Congress reconvenes – What's next for tax legislation?

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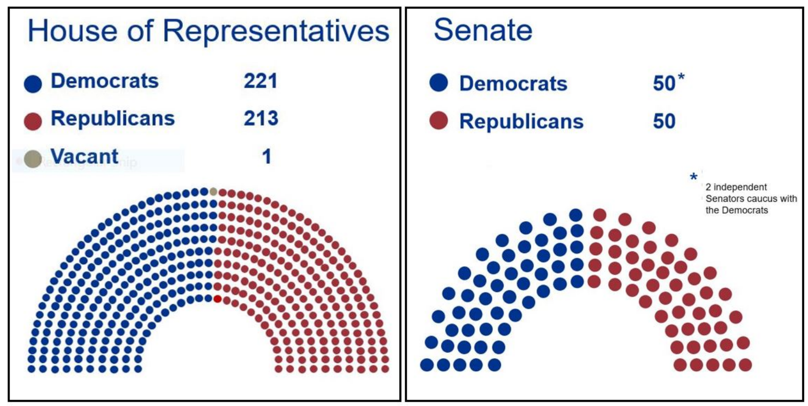
Introduction

The second session of the 117th Congress began today, January 3, 2022. As in the first session, the Democrats control the House of Representatives by only a handful of votes. Further, the Democrats control the "50-50" Senate only because of Vice President Harris's role as president of the Senate and her ability to cast a vote on the Senate floor in the case of a tie.

Congress (as of January 1, 2022)



Continued consideration of "Build Back Better" legislation (with its major tax proposals) is expected to be a high Democratic priority as 2022 begins. Other priorities competing for attention include election reform, funding the government, and, possibly, addressing the latest COVID-19 outbreak.

In addition, provisions relating to the amortization of research expenses and a tightening of the limit on the deduction for business interest expense become effective in 2022, while certain tax incentives expired at the end of 2021. These changes raise the question of whether some expirations and other scheduled changes to the tax law might be addressed (potentially retroactively) in the second session of the 117th Congress.

This report takes a quick look back at 2021 and then provides some high level observations about the federal tax legislative outlook for 2022.

A quick look back

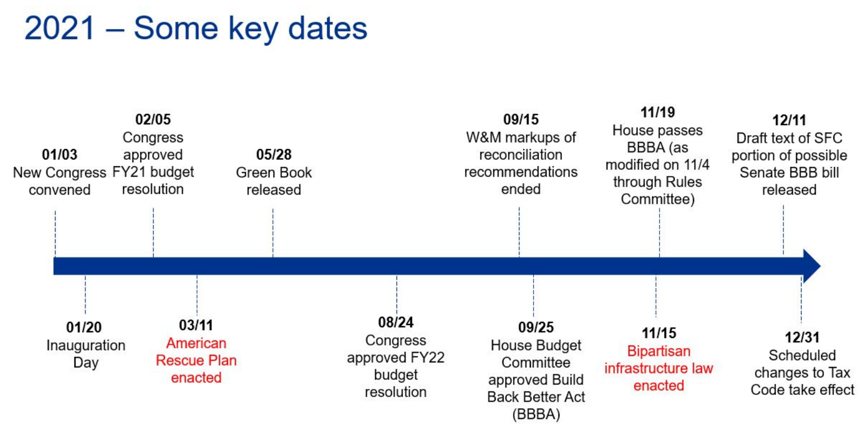
In the first session of the 117th Congress, two laws with significant tax provisions were enacted: (1) the American Rescue Plan Act ("ARPA") and (2) the Infrastructure Investment and Jobs Act (often called the "Bipartisan Infrastructure Framework" or the "BIF").

ARPA was enacted using special budget reconciliation procedures that allowed it to pass the Senate by only a majority vote without being subject to a filibuster.[1] Among other tax provisions, ARPA included a temporary enhanced refundable and advanceable child tax credit, which expired at the end of 2021.

[1] Reconciliation procedures are set forth in the Congressional Budget Act of 1974 (as amended) and include complex rules that can affect the design and substance of legislation. For example, as a very general matter, a reconciliation bill can only increase the deficit by an amount set forth in the budget resolution within the 10-year budget window and cannot increase the deficit at all in any year outside that window; each provision in a reconciliation bill must modify spending or revenue and those changes cannot be "merely incidental" to the non-budgetary purpose of the provision; there can be only one reconciliation bill with tax provisions with respect to a fiscal year; and a reconciliation bill cannot contain changes to the OASDI program established by the Social Security

The BIF includes infrastructure priorities that President Biden initially had proposed as part of his larger set of economic recovery legislative proposals, along with several revenue-raising provisions. With Biden's support, a group of moderate Senate Democrats and Republicans negotiated the BIF, and the legislation ultimately was enacted with bipartisan support. For more on the tax provisions in ARPA and the BIF, read ***TaxNewsFlash*** and ***TaxNewsFlash***.

During 2021, Congress also began consideration of the president's remaining economic agenda. The so-called "Build Back Better" (or "BBB") proposed legislation includes programs addressing climate change and green energy, education, child care, dependent care, health care, immigration, and other initiatives. These proposals include major changes in both the tax and spending realms.



Given the general need for at least 60 votes for Senate consideration and passage of legislation and the expected lack of Republican support, Congressional Democratic leadership has been trying to move BBB legislation using the budget reconciliation process as it did with ARPA.[2]

To that end, Democrats in the House and Senate initiated the reconciliation process in August of 2021 by passing a joint budget resolution for FY 2022. The budget resolution allows for a deficit increase of up to $1.75 trillion over the 10-year budget window. It instructs the House and Senate tax-writing committees to report changes in laws within their jurisdictions that would reduce the deficit by not less than $1 billion over that period, giving those committees substantial flexibility in providing revenue to fund BBB programs.

Shortly after passage of the budget resolution, House committees started marking up recommendations for legislation falling within their respective jurisdictions. The Ways and Means Committee ended its markups on September 15, 2021. (Read ***TaxNewsFlash*** for KPMG's summary and analysis of the Ways and Means recommendations.)

The House Budget Committee then compiled the various Committees' recommendations into a single package. Importantly, however, this package, including the tax title, was substantially modified through the House Rules Committee process in early November. Many of the modifications were intended to reduce the revenue cost and to otherwise bring the bill closer to what Congressional leadership believed was necessary to allow subsequent Senate passage, for which every Senate Democratic vote is needed.

Act or decrease social security trust fund surpluses (or increase any such deficits).

[2] The ARPA process began with the passage of a House-Senate budget resolution with respect to fiscal year 2021. The BBB process began with the passage of a joint budget resolution with respect to the following fiscal year–i.e., fiscal year 2022.

The House passed its version of BBB legislation (H.R. 5376) by a vote of 220 to 213 on November 19, 2021 (four days after the "BIF" was signed into law). Read a **KPMG report** with analysis and observations on the tax provisions in the House bill**.**

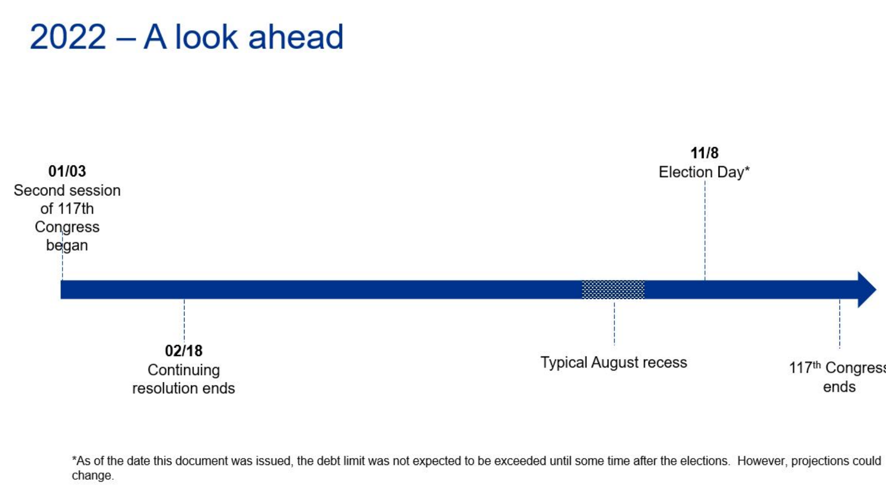
Following House action, Senate Democrats continued to explore what modifications to the House bill would be necessary to meet not only the budget reconciliation requirements (so that the legislation could pass the Senate with only a majority vote), but also the political challenges of securing support from all 50 Senate Democrats. As part of this effort, on December 11, 2021, Senate Finance Committee Chairman Ron Wyden (D-OR) released preliminary text of a possible Finance Committee title for BBB legislation that included technical and policy changes to the House bill, as well as some modifications to comply with budget reconciliation rules. (Read ***TaxNewsFlash***.)

Several days later, however, it became clear that there was no agreement among all 50 Senate Democrats regarding the substance of a possible bill. Notably, Senator Joe Manchin (D-WV) indicated his opposition to certain spending programs and his strong preference for (among other things) having fewer programs and making them longer-term as opposed to instituting more programs on a shorter-term basis (the approach the House took to limiting the revenue cost of its bill).

Given the lack of the needed unanimous Democratic consensus in the Senate in 2021, both President Biden and Senator Majority Leader Schumer indicated that the Build Back Better process would continue into 2022.

Build Back Better in 2022?

As the second session of the 117th Congress begins, continuing to work on BBB legislation is expected to be a priority. Moreover, the White House and Democratic Congressional leadership are likely to press for an agreement to be reached and for legislation to be enacted early in the year, since reaching sufficient consensus among Congressional Democrats might become increasingly more difficult as the year progresses and the fall elections approach.



The expiration of ARPA's enhanced advanceable and refundable child care tax credit at the end of 2021 might also put pressure on some Democrats to enact BBB legislation that includes an extension of ARPA's advanceable and refundable child care credit early in 2022. Because of the expiration of the ARPA enhancements, some families that have been receiving payments of advanced child care credits in the middle of each month under ARPA will not receive such payments starting on January 15, 2022.

At this point, it is not certain how the tax and nontax provisions of the House BBB bill might be modified so as to secure the votes of all 50 Senate Democrats—if reaching such consensus is indeed possible. It is possible that the overall size of the bill (including the amount "spent" on tax incentives and nontax programs within the tax writing committees' jurisdictions) might be reduced to respond to concerns from some Democrats.[3] If this is the case, it is possible that the tax title might be modified to include a lower gross amount of revenue-raising provisions.

It is also possible that the substance of a tax title and the specifics of revenue-raising provisions ultimately might be driven largely by what provisions are politically acceptable to all 50 Senate Democrats, with those revenue raisers previously recommended by the House Ways and Means Committee or passed by the House reflecting in large part the "menu" from which raisers would be chosen.

It similarly is not clear whether and to what extent effective dates of House tax bill provisions might be changed given that legislative action that began in 2021 is continuing into 2022. Revenue, political, and policy considerations all might come into play in assessing whether effective dates (including dates that now may be retroactive) should be retained or changed.[4]

Shifting effective dates of **revenue-raising** provisions forward relative to the House bill generally might be expected to be scored as raising less revenue within the 10-year budget window (which began on October 1, 2021). Nonetheless, from a political perspective, it may become harder to retain effective dates for House revenue raisers the longer BBB legislation is delayed into 2022. Thus, to the extent revenue or other considerations favor retaining effective dates of some revenue raisers, this may put further pressure on reaching consensus as early in 2022 as is possible.

Conversely, shifting effective dates of **revenue-losing** provisions forward might cause the costs of some of those provisions to be lower over the 10-year budget window, reducing the overall costs of BBB legislation. However, it might be politically challenging for Democrats to push back effective dates for some tax benefits and incentives previously approved by the House. Indeed, upcoming income tax return filing dates might put pressure on Democrats to try to reach consensus early in 2022 on some tax incentives that would be retroactively available for the 2021 year if House effective dates were retained.

Finally, keep in mind that both the House and Senate would need to pass identical versions of BBB legislation to send a bill to the President for his signature. Thus, if the Senate were to succeed in passing a modified version of BBB legislation, either (1) the House would need to pass the Senate bill without any further changes or (2) the House and Senate would need to resolve their differences and then each chamber would need to pass identical legislation. Given how difficult it may be to secure support of all 50 Senate Democrats for a Senate bill, the House passing the Senate bill without any changes may be the more likely outcome.

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[4] While not common, there are historical precedents for tax rate increases being applied retroactively. For example, Public Law No. 103-66, the Omnibus Budget Reconciliation Act of 1993, which was enacted on August 10, 1993, generally provided for higher income tax rates for some individuals and corporations effective for tax years beginning after December 31, 1992; and reinstated the two highest estate and gift tax rates that had expired at the end of 1992, effective for decedents dying, gifts made, and generation-skipping transfers occurring after December 31, 1992. The Supreme Court has upheld some retroactive changes to existing tax laws against challenge under the "due process" clause of the U.S. Constitution. As discussed in *Mertens Law of Federal Income Taxation*:

> Retroactive taxation is allowed because taxation is neither a penalty imposed on the taxpayer nor a liability which the taxpayer assumes by contract, but rather a method of apportioning the cost of government among those who enjoy its benefits and who must bear the resulting burdens. In addition, some limited retroactivity may be necessary as a practical matter to prevent the revenue loss that would result if taxpayers, aware of a likely impending change in the law, were permitted to order their affairs to avoid the effect of change.

Other possible tax legislation?

At this time, none of the appropriations bills for the fiscal year that began on October 1, 2021, has been enacted. Instead, the government is being funded through a "continuing resolution" that expires on February 18, 2022. Thus, in addition to BBB legislation, enacting appropriations legislation for various government functions and/or passing another continuing resolution by February 18, 2022 to avoid a full or partial government shutdown can be expected to be a major legislative priority early in 2022.

Addressing government funding requires bipartisan support in the Senate. It is possible, although not particularly likely, that some tax provisions could be added to government funding legislation on a bipartisan basis—particularly if BBB legislation remains "stalled" in mid-February. Nonetheless, it is not clear that either party has much appetite for a bipartisan effort on any tax legislation prior to the elections. Moreover, even if some tax provisions were added to a government funding bill on a bipartisan basis, they likely would be very limited in scope and any revenue raisers that might be included likely would be noncontroversial (e.g., procedural or reporting changes).

A number of tax incentives expired at the end of 2021, including ARPA's previously discussed enhanced refundable child tax credit as well as some tax credits that have been on the list of so-called "extenders" in the past.[5] In addition, the so-called "Tax Cuts and Jobs Act of 2017" (or "TCJA") included two revenue-raising provisions that were scheduled to take effect beginning in 2022 that are now effective for some taxpayers.

Some of the provisions that expired at the end of 2021 might be addressed at some point in 2022 if not early next year. Indeed, it has become common practice for extenders to expire and then be extended retroactively.

Selected scheduled changes and expirations

- **Expanded and advanced refundable child credit provided by ARPA expired at end of 2021/first payment in 2022 would have been made on January 15, 2022 (if extended)**
- **Increased amount of qualifying child-care expenses that eligible taxpayers may exclude under ARPA expired at end of 2021**
- **Credit for health insurance costs of eligible individuals expired at end of 2021**
- **R&E costs begin to be amortized over 60 months beginning in 2022 (under TCJA)**
- **Interest expense limitation formula changes (EBIDTA to EBIT) beginning in 2022 (under TCJA)**
- **Ability of non-itemizers to deduct charitable contributions (as well as temporary modification of charitable contributions limitation for corporations) expired with respect to tax years after 2021**
- **Various energy and environmental related credits, and some other "regular" extenders, expired at end of 2021**

Future developments

Given the fluidity of the legislative process, stay tuned to ***TaxNewsFlash-Legislative Updates*** for breaking developments and analysis.

[5] Although these "regular" extenders used to expire at generally the same time, some now have different expiration dates; as a result, not all of the regular extenders expired at the end of 2021.

Contact us

For questions on legislative matters, contact a professional in the Federal Legislative and Regulatory Services group of KPMG's Washington National Tax:

John Gimigliano
T: +1 (202) 533-4022
E: jgimigliano@kpmg.com

Carol Kulish
T: +1 (202) 533-5829
E: ckulish@kpmg.com

Tom Stout
T: +1 (202) 533-4148
E: tstoutjr@kpmg.com

Jennifer Acuña
T: +1 (202) 533-7064
E: jenniferacuna@kpmg.com

Jennifer Bonar Gray
T: +1 (202) 533-3489
E: jennifergray@kpmg.com

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