS”), (ii) is not triggered unless certain related party payments exceed 3 percent (2 percent for financial groups) of the overall deductions taken by a multinational corporation, and has certain other limitations, the Green Book questions whether BEAT adequately protects the U.S. tax base. The Green Book proposes to replace the BEAT with the SHIELD rule to specifically target profit shifting to low-taxed jurisdictions and incentivize low-taxed jurisdictions to adopt the global minimum tax standard under Pillar II.

According to the Green Book, under SHIELD, a deduction is disallowed to a domestic corporation or branch on gross payments made (or deemed made) to low-taxed members of the financial reporting group. The SHIELD rule would be applicable to financial reporting groups with greater than $500 million in global annual revenues based on consolidated financial statements. Financial reporting group is defined as a group that prepares consolidated financial statements under US Generally Accepted Accounting Principles (“GAAP”), International Financial Reporting Standards (“IFRS”) or another authorized method and has at least one domestic corporation or partnership or foreign entity with a U.S. trade or business. A low-taxed member is defined as any group with an effective tax rate (“ETR”) below a designated minimum tax rate determined on a jurisdictional basis, which will either be set at the Pillar II agreed rate or, if an agreement is not reached before SHIELD’s enactment, at the new GILTI rate of 21 percent. Payments that are deductible costs will be disallowed entirely, and payments such as COGS and unrelated-party deductions would be disallowed up to the amount of the payment.

Notably, under SHIELD, deductions may be disallowed for payments to affiliates who are not low-taxed members. Payments to group members who are not low-taxed would be partially subject to SHIELD to the extent that other group members are subject to a tax rate below the minimum threshold.

The Internal Revenue Service ("IRS") would be given authority to provide special rules to account for permanent and temporary differences between the income tax base and the financial accounting base and for net operating losses ("NOLs"), as well as exempt payments, in general, made to various types of entities.

The proposal would be effective for taxable years beginning after December 31, 2022.

Expanded Anti-Inversion Rules

Under current law, a corporate inversion occurs, and a foreign acquiring corporation is treated as a domestic corporation for U.S. federal income tax purposes, when the following conditions are satisfied: (i) a foreign corporation acquires (directly or indirectly) substantially all of the properties of a U.S. corporation; (ii) the former owners of the U.S. entity hold 80 percent or more of the stock of the foreign corporation after the transaction by reason of having held equity interests in the U.S. corporation (the "80-percent test"); and (iii) the expanded affiliated group ("EAG") does not have substantial business activities in the foreign country of the acquirer. If the ownership percentage is between 60 and 80 percent, the foreign acquirer is respected as foreign, but some tax benefits of the inversion (*e.g.*, NOLs) or other tax attributes that reduce taxable income), in general, are limited (the "60-percent test").

The Green Book proposes to broaden the definition of an inversion transaction by replacing the 80-percent test with a greater than 50-percent test and eliminating the 60-percent test.

The Green Book further expands the inversion rules to apply regardless of the level of shareholder continuity if the following three requirements are met: (1) the fair market value of the domestic entity is greater than the fair market value of the foreign acquiring corporation immediately before the acquisition, (2) the EAG is primarily managed and controlled in the United States after the acquisition, and (3) the EAG does not conduct substantial business activities in the country in which the foreign acquiring corporation is created or organized.

The proposal expands the scope of acquisitions subject to these rules and also covers certain distributions of foreign corporation stock by a domestic corporation or a partnership.

The proposal would be effective for transactions that are completed after the date of enactment.

Interest Expense Disallowance for Disproportionate Borrowing in the U.S.

The Green Book adds an additional limitation on the deductibility of interest expense if: (i) the entity is a member of a multinational group that prepares consolidated financial statements under GAAP or IFRS; and (ii) the entity's net interest expense for U.S. tax purposes exceeds the member's proportionate share of the financial reporting group's net interest expense allocated based on earnings before interest, taxes, depreciation, and amortization ("EBITDA"). The Green Book provides for a carryforward of the excess interest expense limitation and the disallowed interest expense into future years.

The proposal would not apply to financial services entities or financial reporting groups that would otherwise report less than $5 million of net interest expense, in the aggregate, on one or more U.S. income tax returns for a tax year.

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

Repeal of HTE for both GILTI and Subpart F

Consistent with eliminating the GILTI HTE, the Green Book also repeals the HTE for Subpart F income.

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

Expand Disallowance of Deductions Allocable to Foreign Gross Income

The Green Book expands the application of IRC Section 265 to disallow deductions allocable to foreign gross income that is exempt from U.S. tax, *e.g.*, under IRC Section 245A or subject to a preferential rate, *e.g.*, under IRC Section 250. The Green Book also repeals IRC Section 904(b)(4).

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

Treat Dispositions of "Specified Hybrid Entities" Similarly to Disposition of Stock

The Green Book extends the stock sale treatment to an entity that is treated as a corporation for foreign tax purposes but as a partnership or disregarded entity for U.S. tax purposes ("specified hybrid entity"). As a result, under the proposal, for purposes of determining the seller's foreign tax credit ("FTC"), the seller would be treated as selling stock in a corporation, rather than selling a partnership interest or the assets of a transparent entity, potentially limiting the use of FTCs.

The proposal would be effective for transactions occurring after the date of enactment.

Onshoring / Offshoring Tax Considerations

The Green Book provides a new general business credit equal to 10 percent of the eligible expenses related to *on*shoring a foreign trade or business under certain circumstances. The Green Book also disallows deductions for expenses related to *off*shoring a U.S. trade or business under certain circumstances.

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

Changes to Prioritize Clean Energy

The Green Book includes numerous proposals that eliminate fossil fuel tax preferences and expand tax incentives for clean energy such as wind, solar, and other renewable generation and storage facilities.

Tax Compliance and Administration

The Green Book proposes to add significant funding resources to the IRS, including a multi-year adjustment of $6.7 billion to the discretionary spending allocation for the IRS Enforcement and Operations Support accounts, $72.5 billion in mandatory funding over the 10-year budget window, and directs additional resources toward enforcement against wealthy taxpayers.

The Green Book also creates a comprehensive financial account information reporting regime under which financial institutions, in general, would be required to report data on certain financial accounts on an annual information return. The return would report gross inflows and outflows with a breakdown for physical cash, transactions with a foreign account, and transfers to and from another account with the same owner.

Among other tax compliance changes, the Green Book expands the scope of information reporting by brokers who report on crypto assets to include reporting on certain beneficial owners of entities holding accounts with the broker.

The IRS would be given broad authority to issue regulations necessary to implement the proposal, which would be effective for tax years beginning after December 31, 2022.

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