Tax Insights
from Washington National Tax Practice

House Ways and Means Committee approves reconciliation tax bill - key business provisions

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In brief

The House Ways and Means Committee on September 15 approved tax increase and tax relief proposals that are to be acted on by the House of Representatives as part of 'Build Back Better' reconciliation legislation (the bill). The legislation was approved by a largely party-line vote of 24 to 19; Rep. Stephanie Murphy (D-FL) was the only member to cross party lines by casting a vote opposing the bill along with all Ways and Means Republicans. House and Senate tax proposals are being considered under a fiscal year 2022 budget resolution that provides reconciliation instructions for a package that currently adds up to about $3.5 trillion of spending and tax relief provisions, offset in part by corporate and individual tax increases.

Outlined below is a high-level overview of some of the key business provisions contained in the Ways and Means Committee-approved legislation. For a separate PwC Insight that discusses key individual tax provisions in the bill, click here. More detailed Insights on certain individual and business provisions will be issued later.

Differences between the House tax proposals and forthcoming Senate tax proposals that are expected to be considered in coming weeks will have to be resolved before final legislation can be put to a vote in each chamber. Senate Finance Committee Chairman Ron Wyden (D-OR) and other Finance Committee Democrats have recently released a series of discussion drafts on business, international, and individual tax proposals. Congressional Democratic leaders are seeking to complete action on the legislation so it can be signed into law by President Biden before the end of this year.

Observation: Reconciliation legislation can be approved with only Democratic votes over the expected objections of Congressional Republicans, but moderate Democrats in both the House and Senate have indicated that they will not support a package with a price tag of $3.5 trillion over 10 years. While the cost of any final package remains uncertain, the Ways and Means Committee-approved bill features significant business and individual tax increases. Moderate House and Senate Democrats are expected to insist on scaling back the scope of both the spending proposals and certain tax increase proposals.

Action item: Multinational and domestic companies should model these new provisions to understand the potential tax implications and should consult with advisors on which provisions are most likely to be enacted as part of final legislation. Most of the business tax reform provisions are proposed to be effective for tax years beginning after December 31, 2021. Businesses also should consider the potential effects of global tax policy proposals being developed by the OECD. On Tuesday, September 21, PwC will host a webcast on which we will cover some of the key provisions in the reconciliation legislation. Please register in order to participate.

In detail

Background

The bill includes significant business and international provisions, including changes to the corporate tax rate, limitations on interest expense of international financial reporting groups, modifications to inbound and outbound international provisions - including global intangible low-taxed income (GILTI), foreign derived intangible income (FDII), foreign tax credit rules, base erosion and anti-abuse tax (BEAT), and subpart F income, and the extension of expensing (i.e., current deduction) of research and experimental costs under Section 174. The corporate and international provisions proposed in the Ways and Means Committee-approved bill would raise $963.6 billion over 10 years, according to JCT staff estimates.

Increase in corporate tax rate

The bill would introduce a graduated US federal income tax rate structure for most corporations. A corporation's taxable income that (1) does not exceed $400,000 would be subject to a new 18% tax rate, (2) exceeds $400,000 but does not exceed $5 million would be subject to a 21% tax rate, and (3) exceeds $5 million would be subject to a 26.5% tax rate. Taxes owed by corporations with income in excess of $10 million also would be increased by the lesser of (1) 3% of the excess or (2) $287,000, which would have the effect of phasing out the benefit of the graduated tax rates. The graduated rate structure would not apply to qualified personal service corporations (as defined in Section 448(d)(2)); instead, these corporations would be subject to a flat US federal income tax rate of 26.5%.

Deductions on dividends received from a domestic corporation under Section 243 would be increased from 65% to 72.5% for dividends received from 20%-owned corporations and from 50% to 60% for other dividends that are not qualifying dividends. These changes to the corporate income tax rate and domestic dividends-received deduction would be effective for tax years beginning after December 31, 2021.

Observation: Under Section 15, a fiscal-year taxpayer must perform a prorated tax liability computation if a change in tax rate goes into effect on any date other than the first day of the taxpayer's tax year. If the tax rate changes for tax years beginning or ending after a certain date, the day following that date is the effective date of the change. The effective date of the rate modifications in the bill is January 1, 2022. As a result, fiscal-year taxpayers would have a prorated tax rate for the tax year that includes January 1, 2022.

Interest expense of international financial reporting groups

The bill provides for new Section 163(n) to limit interest deduction of certain domestic corporations and foreign corporations that are engaged in a US trade or business and are members of an international financial reporting group. The limitation generally applies only to C corporations with average excess interest expense over interest income includible over a three-year period exceeding $12 million. The Section 163(n) limitation generally equals 110% of the domestic corporation's share (determined based on an EBITDA ratio) of the group's net interest expense.

The bill would amend Section 163(j) for partnerships and S corporations to apply at the partner and S corporation shareholder level and provide special transition rules for partners in a partnership. The bill applies an aggregate approach to partnerships and S corporations and proposes corresponding changes to Section 163(j)(4) to reflect a consistent aggregate approach.

The bill would add Section 163(o), providing for a five-year carryover of disallowed interest expense under Section 163(j)(1) or Section 163(n)(1) (whichever is lower). For this purpose, interest is treated as allowed as a deduction on a first-in, first out basis.

Sections 163(n) and 163(o) are proposed to apply to tax years beginning after December 31, 2021.

Observation: Unlike the Biden administration proposal, the Ways and Means Committee provision would apply Section 163(n) to both US and non US-based multinationals. A similar provision was included in both the House and Senate-passed versions of the 2017 tax reform bill but was dropped from the final legislation. The calculation may create an administrative burden on companies to compute/substantiate their US and non-US interest expense; unlike the Administration proposal, the Ways and Means Committee provision does not provide an alternative method. Note also that the bill does not address the change in the definition of 'adjusted taxable income' (ATI) in Section 163(j). For tax years starting on or after January 1, 2022, the definition of ATI will be calculated similar to EBIT, whereas under current law ATI is calculated similar to EBITDA.

Observation: Concepts similar to current law Section 163(j) and proposed Section 163(n) are found in the laws of other countries and are discussed in the OECD's BEPS Action 4 Report.

Under the OECD's recommended approach, however, taxpayers could deduct interest expense based on which of the two limitations allowed for a *greater* interest expense deduction, while the Ways and Means Committee bill would only permit deductions based on the lesser amount allowed under the two provisions.

Modifications to deduction for FDII & GILTI

The bill would reduce the Section 250 deduction for FDII to 21.875% (from 37.5%) and the Section 250 deduction for GILTI to 37.5% (from 50%). The changes to the Section 250 rates are effective for tax years beginning after December 31, 2021. The bill also repeals the existing taxable income limitation on the Section 250 deduction, which limits the amount of the deduction if it would otherwise exceed the taxpayer's income prior to taking the deduction into account. The bill permits this excess deduction to be taken into account in determining a taxpayer's net operating loss (NOL).

The bill also would provide a 'technical correction' that amends Section 250(b)(3) to provide that the definition of 'deduction eligible income' (DEI) excludes, among other things, income that "is of a kind which would be foreign personal holding company income" under Section 954(c). This change is intended to apply to tax years beginning after December 31, 2017.

Observation: Combined with the proposed 26.5% corporate rate and a reduced haircut of 5% on deemed paid taxes related to tested income, this proposal yields a GILTI rate of approximately 17.4%, and an FDII rate of approximately 20.7%. This would introduce a disparity between the GILTI rate and the FDII rate that does not exist under current law (factoring in the existing 20% haircut on deemed paid taxes, the current law GILTI rate is 13.125%, which is equivalent to the current law FDII rate). This disparity results because the bill accelerates the modifications in the Section 250 deduction for GILTI and FDII that were already scheduled to take effect in 2026. These modifications would have maintained the parity between GILTI and FDII on the basis of an assumed 20% haircut on deemed paid taxes.

Observation: The scope of the exclusion from the definition of DEI is unclear as currently drafted; however, as written, it might result in the exclusion of certain income (including royalties) from DEI and thus from foreign-derived deduction eligible income (FDDEI). Because this change is described as a technical correction, it would apply retroactively to prior years in which a taxpayer took the Section 250 deduction. Based on informal discussions, it appears that the potentially broad scope of an exclusion for royalty income may be unintended, and consideration is being given to determining the appropriate method to address the issue as the legislation moves forward.

Modifications to inclusion of GILTI

The bill would provide for country-by-country application of the GILTI regime and reduce the amount of allowable net deemed tangible income return by replacing 10% of qualified business asset investment (QBAI) with 5% of QBAI. The reduction does not apply to CFC taxable units in US territories. Other changes to the GILTI regime include the ability to carry over country-specific net CFC tested loss to succeeding tax years and the elimination of the exception from tested income for foreign oil and gas extraction income (FOGEI). These changes would be effective for tax years of foreign corporations beginning after December 31, 2021.

Observation: Unlike the Biden administration's and Senate Finance Committee's respective proposals to repeal the QBAI exemption, the Ways and Means Committee provision generally would allow a QBAI return of 5%. Additionally, unlike the Biden administration proposal, the Ways and Means Committee provision would allow losses to be carried forward.

Modifications to foreign tax credit limitation and related provisions

The bill would add new Section 904(e), which requires making foreign tax credit determinations within each of the separate limitation categories, on a country-by-country basis for purposes of Sections 904, 907, and 960. This provision generally assigns each item of income and loss to a taxable unit of the taxpayer that is a tax resident of a country (or has a taxable presence in a country in the case of a branch). The bill also would repeal the foreign branch income basket.

Under the bill, foreign tax credit carryforwards would be limited to five years (currently 10 years under Section 904(c)), and the one-year carryback would be eliminated. In addition, the bill would make a conforming amendment to Section 6511(d)(3)(A) to reduce the period during which a taxpayer may claim a credit or refund attributable to foreign taxes from 10 years to five years from the date prescribed by law for filing a return for the tax year in which the taxes are paid (or deemed paid under Section 960). Similarly, the bill would amend Section 901 to allow taxpayers the same Section 6511(d)(3)(A) five-year period to choose to claim a credit for foreign taxes for a tax year, but would provide taxpayers only the general three-year period of limitations provided in Section 6511(a), or a longer period under Section 6511(c) if extended by agreement, to change from a credit to a deduction for foreign taxes.

Note: The five-year carryforward also applies to foreign tax credits in the GILTI basket.

Under the bill, no US group expenses would be allocable against GILTI inclusions, other than the Section 250 deduction with respect to the inclusions. Further, the bill includes a special ordering rule that would create a separate limitation loss account with respect to GILTI category income only after all other foreign source income has been considered.

The principles of Section 338(h)(16) would apply in determining the source and character of any item with respect to a 'covered asset disposition' (generally, a transaction treated as a disposition of corporate stock for foreign tax law purposes). These changes would be effective for tax years of foreign corporations beginning after December 31, 2021, and for tax years of US shareholders in which or with which such tax years of foreign corporations end.

Observation: The proposal to allocate only the Section 250 deduction to the GILTI basket, as well as the special separate limitation loss rules applicable to the GILTI basket, are taxpayer-favorable changes, which should help to preserve GILTI-basket foreign tax credit limitation. Further, the amendment to Section 904(c) to create parity in the treatment of excess foreign taxes (i.e., the foreign tax credit carryforward) in the GILTI basket and the other Section 904 categories is welcomed. However, the restrictive amendments to Section 904(c), and corresponding amendments to the Section 6511(d)(3)(A) statute of limitations, have the potential to subject taxpayers to significant double taxation and increased administrative burdens when considering that foreign tax controversies are not likely to be resolved within the more limited five-year period.

Modification to deemed paid credit for taxes properly attributable to tested income

The bill would amend Section 904(d)(1) to effectively reduce the 'haircut' on deemed paid credit for taxes attributable to GILTI under Section 960(d) from 20% to 5% and amend Section 904(d)(3) to potentially allow foreign taxes incurred by net tested loss CFCs to be credited. This change would be effective for tax years of foreign corporations beginning after December 31, 2021.

Observation: While the Biden administration proposal retained a current-law foreign tax credit 'haircut,' the Ways and Means Committee provision would reduce the haircut, resulting in GILTI being assessed on foreign income taxed at rates up to 17.4% (based on the 26.5% corporate tax rate). At the 25% corporate rate favored by some moderate Senate Democrats, assuming no other changes, the effective GILTI hurdle rate would be 16.5%.

Modifications of foreign tax credit rules applicable to dual capacity taxpayers

Under the bill, 'dual capacity taxpayers' (i.e., US persons that are subject to levy in and also receive certain benefits from a foreign country or possession of the United States) are denied Section 901 credits in excess of the general applicable income tax (i.e., an income tax, or a series of income taxes, generally imposed on residents that are not dual capacity taxpayers) under the laws of a foreign country or possession of the United States. This provision is effective for tax years beginning after December 31, 2021.

Observation: This provision is expected to deny a claim of foreign tax credits by dual capacity taxpayers that pay amounts to a foreign country when the foreign country does not have a generally applicable income tax that is imposed on residents of the country, and would otherwise limit the amount of any potential credit to the amount that otherwise would be imposed on the dual capacity taxpayer under any relevant generally applicable income tax.

Observation: This change could have a significant impact on companies in the natural resource industry that presently utilize the facts and circumstances method.

Foreign oil-related income to include oil shale and tar sands

The bill would expand the definition of foreign oil-related income in Section 907(c)(2)(A) to include oil shale and tar sands, effective for tax years of foreign corporations beginning after December 31, 2021.

Repeal of election for one-month deferral in determining tax year of specified foreign corporations

The bill repeals Section 898(c)(2), which allows a specified foreign corporation (as defined in Section 898(b)) to elect a tax year beginning one month earlier than the majority US shareholder year (as defined in Section 898(c)(3)). This change is effective for tax years of specified foreign corporations beginning after November 30, 2021.

Observation: The repeal of Section 898(c)(2) (and the absence of any implementing final regulations under Section 898) is expected to result in a specified foreign corporation being generally required to adopt the majority US shareholder year. This also means that the conforming short year for calendar-year taxpayers would be December 1, 2021 to December 31, 2021, which may result in losses in the short period for CFCs with calendar-year foreign tax years.

Deduction for foreign source portion of dividends limited to CFCs

The bill would amend Section 245A to limit availability of the Section 245A dividends received deduction to dividends from CFCs (dividends from specified 10%-owned foreign corporations no longer would be eligible). This change would apply to distributions made after the enactment of the legislation.

In addition, the bill would amend the language in section 245A(g), which authorizes regulations or other guidance as may be necessary or appropriate to carry out the provisions of Section 245A, including where a US shareholder owns stock of a specified 10%-owned foreign corporation through a partnership. This language would be amended by (i) changing the reference to a '10% owned foreign corporation' to 'CFC' in accordance with other changes in the bill, and (ii) adding a second section to include the denial of all or a portion of the Section 245A dividends received deduction for dividends arising from certain related-party transactions during the 'gap period' for fiscal-year taxpayers, as well as where a transfer of CFC stock to a related person reduces the US shareholder's pro rata share of subpart F or tested income. The bill also would provide that, for purposes of Section 78 and with respect to fiscal-year taxpayers, any reference to Section 245 is treated as including a reference Section 245A. The regulations authorized under amended Section 245A(g) as well as the change in the treatment of amounts under Section 78 would apply to distributions made after December 31, 2017.

Observation: The impact of the proposal to limit the Section 245A dividends received deduction to dividends from CFCs may be mitigated through a new election regime to treat certain foreign corporations as CFCs, as discussed below. The retroactive application of regulations issued pursuant to Section 245A(g) and retroactive treatment of Section 78 amounts under Section 245A(a) appear intended to target transactions undertaken by fiscal-year taxpayers during the 'gap period.'

Modifications related to determination of status as a CFC

The bill would restore former Section 958(b)(4), providing that a US person is not treated as owning stock which is owned by a non-US person when applying the downward attribution rules. The bill also would add new Section 951B, which provides that the subpart F provisions generally apply to any 'foreign controlled United States shareholder' (i.e., a US majority shareholder without regard to the application of restored Section 958(b)(4)) of a 'foreign CFC' (i.e., a foreign corporation, other than a CFC, that would qualify as a CFC if 'foreign controlled United States shareholder' is substituted for 'United States shareholder' and ownership is determined without regard to Section 958(b)(4))). Section 951B also would allow certain foreign corporations with US shareholders to elect under Section 951B to be treated as CFCs. These changes would be effective for the last tax year of foreign corporations beginning before January 1, 2018, and each subsequent tax year of the foreign corporations.

Observation: The proposal to restore former Section 958(b)(4) on a retroactive basis, along with the introduction of Section 951B that is more narrowly targeted to address decontrolled structures, generally is expected to address certain unintended adverse consequences that arose from the repeal of Section 958(b)(4) under the 2017 tax reform legislation. The actual impact of this proposal for each taxpayer, however, would need to be analyzed.

Limitation on foreign base company sales and services income

The bill would amend Section 954(d)(2) to limit the definition of a related person for purposes of 'this subsection' to a taxable unit (within the meaning of Section 904(e)), which is a tax resident of the United States. The bill also

would replace the reference to a related person in Section 954(e)(1)(A) with a reference to Section 954(d) instead of a reference to Section 954(d)(3), which provides the general definition of a related person, thereby seeming to incorporate the new limitation in Section 954(d)(2) into the definition of foreign base company services income (FBCSvI) as well. This amendment would apply for tax years of foreign corporations beginning after December 31, 2021.

Observation: Section 954(d)(2) currently provides the branch rule for foreign base company sales income (FBCSI), pursuant to which branches of a CFC may be treated as separate corporations for purposes of applying the FBCSI rules. This amendment would replace the branch rule with a rule that limits related-person transactions for FBCSI and FBCSvI purposes to transactions with taxable units that are US tax residents. Note, however, that the amendment also grants regulatory authority to provide guidance addressing the application of this rule to a series of transactions in which a related person is a party, such that future regulations may require consideration of parties beyond those directly participating in a transaction in order to determine whether a series of transactions may give rise to FBCSI or FBCSvI.

Subpart F pro rata determination

The bill would add new Sections 951(a)(2), (3), and (4) for subpart F pro rata share determination purposes. Under new Section 951(a)(2), a US shareholder's pro rata share of subpart F income is determined based on whether it owns, within the meaning of Section 958(a), stock of a foreign corporation as of the close of the last day of the tax year in which the foreign corporation is a CFC (last relevant day). If the shareholder has Section 958(a) ownership of the CFC's stock on the last relevant day of the CFC's tax year, then the pro rata share is the shareholder's 'general pro rata share' determined under new Section 951(a)(3). If the shareholder does not have such ownership, the pro rata share is the 'aggregate non taxed current dividend shares' as determined under Section 951(a)(4). These rules would apply for distributions made after December 31, 2017, and for tax years of foreign corporations beginning after December 31, 2017.

Observation: One potential consequence of the proposed changes to Section 951(a) appears to be the inclusion of subpart F or GILTI amounts in a US shareholder's income where the shareholder has disposed of its CFC shares prior to the end of the CFC's tax year and a dividend paid with respect to the shares is excluded from the US shareholder's income pursuant to Section 245A(a) or from the CFC's income pursuant to the high-tax exception in Section 954(b)(4), the same-country exception in Section 954(c)(3), or the look-through rule in Section 954(c)(6).

Modifications to BEAT

The bill would amend the BEAT rate to 10% for tax years beginning after December 31, 2021, and before January 1, 2024; 12.5% for tax years beginning after December 31, 2023, and before January 1, 2026; and 15% for tax years beginning after December 31, 2025. Under the proposal, the base erosion minimum tax amount is determined without regard to any credits (i.e., regular tax liability would be larger), and Section 38 general business credits may be taken against the BEAT. The bill eliminates the 3% base erosion percentage threshold except for tax years beginning before January 1, 2024.

The bill would amend Section 59A(c) to compute modified taxable income by (1) disregarding base erosion tax benefits, (2) disregarding any base erosion payments in determining the basis of inventory property, (3) determining net operating losses without regard to any deduction which is a base erosion tax benefit, and (4) making adjustments under rules similar to the rules applicable to the alternative minimum tax.

The bill would expand the definition of a base erosion payment by including certain inventory-related amounts paid or accrued to a foreign related party, such as indirect costs that are capitalized under Section 263A and those paid for inventory that exceed certain direct and indirect cost of property in the hands of the foreign related party.

Observation: While these changes would expand the definition of base erosion payment to include some payments that are included in cost of goods sold (COGS), the bill does not treat all COGS as base erosion payments.

The bill would expand the existing withholding tax exception for base erosion payments by generally exempting amounts (determined under rules similar to the rules of the pre-2017 tax reform Section 163(j)(5)) on which US federal income tax is imposed. In line with the Biden Administration's SHIELD proposal, the bill exempts payments subject to an effective foreign tax rate not less than the applicable BEAT rate.

Amended Section 59A is proposed to apply to tax years beginning after December 31, 2021.

Observation: By eliminating the base erosion percentage threshold post-2024, the proposal would subject more taxpayers to BEAT. The proposal also modifies the BEAT base by treating certain costs included in inventory as base erosion payments while retaining an exception for amounts that relate to services that meet the requirements for eligibility for the services cost method. On the other hand, the bill would turn off the add-backs to taxable income embedded in net operating losses, which would have the effect of decreasing modified taxable income. The modification to the treatment of credits for determining the base erosion minimum tax amount is taxpayer-favorable, and an additional benefit would be provided by allowing Section 38 credits against the tax under BEAT. The proposal also seeks to alleviate the overinclusive application of BEAT by exempting from base erosion payments amounts that already are subject to US tax or subject to sufficient foreign tax.

Taken together, the changes to the BEAT described above could significantly reduce the circumstances in which US-headquartered companies would be subject to the BEAT. Specifically, the exemption from base erosion payments for amounts that are subject to US tax (including effectively connected income, as well as amounts subject to tax under subpart F or GILTI) likely could result in US multinationals not having any significant base erosion payments.

Modification to the portfolio interest exemption

For purposes of disallowing the portfolio interest exemption for interest received by a '10-percent shareholder,' the bill would modify the definition of '10-percent shareholder' with respect to corporations under Section 871(h)(3)(B)(i) to include ownership by value. This proposal applies to obligations issued after the date of the bill's enactment.

Adjustments to earnings and profits of CFCs

The bill would relocate Section 952(c)(3), a special rule for determining E&P of a CFC for Section 952(c) subpart F limitation purposes, to Section 312(n), so that it is more generally applied in determining the E&P of CFCs. Accordingly, the E&P of a CFC would be determined without adjustments for use of a LIFO inventory, installment sale, or completed contract method of accounting. This amendment is effective for tax years of foreign corporations beginning after December 31, 2021.

Observation: This amendment is expected to have an impact on the determination of a CFC's E&P for broader purposes of the Code.

Certain dividends from CFCs to US shareholders treated as extraordinary dividends

The bill would add new Section 1059(g), providing that any disqualified CFC dividend is treated as an extraordinary dividend without regard to the period the taxpayer held the stock to which such dividend relates (i.e., the general two-year holding period requirement under Section 1059). For purposes of this new rule, a disqualified CFC dividend means any dividend paid by a CFC to a United States shareholder of such foreign corporation if such

dividend is attributable to earnings and profits which that earned, or are attributable to gain on property which accrued, while such foreign corporation was not a CFC, or such stock was not owned by a United States shareholder. This provision would apply to distributions made after the date of enactment.

Clarification of treatment of DISC gains and distributions of certain foreign shareholders

The bill would modify Section 996(g) to provide that gains from the sale or exchange of, and distributions by, a DISC or FSC to a foreign shareholder are treated as effectively connected with the conduct of a trade or business conducted through a permanent establishment that is 'deemed to be had by' the shareholder in the United States. This amendment is effective for distributions on or after December 31, 2021.

Extension of expensing of research and experimental costs under Section 174

The bill would extend the expensing of research and experimental costs under Section 174 for expenses paid or incurred in tax years beginning before 2026. Section 174 expensing currently is scheduled to expire for tax years beginning after 2021.

Observation: Taxpayers with research and development expenses would continue to have the options of deducting in the tax year paid or incurred, capitalizing and amortizing generally over five years under Section 174, or capitalizing and amortizing over 10 years under Section 59(e).

Observation: Unlike tax increase proposals in the bill, this provision is expected to have support from both Democrats and Republicans since research activities are seen as having broad economic benefits. Bipartisan legislation has been introduced in both the House and Senate to delay or repeal the scheduled move to research amortization.

Modifications to treatment of certain losses in a Section 331 liquidation

The bill would add new Section 267(h), which would defer the recognition of certain losses realized on the stock or securities of a liquidating corporation in a complete liquidation to which Section 331 applies. Specifically, in the case of two related corporations within the meaning of Section 267(b)(3), no loss is recognized on the stock or securities of a liquidating corporation in a complete liquidation to which Section 331 applies until the corporation receiving property in such liquidation disposes of substantially all of the property it received in such liquidation to one or more persons who are not related to such corporation (within the meaning of Section 267(b)(3) or Section 707(b)(1)). The provision would be applicable to liquidations occurring on or after the date such provision is enacted.

Observation: The provision would effectively eliminate so-called *Granite Trust* transactions, which involve structuring the liquidation of a subsidiary to be taxable to allow a pre-existing loss in the stock of the subsidiary to be recognized.

Additional limitation on divisive reorganizations in the context of leveraged spinoffs

The bill would add new Section 361(d), which would limit the tax-free transfer of boot and controlled corporation debt securities by a distributing corporation to its creditors. Under new Section 361(d), a distributing corporation in a divisive reorganization would recognize gain on the boot received to the extent of the excess of (a) the sum of 1) boot issued, 2) controlled securities issued, and 3) liabilities assumed by the controlled corporation, over (b) the basis in the assets transferred by the distributing corporation to the controlled corporation in the reorganization. The provision would apply to reorganizations occurring on or after the date enacted.

Observation: Under current law, newly issued controlled corporation debt securities are disregarded in determining the limitation of boot permitted to be received by a distributing corporation in a divisive reorganization without the

recognition of gain. The provision would further limit the amount of boot permitted to be received by a distributing corporation without the recognition of gain by the amount of controlled corporation debt securities issued in the exchange.

Treatment of financial guaranty insurance companies as qualifying insurance corporations under PFIC rules

The bill would amend Section 1297(f)(3) to provide that, if certain conditions are met, a financial guaranty insurance company may include unearned premium reserves in its applicable insurance liability for purposes of determining whether it is a PFIC. Certain items on its financial statement must be reported separately to comply with these conditions. This passive foreign investment company (PFIC) amendment would apply to tax years beginning after December 31, 2017, except for reporting provisions, which are effective for reports made after the date of enactment.

Observation: The provision also provides regulatory authority to impose additional tax reporting requirements on owners of certain financial guaranty insurance companies.

Expansion of constructive sales rules to digital assets

The bill would expand the definition of ‘appreciated financial position’ in the Section 1259 constructive sale rules to include positions with respect to ‘digital assets.’ The bill also would amend Section 1259(d) by adding a definition -- subject to alteration by regulations -- of the term ‘digital asset,’ which would include “any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary.” Furthermore, the types of transactions that may result in a constructive sale of certain appreciated economic short positions with respect to property would be amended to include entering into a contract to acquire the same or substantially identical property. These changes would be effective for constructive sales that occur, or for contracts entered into, after the date of enactment.

Observation: The term ‘digital asset’ has not been used previously in either the Code or the regulations. The proposed definition is the same as in the infrastructure bill passed by the Senate on August 10, 2021. The proposed statutory text provides fairly broad discretion to Treasury to modify the definition by qualifying it with the language “except as otherwise provided by the Secretary” and directing Treasury to specify “any similar technology.”

Observation: The constructive sale rules - which generally prevent taxpayers from deferring gain recognition on appreciated assets by entering into an economically offsetting position to effectively lock in a gain without actually selling the asset- previously applied only to positions in stock, certain debt, partnership interests, and certain trust interests.

Expansion of wash sale rules to new asset classes (including commodities, foreign currencies, and digital assets) and related-party acquisitions

The bill would expand the types of assets subject to the wash sale rules to include, for example, commodities, foreign currencies, and digital assets (including contracts or options to acquire or sell these assets). The definition of digital assets is the same as under the infrastructure bill, consistent with the proposed amendment to Section 1259.

An exception is provided for any sale or disposition of a foreign currency or commodity that is directly related to the business needs of a trade or business of the taxpayer -- other than the trade or business of trading foreign currencies or commodities -- or is part of a hedging transaction within the meaning of Section 1221(b)(2).

The bill would expand the wash sale rules to cover acquisitions by related parties. Related parties include an individual, corporation, partnership, trust, or estate that controls or is controlled by (within the meaning of Section 954(d)(3)) the taxpayer, among others. The bill directs Treasury to issue regulations to treat persons as related parties if the persons are formed or availed of to avoid the purposes of the wash sale rules.

Observation: The expanded wash sale rules, including the new related-party rules, would significantly increase the volume of transactions for which the wash sale rules are relevant. These rules can affect ordinary treasury management activities (like purchases and sales of money market funds, investment assets, and other transactions), including both internal and external transactions.

Further, the addition of the related-party rules may require the tracking of transactions across separate taxpayers that may not have full access to such information.

Observation: The lack of a business-needs exception for digital assets could prove problematic for businesses that receive digital assets (like cryptocurrency) as payment for goods and services or otherwise transact in these assets as part of the normal course of their trades or businesses.

The bill also amends the wash sale basis adjustment rules to address the expansion of the wash sale rules to related parties.

The bill provides that if the taxpayer (or the taxpayer’s spouse) acquires substantially identical assets during the period which begins 30 days before the disposition at a loss (that was disallowed under the wash sale rules) and ends with the close of the taxpayer’s first tax year which begins after such disposition, the basis of such assets is generally increased by the amount of the loss disallowed. The bill does not provide for such a basis adjustment to the extent a related party (other than the taxpayer’s spouse) acquires substantially identical assets.

Observation: The amended basis adjustment rules generally prevent a loss that is disallowed under the wash sale rules because of a related party acquisition from being added to the basis of substantially identical assets acquired by such related-party (unless the related party is the taxpayer’s spouse), which may result in a permanent disallowance (rather than a deferral) of such loss.

This provision would apply to sales and other dispositions made after December 31, 2021.

Observations on industry impacts

Insurance industry implications

Like the Biden administration’s revenue proposals, the bill includes no notable broad-based proposals specifically focused on insurance companies. Some of the proposals would uniquely affect insurers, however. For example, the proposed increase in the corporate tax rate from 21% to 26.5% might lead to a significant increase in the value of a particular company's deferred tax assets and liabilities. This, in turn, could meaningfully change the amount of an insurance company's regulatory surplus or risk-based capital. Because this metric is important to state insurance regulators, insurers may be more sensitive to an increase in tax rates than other corporate taxpayers.

The nontax subtitles in the bill include numerous investment incentives for infrastructure and green energy. Both life and nonlife insurance companies invest heavily in a wide variety of instruments to support their obligations under insurance and annuity contracts. Many of those investments involve tax credits and other benefits. The proposed expansion of low-income housing and other credits, and subsidies for infrastructure bonds, could significantly change the range of investment options and the calculus for investing capital.

Although the proposed changes to BEAT and GILTI in the bill do not specifically target insurance companies, many of the issues encountered implementing those provisions under the 2017 tax reform act would remain important to insurers. In general, GILTI and BEAT are subject to rate increases, which would affect inbound and outbound insurance multinationals. A favorable change for the insurance industry is the limited ability to carry forward tested losses. An exception is created for base erosion payments, which includes reinsurance payments as before, subject to US tax or a minimum foreign tax.

Lastly, any change in the taxation of policyholders could affect the types of products that insurers offer. For example, modifications in the bill to estate tax valuation rules with respect to certain discounts could result in higher estate tax liability and, as a result, a need for increased liquidity upon the death of a high net-worth taxpayer. In addition, increasing the highest individual rate on ordinary income to 39.6% and the highest capital gain rate to 25%, and expanding the net investment income tax to apply to more income, could affect investment decisions that are part of the estate plan or insurance plans of high-income individuals.

Real estate industry implications

Several provisions in the bill are of particular importance to the real estate industry. The proposed increases in rates for both individuals and corporations that may affect after-tax returns could impact the decision to invest in real estate through an entity treated as a corporation or a partnership for tax purposes. Investors in real estate through corporations would be most impacted by increases in the corporate tax rate. If a non-US person owns real estate through a US corporation, the corporation could be subject to more tax as a result of the changes to the BEAT, and interest from loans to the corporation in which the non-US person owns a 10% economic interest could be subject to 30% withholding even if the non-US person does not have any voting interest in the corporation. On the other hand, individuals who invest through partnerships would be impacted by the changes to individual rates, and limitations on the 20% deduction under Section 199A, and individuals who qualify as real estate professionals might become subject to the 3.8% net investment income tax even though they were not subject to that tax before.

For individuals who may have a carried interest, while many real estate partnerships might not be subject to the proposed increase in the carried interest holding period from three to five years, a variety of changes would impact owners of carried interest in real estate partnerships. The gains from real estate used in a trade or business would be subject to the proposal, even though these gains are not subject to the current carried interest rules. For purposes of determining whether the requisite three- or five-year holding period for real estate is satisfied, the period may start tolling later because the proposal generally provides that the holding period would begin at the later of the time the individual receives substantially all of the partnership interest or the partnerships acquired substantially all of its assets. Currently. the period generally begins when the particular asset being sold was acquired. Property that is held only for investment--as opposed to real estate used in a trade or business -- would be more likely to be subject to a five- year hold under the proposal.

Rules that affect real estate investment trusts include a helpful change to the attribution rules that apply in determining whether a tenant is a related-party tenant or whether a service provider is an independent contractor, which would make it less likely that entities would be treated as related. The bill also would provide that the leasing of property used in connection with a prison would not generate qualifying income for purposes of the REIT income tests.

Pharmaceuticals and industrial products companies implications

New Section 163(n) likely would adversely affect many US-based companies, including companies in the industrial products and pharmaceutical and lifes sciences sectors, that are part of international financial reporting groups. The provision applying GILTI on a country-by-country basis also likely would adversely affect and greatly increase the compliance burden of industrial products and pharmaceutical and life sciences companies. The provisions

modifying BEAT likely would be beneficial to US-based pharmaceutical and life sciences companies, but may adversely affect inbound pharmaceutical and life sciences companies.

The proposed changes to FDII likely would increase the rate of tax on FDII income and potentially limit its application for certain business sectors, including pharmaceutical and life sciences companies. Companies in certain sectors, such as the industrial products and pharmaceutical and life sciences sectors, likely would be adversely affected by the provision requiring that foreign tax credit determinations be made on a country-by-country basis, but likely benefit from the provision that no domestic expenses would be allocable against GILTI inclusions.

Consumer markets industry implications

While there are no tax proposals focused on the consumer markets industry as a whole, some of the proposals nevertheless could have a significant effect on certain industry members.

Consumer markets companies could be impacted disproportionately from the proposed increase in the corporate tax rate, especially those that have a greater domestic business profile. For example, large domestic retailers currently have one of the highest effective tax rates among the industry groups, which would make an increase in the corporate tax rate additionally burdensome, even with the retention of certain credits and the FDII deduction in some form (e.g., the proposed retroactive claw-back of benefits related to certain types of income, including internal inbound license payments to the United States).

The reduction in available cash from the proposed increase in the corporate tax rate could complicate improving supply chain and omnichannel capabilities, expanding product development, enhancing the customer experience, bolstering ESG initiatives, servicing debt obligations, and growing the business. Smaller, more localized domestic retailers may fare better due to the proposed graduated rate structure. Retailers with seasonal businesses that utilize a fiscal year would need to pay special attention to how the new rate would impact them upon transition.

Multinational consumer markets companies could be adversely affected by the changes to GILTI and BEAT. For example, the GILTI rate increase and per-country application could reduce (but not eliminate) the benefit from principal structures that are common in the industry. The proposed changes to FBCSI and FBCSvI could favorably impact companies that are subject to subpart F requirements in connection with their non-US principal or sourcing structures. The revisions to BEAT related to modified taxable income and base erosion payments in connection with inventory (e.g., certain capitalized costs) could adversely impact companies that purchase products from foreign affiliates, with a specific focus on foreign-parented groups. These provisions could cause companies to reevaluate their operational strategy, including service models, supply chains, intercompany financing, and IP ownership structures, along with current transfer pricing arrangements.

The collective impacts of these tax proposals might be a mixed bag for companies operating within the consumer markets industry. Specific impacts likely would depend on the nature and extent of the specific business, including its global footprint, overall structure, and core customer base. Modeling would assist in assessing all of these factors.

Tax accounting implications

The income tax financial accounting standard requires that the effects of a change in tax law or rates be recognized in the period that includes the enactment date. For US federal tax purposes, the enactment date is most often the date the President signs the bill into law. From a state and local income tax perspective, companies would need to analyze how each jurisdiction adopts or otherwise conforms to the Internal Revenue Code (e.g., adoption of the Code as of a specific date, 'rolling conformity' that adopts federal amendments automatically, or other approaches).

Certain aspects of any potential federal tax law amendments may require additional guidance before tax accounting outcomes can be determined. Other elements, such as a potential change in the corporate tax rate, generally are clearer. The total effect of changes in tax laws or rates on current and deferred tax balances are recorded as a component of the income tax provision related to continuing operations for the period in which the law is enacted, even if the assets and liabilities relate to other components of the financial statements, such as discontinued operations, a prior business combination, or items of accumulated other comprehensive income. Deferred taxes would require remeasurement on the date of enactment, which may not correspond to a financial reporting period end and may not correspond to a year-end financial reporting period.

To the extent that an enactment date occurs within an interim accounting period, companies would need to determine what impacts of the federal amendments are recognized through the annual effective tax rate and what should be recorded discretely in the period of the enacted change in tax law.

For more information, see the following materials

- PwC Insight on the Ways and Means bill as originally proposed by Chairman Neal
- Statutory text related to the Ways and Means Committee-approved tax increase proposals
- Section-by-section summary of the Way and Means Committee-approved tax increase proposals
- JCT staff revenue estimate
- JCT staff technical explanations

Let’s talk

For a deeper discussion of how the House Ways and Means Committee proposals might affect your business, please contact:

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