This report provides an analysis and observations of the Senate-passed bill. See *TaxNewsFlash-Legislative Updates* for updated analysis following enactment on August 16, 2022.

KPMG

Initial analysis and observations about tax law changes in budget reconciliation bill (as passed by Senate)

August 10, 2022

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Introduction

The U.S. Senate on August 7, 2022, passed budget reconciliation legislation (H.R. 5376) that includes significant tax law changes. All 50 Senate Democrats voted for the legislation (the "Senate bill"), while all 50 Senate Republicans voted against it. Vice President Harris cast the tie-breaking vote in favor of the legislation.

This report provides preliminary analysis and observations regarding the Senate bill based on the legislative text for the final bill that was released the morning of August 9, 2022, and the Joint Committee on Taxation (JCT) revenue estimates released later that same day. Read a ***KPMG report (August 16, 2022)*** *[PDF 1.5 MB] (73 pages) for analysis following enactment.*

Scope and general substance

The Senate bill is significantly smaller in size, and includes far fewer revenue-raising provisions, than the reconciliation bill the House passed in November 2021 under the "Build Back Better" moniker (the "House BBBA"). Read the **KPMG report** [PDF 2.5 MB] on the House BBBA. Significant tax revenue raisers in the Senate bill (and their respective revenue effects as estimated by the JCT) include the following:

- An alternative minimum tax (AMT) on certain large corporations (applicable to tax years beginning after December 31, 2022) [estimated to raise approximately $222.25 billion over 10 years]
- A tax on stock buybacks (applicable to repurchases of stock after December 31, 2022) [estimated to raise approximately $73.69 billion over 10 years]
- A two-year extension of the section 461(l) loss limitation rules for noncorporate taxpayers (extension to tax years beginning before January 1, 2029) [estimated to raise approximately $52.76 billion over 10 years]
- Reinstatement of Superfund taxes on crude oil and petroleum products (effective January 1, 2023) [estimated to raise approximately $11.72 billion over 10 years]

The Senate bill also reflects changes to draft legislative text that was previously released on July 27, 2022, by Majority Leader Chuck Schumer (D-NY) and Senator Joe Manchin (D-WV) (the "July 27 Draft Text"). Changes to tax provisions include:

- The deletion of a provision regarding the treatment of partnership interests held in connection with the performance of services (i.e., "carried interest")
- The addition of the tax on stock buybacks
- Significant narrowing of the scope of the proposed corporate AMT (including changes with respect to cost recovery for tangible property)
- Addition of the two-year extension of the section 461(l) loss limitation as a revenue raiser

The bill continues to include a substantial package of energy and climate related provisions, tax provisions relating to health care, and provisions for an approximately $79.6 billion increase in the funding of the Internal Revenue Service (IRS) over a 10-year period. The Congressional Budget Office (CBO) has indicated in a footnote to its official cost estimate of the bill that the increase in IRS funding for tax enforcement activities would result in increased revenues of approximately $203.7 billion over the 10-year period even though that revenue is not included in its official estimate.

KPMG observation

Notably, the Senate bill does not include the substantial number of international tax changes that the House BBBA had proposed. The House bill would have modified GILTI, the BEAT, interest limitations, and a number of other international provisions in significant ways. Many of those changes would have aligned the US tax system more closely with those proposed in the ongoing BEPS 2.0 project. By excluding those changes, it is not clear where the Senate bill leaves the US system relative to the changes being contemplated outside the United States (in particular with regard to Pillar Two).

Also, unlike the House BBBA, the Senate bill does not include changes to the limitation on the state and local tax (SALT) deduction. It also does not change the treatment of research and experimentation (R&E) expenditures under section 174.

Bill text and floor amendments

Final text of the Senate bill, as amended, was not released until the morning of August 9. **Reading the final text can be difficult in places for a number of reasons—not the least of which relates to the way the text takes into account some modifications made to the bill on the Senate floor before final passage.**

Two amendments were approved on the Senate floor.

- The first removed language from the corporate AMT provisions addressing the application of Code section 52 (with a revenue offset that would have extended the SALT limitation).
- The second, which was adopted immediately after the corporate AMT amendment, in effect replaced the SALT limitation revenue offset with a two-year extension of the section 461(l) limitation.

The way these two floor amendments were incorporated into the text of the bill is not straightforward and, as a result, can create some confusion. For example, section 10101 of the bill (which begins on page 2) relates to the corporate AMT. However, the floor amendment with respect to the corporate AMT does not appear until Senate bill section 13904 (which begins on page 537 of the Senate bill). Likewise, Senate bill section 13904 shows a change to the SALT limitation; however, that change is, in effect, reversed by the previous Senate bill section (bill section 13903), which also adds the extension of the Code section 461(l) limitation.

In addition, during floor consideration, the name "Inflation Reduction Act of 2022" was removed from the bill after a point of order was sustained that inclusion of the name violated the budget reconciliation rules being used to move the bill through the Senate. As a result, the legal title of the bill is "An Act to provide for reconciliation pursuant to title II of S. Con. Res. 14." The table of contents also was stripped from the bill to comply with the reconciliation requirements, complicating the ability to quickly locate particular provisions. [1]

Background on the budget reconciliation process

The Senate currently is split equally (50-50) between Republicans and Democrats (counting as Democrats two Independents who caucus with Democrats—Senators Bernie Sanders (VT) and Angus King (ME)). As vice president

[1] In 2017, the name "Tax Cuts and Jobs Act" and the table of contents similarly were stricken from tax legislation that moved through the Senate using budget reconciliation rules when Republicans controlled the Senate by a narrow margin (Pub. L. No. 115-97). As a result, the legal title of the legislation that is commonly called the "TCJA" is "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution of the budget for fiscal year 2018."

of the United States, Kamala Harris is president of the Senate and may vote in the Senate in the case of a tie. Thus, the Democrats control the Senate and its legislative agenda. Senate cloture rules, however, generally require 60 votes to end debate before Senators can proceed to vote on legislation. Thus, absent 60 votes, one or more Senators can delay, and effectively stop, movement on legislation through "filibustering."

Importantly, however, special "budget reconciliation" procedures allow some types of legislation, including certain tax legislation, to move through the Senate by only a majority vote, without being subject to a filibuster. Reconciliation procedures are set forth in the Congressional Budget Act of 1974 (as amended) and include complex and intricate rules that can affect the design and substance of legislation. (For more information on the budget reconciliation process, read a **February 2021 report** [PDF 2.79 MB] on the Biden Administration and the 117th Congress.)

In August 2021, the House and Senate put reconciliation into play by agreeing to a joint budget resolution that set forth revenue and spending goals for the federal budget for the year that began October 1, 2021, and that will end on September 30, 2022. Read ***TaxNewsFlash*** for prior coverage. At that time, Congressional Democrats were seeking to use the budget reconciliation to advance legislation under President Biden's "Build Back Better" initiative. The budget resolution allowed for up to $3.5 trillion in new spending and, in effect, instructed the House and Senate tax-writing committees to offset the cost of spending they approve within their jurisdictions, including the tax incentive and benefit provisions, and to raise an additional $1 billion—a small amount given the scale of the overall package.

Soon after adoption of the budget resolution, the House Ways and Means Committee began marking up its recommendations for provisions to be included in House reconciliation legislation. On September 15, 2021, Ways and Means concluded its mark ups of items within its jurisdiction. Among other things, it approved a substantial tax title with more than a trillion dollars in tax cuts and spending and more than two trillion dollars in gross tax increases. Read a **KPMG report** on the Ways and Means revenue recommendations. The House Budget Committee then packaged these recommendations together with recommendations from other House committees for a possible House bill with an estimated cost of approximately $4.5 trillion.

Before voting on a House bill, however, with the approval of the Biden Administration, House Democrats cut the size of the bill substantially and made significant changes to the tax proposals that Ways and Means had previously recommended. These changes included deleting some significant revenue raisers (such as proposed individual and corporate rate increases), adding other revenue raisers (such as a tax on stock buybacks and a new corporate minimum tax), and including a provision relating to the limitation on the SALT deduction provided by the the 2017 reconciliation bill commonly known as the "Tax Cuts and Jobs Act" (TCJA). The House approved the modified bill (the "House BBBA") on November 19, 2021, by a vote of 220 to 213, with all House Republicans opposing the bill. Read a **KPMG report** [PDF 2.5 MB] on the tax provisions in the House bill.

In December of 2021, Senate Finance Committee Chair Ron Wyden (D-OR) released draft updated legislative text related to the Build Back Better Act (the "SFC BBBA Draft"). This draft included modifications to some of the tax proposals in the House BBBA, including changes to the new corporate AMT proposed in the House BBBA as well as changes to some energy provisions. Read ***TaxNewsFlash***. The SFC BBBA Draft was not acted on by either the Senate Finance Committee or the full Senate. Instead, shortly after its release, it became apparent that there was not yet political consensus among all 50 Democratic Senators on the substance of a possible reconciliation bill.

Months later, on July 27, 2022, Senate Majority Leader Schumer and Senator Manchin announced that they had reached an agreement on tax, climate change, energy, and health care provisions to be included in the "Inflation Reduction Act of 2022." Read ***TaxNewsFlash*** for a link to the July 27 Draft Text. The Senate began to consider a modified version of this bill under the rules of budget reconciliation on Saturday, August 6, 2022 (the "August 6 Text"). Amendments relating to tax provisions were also adopted during floor consideration. As a result, as indicated earlier in this report, there are some significant differences between the final Senate bill and the July 27

Draft Text.

What's next?

House leadership has indicated that the House will return to vote on the Senate bill this Friday, August 12, 2022. Read **Floor schedule update** issued by House Majority Leader Steny Hoyer on August 5, 2022.

If the House were to approve the Senate-passed bill with no modifications, the legislation then would be sent to President Biden for his expected signature. In the unlikely event the House were to approve a bill that was modified in any way from the bill passed by the Senate, then any differences would need to be resolved and both the House and Senate would need to pass identical versions of the legislation before it could be transmitted to the president.

Documents

- Read **text of the bill** [PDF 952 KB] (730 pages), as amended and passed by the Senate
- Read **JCX-18-22** (estimated budget effects of the revenue provisions)
- Read **JCX-19-22R** (distributional effects of selected provisions, as later corrected on August 9, 2022)

Contents

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Corporate alternative minimum tax

In general

The Senate bill introduces a new 15% corporate alternative minimum tax (Corporate AMT) on the "adjusted financial statement income" (AFSI) of certain large corporations (very generally, and described in greater detail below, corporations reporting at least $1 billion average adjusted pre-tax net income on their consolidated financial statements) for tax years beginning after December 31, 2022. The JCT has estimated the provision would raise approximately $222 billion over the 10-year budget window.

KPMG observation

Under the Senate bill's Corporate AMT provision, taxpayers could owe Corporate AMT whenever they have significant permanent or temporary book-tax differences that cause financial statement income to exceed taxable income in a given year. These differences could arise from, among other things:

- Excess tax benefits with respect to share-based payments, including stock options
- Accelerated tax amortization and depletion
- Goodwill and indefinite-lived intangibles acquired in taxable transactions
- Accrued liabilities
- Acquired deductible temporary differences and net operating losses (NOLs), though there is regulatory

authority to address corporate reorganizations
- Low-taxed CFC operations
- Foreign-derived intangible income (FDII) (discussed further below)

Notably (and as discussed below), a late change to the Senate bill provides for the calculation of financial statement income for Corporate AMT purposes based on tax (not financial statement) depreciation deductions for tangible property, minimizing one significant potential source of book-tax disconformity.

Although timing differences generally would reverse so that the indefinite Corporate AMT credit carryforward could help to ameliorate their impact over time, there are a number of circumstances when this may not be the case, including, for example, when due to the ordering of when an item is recognized for financial statement and tax purposes, the existence of an AMT credit carryforward is less useful than would be the case for an AMT credit carryback. This would be the case, for example, when a taxpayer recognizes an expense for a significant nonrecurring item, such as a new lawsuit or industrial accident, for financial statement purposes for a liability that becomes deductible in a subsequent year. Another reason that timing differences may be converted to permanent differences is the lack of transition rules to account, for example, for deferred tax assets that exist for expenses that have been recognized prior to the effective date for financial statement purposes but that are not yet deductible for tax purposes. An extreme version of this latter issue exists for pre-2020 NOLs, as well as carryforwards of other attributes from pre-2023 tax years, for which the Senate bill includes no transition relief. Additionally, permanent favorable or unfavorable book-tax differences related to share-based payments may arise.

Finally, FDII, by itself, could cause a taxpayer to owe Corporate AMT because the FDII deduction generally results in a 13.125% rate on a portion of qualifying income. Even if FDII alone would not cause a taxpayer to owe corporate AMT (the more likely scenario for the vast majority of taxpayers), the FDII deduction could bring a taxpayer closer to the 15% rate such that, in combination with other items, a taxpayer could find itself owing Corporate AMT.

The Senate bill provides significant regulatory authority with respect to certain aspects of the Corporate AMT; there are more than 15 specific directions for the "Secretary" to fill gaps in the proposed legislation. Thus, in many respects the operation of the Corporate AMT would depend on Treasury's decisions in implementing the regime – a particularly onerous task given that this provision would be effective in a few months if it becomes law and arguably was not subject to the detailed review and consideration that would be expected for such a complex and robust provision. The House BBBA and the SFC BBBA Draft would have provided the same effective date, but, as they were both considered at the end of 2021 as opposed to late in 2022, they would have allowed an extra year for implementing guidance to be issued. Thus, it may become imperative for some form of interim guidance (e.g., one or more Notices) to provide instruction with respect to the new Corporate AMT computational requirements.

The 2017 tax legislation commonly known as the "Tax Cut and Jobs Act" repealed the prior corporate alternative minimum tax (Former AMT) for tax years beginning after December 31, 2017. The proposed new Corporate AMT tax base calculation would use financial statement income as its starting point—a major distinction from the Former AMT. However, in other ways, the Corporate AMT would operate similarly to the Former AMT. For example, like the Former AMT, the Corporate AMT would be based on the excess of "tentative minimum tax" over regular tax, and payment of the Corporate AMT would give rise to a tax credit that could be used against regular tax in excess of tentative minimum tax in future years. Thus, as with the Former AMT, at least conceptually the Corporate AMT can be thought of as requiring certain taxpayers to prepay their regular tax but not as increasing cumulative federal income tax liability.

A U.S. income tax based on the financial statement income of corporations is not a new idea, and similar proposals have been made from time to time. A version of such a tax was in place from 1987-1989, as a

positive AMT preference item in the Former AMT regime. The 1986 Tax Reform Act had imposed a requirement that the AMT income for corporate taxpayers be adjusted by certain "book income adjustments." In particular, AMT income for corporate taxpayers generally was increased by 50% of the amount by which the corporation's adjusted net financial statement income exceeded its AMT income for the tax year. A compromise in the 1986 conference agreement made the adjustment applicable only to tax years beginning in 1987, 1988, and 1989, and supplanted it with the "adjusted current earnings" (or "ACE") adjustment for tax years beginning after 1989. The book income adjustments were heavily criticized, including by Treasury officials, as having a detrimental effect on the quality of financial reporting and for being a "one-way street" that overtaxed firms because the adjustment could only be positive and, therefore, generally took into account only taxpayer-favorable timing differences.

Taxpayers potentially subject to the corporate AMT

Applicable corporation—in general

The proposed Corporate AMT would apply to an "applicable corporation"—any corporation, other than an S corporation, regulated investment company, or real estate investment trust that meets the "average annual adjusted financial statement income test" (Income Test) in one or more tax years ending after December 31, 2021, but prior to the tax year at issue (e.g., if a corporation first met the Income Test in its 2022 tax year, it would be an applicable corporation beginning in its 2023 tax year). In general, the Income Test would be met for a tax year if the average annual AFSI of a corporation in the three tax years ending with the tax year at issue exceeds $1 billion (subject to certain adjustments for newly formed corporations, predecessor corporations, and short tax years). As discussed in more detail below, once a corporation is an applicable corporation, it remains an applicable corporation for all future years, subject to certain limited exceptions. The Senate bill explicitly provides that financial statement net operating losses (FS NOLs) (discussed below) are not to be taken into account for purposes of the Income Test.

Solely for purposes of the Income Test, aggregation rules would apply to determine a corporation's three-year average AFSI. Specifically, for purposes of the Income Test a corporation's AFSI includes the AFSI of all persons treated as a single employer with that corporation under section 52(a) and (b). In general, section 52(a) provides for aggregation of a controlled group of corporations meeting a more than 50% common ownership standard under section 1563(a). Section 52(b) provides a similar rule for trades or businesses under common control that are conducted by corporations, partnerships, trusts, estates, and sole proprietorships. Generally, these aggregation rules would apply (with some exceptions for U.S.-parented groups with less-than-wholly-owned foreign and/or U.S. affiliates) to count all the adjusted financial statement profits of domestic and foreign entities connected through greater than 50% ownership towards the $1 billion AFSI threshold test.

If the corporation is a member of a foreign-parented multinational group (MNG), the $1 billion AFSI threshold is modified to also include non-ECI financial statement profits of foreign corporations, which is not AFSI by its terms, and would be supplemented by a special $100 million AFSI test that would only take into account the group's actual AFSI (i.e., U.S. ECI-related adjusted financial statement profits of foreign corporations and AFSI of domestic corporations, including CFC income) (together, the "foreign-parented MNG" rule). The additional $100 million test for U.S.-related AFSI would apply based on the same average three-year period rule as applies to the $1 billion test. It is noteworthy that while the "applicable corporation" definition in proposed section 59(k) does not, by its terms, limit the scope of such term only to companies that owe U.S. tax (i.e., domestic corporations and foreign corporations with U.S. ECI), a foreign corporation without U.S. ECI would not appear to be subject to the Corporate AMT because it does not have AFSI.

The term foreign-parented MNG means two or more entities included in the same "applicable financial statement" (described below) with respect to the same tax year if (1) either: (i) at least one entity is a foreign corporation with

U.S. ECI; or (ii) one entity is a domestic corporation and another entity is a foreign corporation, and, generally, (2) the common parent of such entities is a foreign corporation. If there is no common parent, the foreign-parented MNG requirements may still be satisfied as provided under future rules that Treasury is expressly directed to prescribe.

KPMG observation

A foreign-parented MNG is nearly identical to an "international financial reporting group" (IFRG), as defined in the House BBBA and the SFC BBBA Draft's proposed section 163(n)(3). Generally, the foreign-parented MNG rule would preclude the Corporate AMT from applying to certain foreign-parented groups that have substantial aggregate adjusted financial statement income but relatively small (i.e., less than $100 million) U.S.-related adjusted financial statement income.

For example, assume that Foreign Parent (FP) is a corporation that wholly-owns two corporate subsidiaries—U.S. Sub (USS) and Foreign Sub (FS)—all members of the same foreign-parented MNG. Further assume that the combined average annual adjusted financial statement profits of FP and FS exceed $1 billion and USS's average annual AFSI (including CFC income) is $50 million for the applicable testing period. If none of the average annual adjusted financial statement profits of FP and FS relates to U.S. ECI, then USS would not be considered an applicable corporation under the foreign-parented MNG rule. While the foreign-parented MNG would satisfy the more than $1 billion average annual AFSI requirement, only USS's $50 million AFSI would count for purposes of applying the special $100 million U.S.-related AFSI requirement.

As in the SFC BBBA Draft, the Senate bill does not define the term "common parent" and instead expressly grants Treasury regulatory authority to prescribe rules to determine the common parent of a foreign-parented MNG.

KPMG observation

For purposes of applying the foreign-parented MNG rule, the Senate bill provides that if a foreign corporation is engaged in a U.S. trade or business, such U.S. trade or business shall be treated as a separate wholly-owned U.S. corporate subsidiary of the foreign corporation. This rule seems intended to clarify that a standalone foreign corporation that is engaged in a U.S. trade or business can qualify as a foreign-parented MNG.

Once a corporation satisfies the Income Test in any tax year ending after December 31, 2021, the corporation generally would continue to be an applicable corporation even if its income subsequently declines. The Senate bill does provide that a corporation that previously met the requirements under the Income Test would no longer be considered an applicable corporation if: (1) either (a) there is a change in ownership with respect to such corporation or (b) there is a consistent reduction in AFSI below the relevant threshold; and (2) the Secretary determines it would not be appropriate to continue to treat the corporation as an applicable corporation.

KPMG observation

This can be viewed as the once-an-applicable-corporation, almost-always-an-applicable-corporation rule.

The exception to applicable corporation status for a corporation that has previously met the Income Test

appears to require some form of affirmative guidance from Treasury; it is unclear whether the guidance would be categorical (such as a revenue procedure) or individualized (such as a determination letter or private ruling letter). The Senate bill does not, however, indicate what factors should be considered in determining whether it is appropriate to continue to treat a corporation as an applicable corporation.

The Senate bill does not define the term "change in ownership" for this purpose. Existing section 382 provides a complex regime to determine when a corporation experiences an "ownership change," but the Senate bill does not cross-reference section 382. Query how the this once-an-applicable-corporation, almost-always-an-applicable-corporation rule would apply after a change in ownership resulting from a spin-off, corporate division or other similar transaction that removes the entity from the section 52 aggregated group.

The Income Test and AFSI

The Income Test would be based on the corporation's AFSI for each tax year in the testing period. A corporation's AFSI calculation would generally start with the net income or loss reported on its "applicable financial statement" (AFS). A corporation's AFS would be defined (subject to modification by Treasury) by reference to section 451(b)(3) and would generally include GAAP, IFRS, or other financial statements used for reporting to a governmental agency such as the SEC or a foreign equivalent. Further, if a corporation's financial results are reported on an AFS for a group of entities, such statement would be considered the corporation's AFS.

KPMG observation

The term "net income" for financial reporting purposes may refer to the "net income" line on the financial statement and not total comprehensive income, which would also include certain categories of income (e.g., certain hedging and pension plan items) that are not included in the "net income" line.

As described in more detail below, AFSI would not simply be the aggregate net income reported on the consolidated financial statements. Rather, the adjustments that would be involved in calculating AFSI could require separate calculations not normally undertaken in calculating consolidated financial results.

KPMG observation

In the context of assessing "applicable corporation" status, the Corporate AMT shares some similarities to certain rules that apply when determining base erosion and anti-abuse tax (BEAT) "applicable taxpayer" status. Like the BEAT, the Corporate AMT would use a three-year tax period when applying the income threshold tests. The drafting of the three-year tax period rule in the Senate bill is less clear than in the BEAT, but it seems that both rules operate to treat a corporation as an in-scope entity if the relevant gross receipts (in BEAT) or income thresholds (in the Corporate AMT) are met based on an annual average of those items during the three preceding tax years.

Adjustments to financial statement income

The following additional rules would apply to determine the extent to which a corporation's AFSI would include income from entities related to or affiliated with that corporation (subject to adjustments for omissions or duplications in guidance to be provided by Treasury):

If a corporation joins in filing a consolidated return for U.S. federal income tax purposes for a particular tax year, AFSI for the group for the year should take into account items on the group's AFS that are properly allocable to members of the consolidated group.

KPMG observation

This provision appears to treat all members of a consolidated group as a "single entity" for purposes of the Corporate AMT. This, however, raises a number of issues, including how the statutory provision would apply when a subsidiary leaves a consolidated group. For example, under this rule, a subsidiary could potentially be an applicable corporation as a result of the consolidated group's income, and it could retain "applicable corporation" status even after it departs from the consolidated group and would not meet the Income Test separately. However, the provision would grant Treasury the authority to provide exceptions to "single entity" treatment. Similar issues arose under the BEAT rules and were the subject of a number of different proposed (often controversial) approaches before final regulations were adopted.

If the financial results of a taxpayer are reported on the AFS for a "group of entities," the Corporate AMT would apply "rules similar to the rules of section 451(b)(5)."

KPMG observation

Whereas section 451(b)(5) implies the financial statements should be consistent across a group, the regulations under section 451 provide that a taxpayer must use its separate financial statement if it is of an "equal or higher priority to the consolidated AFS." Accordingly, as U.S. GAAP is of the highest priority, if a foreign-parented MNG uses IFRS for its foreign affiliates and on a consolidated basis, but one or more U.S. affiliates prepares U.S. GAAP financial statements for any purpose, the relevant AFS would be different for the different entities. In theory, this result could apply even within a single U.S. consolidated group. Presumably the reference to "rules similar to" section 451(b)(5), rather than directly to that Code section, leaves room for Treasury to provide a consistency rule in computing AFSI for taxpayers within a single consolidated group (or even for all related taxpayers whose AFSI is aggregated for purposes of determining status as an applicable corporation under section 59(k)(1)(D)).

If a taxpayer corporation held an interest in another corporation not included in the taxpayer's consolidated return, the taxpayer corporation's AFSI with respect to that other corporation would include only dividends and certain other amounts includible in gross income (but excluding subpart F and GILTI income) or deductible as a loss for U.S. tax purposes by the taxpayer.

KPMG observation

The Senate bill's updated language regarding the treatment of a taxpayer's interest in a non-consolidated corporation for purposes of determining the taxpayer's AFSI seems intended to favorably resolve ambiguity that had existed as to the treatment of taxpayers that apply a mark-to-market method as to strategic investments under the House BBBA and SFC BBBA Draft.

These prior versions of the proposed rule explicitly provided that a taxpayer's AFSI would be adjusted as necessary to disregard the *earnings* of corporations that are not in the taxpayer's consolidated return except to the extent those earnings were received as dividends or otherwise required to be included in gross income. While this reference to excluding the undistributed "earnings" of non-consolidated corporations

would clearly reverse out equity method accounting treatment when determining a taxpayer's AFSI, there was ambiguity regarding the application of this rule in situations when a long-term, strategic investment, such as an investment with less than 20% ownership in corporate stock, may be accounted for using the fair value accounting method. If a holder reports the lower-tier investment under the fair value method for financial reporting purposes, the holder would use a mark-to-market method to report the change in value of the lower-tier corporation. This generally would not match, or even necessarily correspond with, the lower-tier corporation's earnings during such period. Because the fair value method is not tied to the earnings of the lower-tier corporation, it seems that the statutory language used in both the House BBBA and the SFC BBBA draft rule (stating that AFSI "shall take into account" the earnings of any non-consolidated corporation only to the extent of dividends received) would not, by its terms, apply to disregard the fair value method when determining a taxpayer's AFSI.

The Senate bill appears to address this ambiguity by not referring directly to the earnings of the non-consolidated corporations. Instead, the revised rule applies more broadly to the determination of AFSI "with respect to" such corporation. This ostensibly would apply to any mark-to-market adjustments made by the taxpayer on its applicable financial statement with respect to a non-consolidated corporation. With respect to amounts taken into account for non-consolidated corporations, the Senate bill further added the phrase "and other amounts which are includible in gross income or deductible as a loss under this chapter," which seems to indicate that mark-to-market adjustments made for tax purposes (for example by a dealer in securities under section 475) would be taken into account in determining AFSI, in addition to any dividends.

This apparent harmonization of the treatment of taxpayers that apply the equity method versus the fair value method as to strategic investments seems appropriate.

KPMG observation

It is not entirely clear whether the above rule for "dividends" refers to financial statement dividends or tax dividends. If the former, distributions between U.S. group members and CFCs included on the same consolidated financial statement generally would be eliminated and thus might not give rise to dividends. If the rule instead refers to dividends for U.S. income tax purposes, then such distributions generally would be treated as dividends to the extent of the distributing company's earnings and profits (E&P). Notably, however, distributions of previously taxed E&P (PTEP) from a CFC to its U.S. shareholder would not be treated as a "dividend" for U.S. income tax purposes under section 959(d). By contrast, distributions by CFCs to U.S. shareholders of non-PTEP, or distributions of PTEP to other CFCs, could result in dividends for U.S. income tax purposes.

The section's reference to "other" amounts includible in taxable income when determining AFSI with respect to a non-consolidated corporation also appears to support the position that the reference is to tax dividends (i.e., an amount includible in taxable income). Clarification of this point would, nevertheless, be helpful.

Proposed new section 52A(c)(2)(D) provides two rules regarding AFSI and the treatment of partnerships. Under the first rule (in proposed new section 52A(c)(2)(D)(i)), if a taxpayer is a partner in a partnership, the taxpayer would generally be required to adjust its AFSI to "only" take into account such taxpayer's distributive share of AFSI of the partnership.

Under the second rule (in proposed new section 52A(c)(2)(D)(ii)), the AFSI of a partnership would be the partnership's net income or loss set forth on such partnership's AFS, adjusted under rules similar to the rules applicable to determination of a corporation's AFSI. The Secretary would have the authority to provide otherwise.

It is worth noting that these rules with respect to corporate partners and partnerships were included in the SFC BBBA Draft but differ from the rules with respect to corporate partners and partnerships included in the House BBBA.

KPMG observation

The proposed Corporate AMT rules with respect to corporate partners and partnerships make clear that partnership income or loss may be included in the Corporate AMT base. Internal partnerships of large corporations, third-party joint ventures, and certain partnership-owned corporations may be affected and should carefully consider the proposed Corporate AMT.

As another threshold matter, it is unclear whether certain partnerships would have an AFS. As discussed above, only certain financial statements are AFSs. The financial statements of certain partnerships are neither prepared in accordance with GAAP (or IFRS) nor audited. The definition of AFS would appear to require Secretarial guidance for such financial statements to constitute AFSs. As a result, partnerships may be faced with the cost of preparing financial statements to allow for the determination and reporting of AFSI for corporate partners. Query whether the partnership or the corporate partner should bear the cost of this work. Further, a partnership may not know whether a corporate partner exists in an upper-tier, potentially resulting in the need for any partnership that could have an upper-tier corporate partner to prepare and provide an AFS and report the relevant information to its partners.

Corporation consolidated for financial statement purposes with subsidiary partnership

The partnership-specific rules regarding AFSI are focused on determining Corporate AMT liability in certain specific circumstances. Specifically, the first rule appears to be aimed at ensuring that an applicable corporate partner ("corporate partner") that is consolidated with the partnership includes an "economic" amount of income with respect to the partnership interest and prevent double-counting of partnership income. Specifically, the rule directs the corporate partner to back out all AFSI with respect to the partnership included under the financial accounting rules and only include the corporate partner's distributive share of the partnership's AFSI.

> *Example*
> *An applicable corporation ("Parent") owns a 90% interest in "Partnership" and consolidates Partnership for financial reporting purposes. Parent has $600 million of operating income (as measured for financial statement purposes) from its own operations. Partnership has $1 billion of operating income (as measured for financial statement purposes) from its own operations. The amount of operating income reflected on the Parent's AFS would be expected to be $1.6 billion (100% of Parent's own operating income and 100% of Partnership's operating income). Assuming no difference between the financial statement income and AFSI of Partnership, the rule appears to instruct Parent to subtract 100% of the Partnership AFSI (here, $1 billion) and include only a distributive share of Partnership AFSI. Assuming all items are shared pro rata for economic and tax purposes, one would assume that Parent's distributive share of Partnership AFSI is $900 million and Parent's total AFSI is $1.5 billion.*

As a preliminary observation, this calculation seems unlike any calculation most partnerships that are consolidated with a parent entity currently perform. In our experience, to date, financial statements of such partnerships do not provide a partner's share (distributive or otherwise) of financial statement income. Instead, total financial statement income (for all partners in the aggregate, or for all general partners as a group and all limited partners as a groups) is generally reported. However, the partner would need to determine its share of the partnership's income and would adjust for this below the net income line in the

income statement. Further, questions are raised if, as seems mandated, regulations or other guidance provide for a multi-step process where (i) the AFSI income of a corporate partner is decreased by the financial statement income with respect to the partnership interest, (ii) the AFSI of the partnership is determined; and (iii) the distributive share of a partner is determined.

Regarding the decrease (i.e., the first step in the multi-step process outlined above), it would be rare that the AFS of a corporate partner that is consolidated with a partnership will clearly delineate items associated with the partnership. Furthermore, the proper treatment of numerous common items, including distributions, intercompany items, related party payments and capital contributions, from a technical and policy perspective, is unclear.

Regarding the computation of partnership AFSI (i.e., the second step in the multi-step process outlined above), the rule in proposed new section 52A(c)(2)(D)(ii) provides little guidance. The rule merely instructs that the AFSI of a partnership is the partnership's net income or loss set forth on such partnership's AFS (i.e., an applicable financial statement as defined in section 451(b)(3)), as adjusted under rules similar to the rules applicable to determination of a corporation's AFSI, and indicates that the Secretary has broad authority to provide otherwise. A number of the enumerated general adjustments to AFSI raise questions in the partnership context. For example, the AFSI adjustment for depreciation suggests that section 743(b) basis adjustments (i.e., partner-specific basis adjustments with respect to partnership property) generally impact AFSI—but it is unclear whether partnership or partner level AFSI would be impacted. Furthermore, it appears that regulations could increase AFSI by recapture amounts and, if so, the operation of section 751 (which can result in partner specific income by virtue of the application of the recapture rules in a hypothetical sale) raises similar questions as it is not entirely clear when partnership tax related concepts apply in the Corporate AMT context. Another example of an adjustment to AFSI that raises questions in the partnership context is the rule providing that if a subsidiary is not included in a consolidated return, only dividends and certain other amounts includible in gross income or deductible as a loss for U.S. tax purposes are included in AFSI. If a corporate partner and the partnership both own stock of a subsidiary that is part of the corporate partner's consolidated group, it is unclear if this rule applies to compute the partnership's AFSI with respect to the subsidiary and/or the corporate partner's AFSI with respect to the partnership.

Multiple approaches could be used to determine a partner's distributive share in the context of the Corporate AMT (i.e., the third step in the multi-step process outlined above). Guidance could, among other options, instruct taxpayers to (1) apply the waterfall in a partnership agreement to AFSI (i.e., create a "parallel and separate" system in a manner somewhat similar to the Former AMT) to determine the distributive share of AFSI items; (2) look to the corporate partner's percentage share of section 704(b) income; (3) look to the corporate partner's percentage share of taxable income (which would have the impact of taking into account section 704(c) and thus the tax basis of contributed property); or (4) adopt the methodology used by the partner to determine how much of partnership's income is attributable to noncontrolling interests for consolidated partnerships, or the amount used for determining equity method income for equity method partnerships. Guidance could also specify the relevant period (e.g., tax year, financial statement year, life of the partnership) over which the distributive share would be determined. The lack of clarity until guidance is issued could result in modeling challenges for taxpayers seeking to quantify the impact of the Corporate AMT: the different possible approaches could yield vastly different results. Furthermore, all of the approaches identified above could be viewed as divorcing the Corporate AMT from the underlying economics, arguably frustrating the policy goals of the Corporate AMT. For example, none of the approaches appears to align tax and economics when partners share income and loss differently and there is income for AFSI purposes and a loss for tax purposes (or vice versa). Furthermore, looking to either section 704(b) income or taxable income could be viewed as making the tax rules, including taxpayer choices, central to the operation of Corporate AMT. Query if this is consistent with the policy of the Corporate AMT.

The application of partnership-specific rules regarding AFSI in a situation where a corporate partner is consolidated with the partnership raises questions with respect to the threshold determination. In situations where a corporate partner is consolidated with the partnership, the rules of Section 52(b) may apply to treat the corporate partner and partnership as a "single employer" and, only for purposes of the Income Test (i.e., threshold determination), the corporate partner's AFSI would include the AFSI of the partnership. Without the Secretarial exercise of the regulatory grant to address "duplications and omissions," a very literal application of the rules could result in corporations inappropriately being treated as applicable corporations.

Example

A corporation ("Parent") owns a 90% interest in the capital and profits of "Partnership." Parent and Partnership are consolidated for financial statement purposes and treated as a single employer under the rules of section 52(b). Parent has $475 million of operating income (as measured for financial accounting purposes) from its own operations. Partnership has $500 million of operating income (as measured for financial statement purposes) from its own operations. Assume no adjustments to AFSI other than the partnership-specific AFSI adjustments.

The amount of operating income reflected on the Parent's AFS would be expected to be $975 million ($475 million plus $500 million). The partnership-specific AFSI rule appears to instruct Parent to adjust this amount by subtracting 100% of the Partnership AFSI ($500 million) and including only a distributive share of Partnership AFSI. Assuming all items are shared pro rata for economic and tax purposes, one would assume that Parent's distributive share of Partnership AFSI would be $450 million (90% of $500 million) and Parent's total AFSI would be $925 million ($475 million plus $450 million). The combined AFSI of Parent and Partnership (and thus Parent for purposes of the Income Test) "should" be $975 million ($475 million plus $500 million). Thus, Parent should not meet the Income Test with respect to the year. Query, however, whether a very literal application of the rules suggests that the combined AFSI of Parent and Partnership (and thus Parent for purposes of the Income Test) would be $1.425 billion (i.e., Parent's pre-adjustment AFSI of $925 million plus Partnership's AFSI of $500 million).

Secretarial exercise of the regulatory grant of authority to address "duplications and omissions" can clarify this issue and rules that double count the same dollar of AFSI would appear contrary to Congressional intent. However, query whether guidance would need to provide different rules with respect to the computation of AFSI for purposes of the threshold determination and for purposes of the liability determination, adding further complexity to the regime.

A corporate partner and partnership could be consolidated for financial statement purposes but not treated as a single employer under section 52(b) (e.g., where the corporate partner has voting control over the partnership but owns only a 50% interest in the partnership's capital or profits). In such a situation, the corporate partner's AFSI, for purposes of the both the threshold determination and liability, would appear to include only a distributive share of partnership AFSI. This appears to be the case even though the corporate partner's AFS may reflect 100% of the partnership's financial statement income. Said differently, the rule in proposed new section 56A(c)(2)(D)(i)), providing that a corporate partner "only" takes into account its distributive share of AFSI of the partnership, appears to override the financial statement treatment.

Example

A corporation ("Parent") owns a 50% interest in the capital and profits of "Partnership." Parent and Partnership are consolidated for financial statement purposes and are not treated as a single employer under the rules of section 52(b). Parent has $600 million of operating income (as

measured for financial accounting purposes) from its own operations. Partnership has $500 million of operating income (as measured for financial accounting purposes) from its own operations. Assume no adjustments to AFSI other than the partnership-specific AFSI adjustments.

The amount of operating income reflected on the Parent's AFS would be expected to be $1.1 billion ($600 million plus $500 million). The partnership-specific AFSI rule appears to instruct Parent to adjust this amount by subtracting 100% of the Partnership AFSI ($500 million) and including only a distributive share of Partnership AFSI. Assuming all items are shared pro rata for economic and tax purposes, one would assume that Parent's distributive share of Partnership AFSI would be $250 million (50% of $500 million) and Parent's total AFSI would be $850 million ($600 million plus $250 million). Because section 52 does not treat Parent and Partnership as a single employer, the stand-alone AFSI of Partnership is not included for purposes of the Income Test. As a result, Parent does not appear to meet the Income Test with respect to the year.

It is also worth noting that the Secretary would be instructed to provide a simplified method for determining whether a corporation meets the applicable corporation definition, and such guidance could prove useful to taxpayers (including for those in situations similar to the one in the example above).

Corporations not consolidated for financial statement purposes with subsidiary partnerships

The application of partnership-specific AFSI rules where a corporate partner is not consolidated with the partnership raises additional questions.

As background, where a corporate partner is not consolidated with the partnership, the corporate partner generally reflects its investment in the partnership on its AFS using the equity method or fair value method. The equity method is applied when the corporate partner has significant influence over the partnership (generally presumed with ownership of more than 3%); otherwise, the fair value method generally is used.

Furthermore, it is unclear as a policy matter why a corporate partner using the equity method necessarily needs to compute its distributive share of partnership AFSI. Conceptually, one might reason that the amount reflected on a financial statement when the equity method is used and the amount reflected as a distributive share of AFSI are or should be similar. Both aim to reflect an economic share of partnership income and the measurement starts with the partnership's financial statement income. Assuming (i) there is no difference between the partnership's financial statement income and AFSI and (ii) a distributive share for purposes of Corporate AMT is the same share used for purposes of the equity method, one would expect a corporate partner's distributive share of AFSI to be the same, or very similar, to the amount reflected on the corporate partner's AFS with respect to the partnership investment when the equity method is used. If so, given the broad grant of authority to the Secretary, a corporate partner that uses the equity method with respect its partnership investment could be required or allowed to apply the amount included under the equity method of accounting as its preliminary distributive share of Partnership AFS and simply make certain adjustments to account for the differences between financial statement income and AFSI as outlined in the statute.

Furthermore, Treasury could consider extending the rule described immediately above to corporate partners that do not use the equity method of accounting and such an approach may ease administrative burdens. Additionally, or alternatively, Treasury could consider providing that where the fair value method is used, a corporate partner's distributive share of AFSI is the corporate partner's distributive share of taxable income or loss. This is consistent with the rule providing that if a corporation held an interest in another corporation not included on the taxpayer's consolidated return, the corporation's AFSI with respect to that other corporation would include only dividends and certain other amounts includible in gross income or deductible as a loss for U.S. tax purposes by the taxpayer.

- If a corporation is a U.S. shareholder of one or more CFCs, the AFSI of such corporation would be adjusted to take into account the corporation's pro rata share (determined under section 951(a)(2) principles) of the net income or loss as computed on the AFS for each CFC. The pro rata share would include all CFC income without regard to whether such income is subpart F, GILTI, or section 245A exempt. The corporation's pro rata share of net income and loss from each CFC is netted for purposes of the Corporate AMT calculation and not computed on a country-by-country basis. However, to the extent that a corporation's pro rata share of net income and loss from CFCs would result in a negative adjustment to the corporation's AFSI, such negative adjustment would be disallowed and carried forward (and applied) to the corporation's next tax year.

KPMG observation

This item appears to create tension with the provision, described above, that would limit the inclusion of a CFC's earnings in the AFSI of its U.S. shareholder to the amount paid in dividends. The Senate bill language was updated to indicate that, with respect to CFCs, the rule for the inclusion of CFC earnings is to be applied in addition to the rule that limits amounts included with respect to non-consolidated entities to dividends received from such entities. This appears to still be a drafting glitch; the AFSI rules appear intended to include income earned indirectly through a CFC, regardless of whether distributed in the form of a dividend. If the dividend rule were to also apply, there would be the potential for double-counting of the CFC earnings later paid as a dividend (depending in part on whether the term "dividend" refers to financial statement dividends or tax dividends, as discussed in an earlier observation). The dividend rule provides the Secretary with authority to reduce the amount of dividends included under that rule. Presumably, Treasury would provide rules to address the potential for double-counting under that grant of authority. The inclusion of dividends from CFCs in a taxpayer's AFSI would also create transition issues. For example, untaxed CFC earnings from a tax year before the Corporate AMT's effective date that are distributed to the taxpayer (or to another CFC) as a dividend eligible for the 100% DRD under section 245A in a year to which the Corporate AMT applies would increase AFSI in such later year unless Treasury provides transition rules to exclude such dividend income from AFSI. It is unclear whether Treasury would issue rules excluding dividends from AFSI if the distributing entity's earnings were not previously subject to the Corporate AMT regime. Dividends paid by acquired CFCs, to the extent attributable to pre-acquisition earnings, would raise similar issues.

KPMG observation

The provision to allow a taxpayer to use CFC losses in one jurisdiction to offset CFC income in a separate jurisdiction in the same tax year is similar to the operation of section 951A. A taxpayer's pro rata share of aggregate CFC losses that exceed such taxpayer's pro rata share of aggregate CFC net income may not reduce the taxpayer's AFSI for the year. In other words, CFC-level losses would never be available to offset a taxpayer's other AFSI (e.g., domestic or foreign branch income). Unlike the GILTI regime, however, the Corporate AMT would establish CFC NOLs that may be used in future years to reduce the taxpayer's pro rata share of future year CFC net income.

By contrast, losses from partnerships (discussed above) and disregarded entities (discussed immediately below) would directly reduce the taxpayer's other AFSI (including net positive CFC-level AFSI) in the year such losses were incurred. This disparate treatment of CFC-level losses vs. other losses would seem to favor losses directly incurred by the taxpayer (or incurred by a fiscally transparent entity).

KPMG observation

While the House BBBA and the SFC BBBA Draft proposed substantial changes to the GILTI regime, including increasing the tax rate to 15% and reducing the carve-out rate for tangible depreciable property (from 10% to 5%), the Senate bill does not propose any modifications to GILTI. Accordingly, it is interesting that the Corporate AMT would continue to subject a U.S. shareholder corporation's pro-rata share of CFC-level earnings to a 15% rate of tax (before taking into account credit for foreign taxes paid), which is generally higher than rate of tax applied to CFC-level earnings under the GILTI regime (currently 10.5%, inclusive of the section 250 deduction). The rate differential on CFC-level earnings between the Corporate AMT and the GILTI regime could potentially result in permanent differences attributable to CFC-level earnings.

A corporation would be required to adjust its AFSI to take into account any AFSI of a disregarded entity (DRE) owned by the corporation that is not otherwise included in the corporation's AFS.

KPMG observation

This rule seems intended to ensure that all the AFSI of foreign hybrid entities and other DREs is treated as AFSI of the entities' owners. However, this rule would be needed only in rare situations given the reference to section 451(b)(5) for purposes of determining how to treat financial results of a taxpayer that are reported on a consolidated financial statement for a "group of entities," as noted above. Because section 451(b)(5) and the regulations thereunder start with the single consolidated financial statement and find items attributable to the "taxpayer" (a U.S. tax concept which includes a DRE as part of its owner, as opposed to the concept an "entity" which can exist without regard to U.S. check-the-box fictions), it is rarely going to be necessary to look to the separate financial statement of a DRE.

In the case of an organization subject to tax under section 511, AFSI would include only AFSI: (1) of an unrelated trade or business; or (2) derived from debt-financed property and treated as unrelated business taxable income.

The Senate bill makes certain other general adjustments to AFSI. Of particular note, AFSI would be decreased for tax depreciation claimed with respect to property to which section 168 applies (i.e., depreciation deductions related to tangible property) in the tax year and increased for financial statement depreciation taken into account on the AFS with respect to such depreciable property. A similar substitution of tax amortization for financial statement amortization would apply for certain qualified wireless spectrum acquired after December 31, 2007, and before the enactment of the Senate bill.

KPMG observation

The AFSI adjustment for depreciation was not included in the July 27 Draft Text or the House BBBA or the SFC BBBA Draft versions of the Corporate AMT. It may have been added in response to projections indicating that the Corporate AMT would apply mostly to manufacturing businesses with large capital expenditures. Very generally, substituting tax for financial statement depreciation deductions in calculating AFSI would minimize the differences between tax and financial statement income, particularly for corporations with significant depreciation deductions, and therefore lessen the extent to which these corporations would be subject to the Corporate AMT. However, while depreciation, amortization, and depletion deductions are often all thought of as arising from "wasting assets," only depreciation of tangible assets (and amortization with respect to qualified wireless spectrum) would be subject to this provision.

The adjustments for depreciation would be taxpayer favorable only in years that tax depreciation exceeds financial statement depreciation. This would seemingly penalize corporations (at least as compared to the House and Senate BBBA versions of the Corp AMT) that have claimed 100% bonus depreciation in recent years, as there would be no decrease to AFSI for the prior tax depreciation but the financial statement depreciation would still be required to be added back. Less clear is the treatment of assets that are depreciable for tax purposes but non-depreciable or deductible for financial statement purposes, such as, for example, financial statement impairment losses on assets that continue to be depreciable for tax and certain spare parts that are depreciable for tax but treated as inventory for financial statement purposes. In addition, it is not clear if adjustments for depreciation would include tax depreciation recapture, in particular for items that were depreciated or immediately expensed in tax years prior to the application of the Corporate AMT.

In addition, consistent with the SFC Draft BBBA (but not the House BBBA) proposal, the Senate bill adjusts AFSI to disregard financial statement income, costs, or expense relating to certain defined benefit plans and foreign deferred compensation plans. This adjustment would allow for financial statement numbers to be backed out of the calculation, and amounts taken into account for tax purposes to be used instead.

Additional adjustments to AFS include (but are not limited to):

- Adjustments to account for AFS that cover periods different than the corporation's tax year
- Adjustments to increase a corporation's AFSI for foreign income taxes taken into account on the corporation's AFS, to the extent the corporation elects to claim foreign tax credits
- In the case of a foreign corporation, the principles of section 882 generally apply to include only ECI in the determination of AFSI
- Adjustments to prevent the omission or duplication of items
- Adjustments to take into account minority ownership of members of a consolidated group
- Adjustments to carry out the principles of the corporate liquidation, organization, and reorganization rules, and the rules relating to partnership contributions and distributions

KPMG observation

The explicit reference to the application of section 882 principles seems to confirm that a foreign corporation's AFSI would be limited to the items of financial statement income or loss that relate to U.S. ECI. As such, foreign corporations without U.S. ECI would not have AFSI. It is unclear how section 882 principles would be applied in the financial statement context to parallel the application of the U.S. ECI rules for U.S. taxable income purposes, and it could potentially require extensive additional work to reconstruct financial accounts in accordance with a principle that has heretofore only applied in the U.S. tax accounting realm.

In addition, certain modifications to AFSI would apply for purposes of calculating the Corporate AMT of an applicable corporation but not for purposes of the Income Test.

Consistent with the SFC Draft BBBA (but not the House BBBA) proposal, the Senate bill adjusts AFSI to disregard financial statement income, costs, or expense relating to certain defined benefit plans and foreign deferred compensation plans. This adjustment would allow for financial statement numbers to be backed out of the calculation, and amounts taken into account for tax purposes to be used instead.

Financial statement net operating losses

The Corporate AMT would include a reduction to AFSI for FS NOLs. Specifically, AFSI for a particular tax year would be reduced by the lesser of: (1) the aggregate amount of the corporation's FS NOL carryovers to the year; and (2) 80% of the AFSI for the year computed without regard to FS NOL carryovers. FS NOL carryovers would arise from AFSI net losses for tax years ending after December 31, 2019. An FS NOL could be carried over indefinitely. The Senate bill provides that FS NOL carryovers would not be taken into account for purposes of the Income Test (including the $100 million test of the foreign-parented MNG rule).

KPMG observation

Under prior drafts of the bill there was uncertainty regarding the treatment of financial statement losses for purposes of determining when a corporation would be an applicable corporation. In particular, there was neither an explicit floor of zero in computing AFSI for the averaging provision nor a provision preventing a loss from reducing subsequent year AFSI via the NOL carry-forward mechanism for that purpose. Consistent with the obvious point that double-counting could not have been intended, the Senate bill clarifies that a FS NOL carry-forward does not reduce AFSI for purposes of determining status as an applicable corporation. This particular resolution of the issue may break in favor of certain taxpayers and against others – based largely on the fact that treating AFSI as negative allows full offset of NOLs but only those arising within the three-year period, whereas having dealt with losses via the FS NOL carry-forward would have limited the absorption to 80% of pre-carry-forward AFSI in any year but allowed access to losses arising before the three-year period.

In computing the Corporate AMT (in contrast to applying the Income Test), FS NOLs carry over to subsequent year(s). A corporation can generate FS NOLs beginning with tax years ending after December 31, 2019 (and thus prior to the first tax year in which the Corporate AMT could apply). For example, if a calendar year corporate taxpayer has AFSI of $1 billion in both 2020 and 2021, but a loss of $750 million in 2022, the taxpayer would have an FS NOL carryover from 2022 available to reduce AFSI in subsequent years. Conversely, if that calendar year taxpayer had the loss of $750 million in 2020, and then AFSI income of $1 billion in both 2021 and 2022, it appears that the 2020 loss may be absorbed in 2021 prior to the first tax year, 2023, in which the Corporate AMT could apply. This same phenomenon, regarding expending FS NOLs, can occur with respect to FS NOLs that are carried forward to post-2022 tax years in which the taxpayer is not subject to the Corporate AMT before considering the FS NOL carryover to that tax year.

Further, a corporation may become an applicable corporation after the effective date of the Corporate AMT regime, due to revenue growth or acquisitions. It appears that such a corporation could generate FS NOLs in tax years prior to becoming subject to the Corporate AMT, and that these FS NOLs would be reduced by AFSI in later periods. Thus, seemingly, a corporation that becomes subject to the Corporate AMT at any point would need to calculate its FS NOLs (and any offset of those NOLs against financial statement income) for all tax years ending after December 31, 2019.

For regular tax purposes, the use of net operating losses (NOLs) can become subject to limitation following an “ownership change” within the meaning of section 382. Similarly, the use of NOLs imported into a consolidated group can become subject to the separate return limitation year (SRLY) limitation. The Senate bill does not provide for any similar rules or coordinating adjustments to these regular tax provisions (although it does provide broad regulatory authority to Treasury to potentially address these points).

Further, for regular tax purposes, a member of a consolidated group that contributes to a consolidated NOL can have a portion of that loss allocated to it when it leaves the group (such as when the member is sold to an unrelated buyer). The Senate bill grants authority for regulations as necessary to carry out the purposes

of the AFSI rules, which presumably would include regulations that address many of the issues raised by FS NOL carryovers.

The Senate bill also provides Treasury with broad authority to promulgate regulations to provide other adjustments to AFSI that are necessary to carry out the purposes of the Corporate AMT.

Calculation of Corporate AMT liability

The Senate bill provides that an applicable corporation would be liable for the Corporate AMT to the extent its "tentative minimum tax" exceeds its regular U.S. federal income tax liability (including the BEAT under section 59A), prior to taking into consideration general business credits under section 38. An applicable corporation's tentative minimum tax would equal 15% of the applicable corporation's current year AFSI over the applicable corporation's eligible Corporate AMT foreign tax credits.

Corporate AMT foreign tax credit

If the taxpayer chooses to claim a foreign tax credit (FTC) under section 901 for the year, the Corporate AMT FTC for the year would be the sum of two amounts:

- The lesser of (1) the corporation's pro-rata share of section 901 creditable foreign taxes paid or accrued (for federal income tax purposes) by its CFCs that are taken into account on the AFS of the CFCs, or (2) 15% of the corporation's pro-rata share of aggregate CFC-level AFSI (after grossing-up for foreign income taxes paid) for the year; **and**

- The total amount of section 901 creditable foreign taxes paid or accrued (for federal income tax purposes) by the taxpayer and taken into account on the taxpayer's AFS.

KPMG observation

Although the Corporate AMT FTC would use section 901 creditable taxes to determine the base amount of foreign taxes paid, it is noteworthy that it does not cross-reference the section 904 foreign tax credit limitation rules at all. As such, with respect to creditable taxes that are considered paid directly by the taxpayer (versus by CFCs, for which the Corporate AMT provides its own limitation), the Corporate AMT FTC, unlike section 901 FTCs, would not appear to be limited to U.S. tax on foreign source income, nor would there be any limit on cross-crediting among baskets or low-tax and high-tax jurisdictions.

KPMG observation

The Senate bill's restriction on CFC taxes to 15% of CFC income for purposes of determining the amount of the Corporate AMT FTC is in stark contrast to the treatment of foreign taxes paid by the applicable corporation directly or with respect to a DRE, which are not subject to any limit. The policy rationale for treating taxes paid by a CFC differently than taxes paid by a taxpayer on behalf of a DRE is unclear. Nonetheless, it appears there could be advantages to organizing high-tax foreign operations through DREs, which could conceivably encourage taxpayers that are chronically subject to the Corporate AMT to check the box on one or more high-tax CFCs.

KPMG observation

As discussed above, under the Senate bill, the AFSI of an applicable corporation includes the AFSI of a DRE owned by the applicable corporation. This appears to be the case under the basic rules of proposed section 56A(c)(2)(A) and section 451(b)(5) even before application of the special rule for DREs contained in proposed section 56A(c)(6), discussed above. Thus, FTCs of the DRE ought to be available even if the DRE is treated as a separate entity from the corporation in preparing the AFS. Clarification of this point might, nevertheless, be helpful.

KPMG observation

There is ambiguity concerning which year taxes are taken into account in the Corporate AMT computation when the year of tax accrual for financial statement purposes does not match the year the taxes are paid or accrued for regular tax purposes. While not clear, when such a timing mismatch occurs, it seems that the taxes would be taken into account in the later year because the rule appears to require the taxes to have been both: (1) taken into account on the financials; **and** (2) paid or accrued for U.S. tax purposes.

To the extent the credit for taxes paid by CFCs in the year is reduced because of the 15% limitation, the excess foreign taxes are allowed as a carryover in any of the first five succeeding tax years.

General business credits

The Senate bill would amend section 38 (General Business Credit (GBC)) to take into account the Corporate AMT. The Senate bill limits the availability of GBCs to $25,000 plus 75% of a taxpayer's net income tax that exceeds $25,000. This generally follows the current law paradigm for the ability to use GBCs. For this purpose, net income tax means the sum of regular tax liability and the AMT, reduced by credits allowed under Subpart A and B of Part IV of the Code (Credits Against Tax). Section 901 foreign tax credits are included among the taxes allowed under Subpart B.

KPMG observation

Both the House BBBA and the SFC BBBA Draft would have amended section 38(c)(1) to take into account section 59A taxes in "net income tax," along with regular taxes and the Corporate AMT. This change to section 38(c)(1) was in the BBBA inbound international provision (section 128131(a)(6) of the SFC BBBA Draft and section 138131(a)(6) of the House BBBA), which the Senate bill does not include. Consequently, the Senate bill is less generous with respect to allowable GBCs than the BBBA would have been.

KPMG observation

The fact that GBCs can potentially be used to satisfy a new corporate minimum tax is very significant because with the Former AMT:

- GBCs generally were not available to offset any corporate AMT
- If a taxpayer had no AMT liability, the taxpayer generally could not use GBCs to reduce its tax liability

below its tentative minimum tax. For example, if a corporate taxpayer had a regular tax liability of $10 million and a tentative minimum tax of $8 million, the taxpayer would not have any AMT liability, but generally would not be allowed to claim GBCs in an amount that would reduce its tax liability below the tentative minimum tax threshold of $8 million.

KPMG observation

It is perhaps noteworthy that there is no special treatment in the Senate bill for the section 250 deduction for FDII (generally applicable to sales or services provided to foreign persons and/or outside the United States). Thus, in contrast, to the treatment of GBCs where favorable treatment is generally preserved under the Corporate AMT, a taxpayer that otherwise would benefit from section 250 may lose significant benefits, at least until it is able to utilize any resulting AMT credit carryforward.

Corporate AMT credit

Applicable corporations would also be allowed to claim a credit for Corporate AMT paid against regular tax in future years, but the credit could not reduce that future year's tax liability below the computed Corporate AMT for that year.

KPMG observation

As noted previously, the proposed Corporate AMT credit mechanism is similar to the AMT credit provided by the Former AMT regime and would similarly cause the proposed Corporate AMT to be (at least theoretically) seen as an acceleration of regular tax liability.

Under the Former AMT, a taxpayer's ability to use AMT credit carryovers could become limited under the rules of section 383, following a section 382 ownership change. The Senate bill places the proposed Corporate AMT credit within the framework of section 53, which sets forth the rules that applied to the Former AMT (and that continue to apply to certain noncorporate taxpayers after the repeal of the Former AMT). Thus, Corporate AMT credit carryovers are expected to be subject to a section 383 limitation following an ownership change.

Regulatory grant with respect to partnerships

The Corporate AMT contains a number of regulatory grants and directives, as noted above, including two partnership-specific ones. The Corporate AMT would instruct the Secretary to issue "regulations or other guidance to provide for such adjustments to adjusted financial statement income as the Secretary determines necessary to carry out the purposes of this section, including adjustments … to carry out the principles of … part II of subchapter K of this chapter (relating to partnership contributions and distributions)." Another regulatory directive instructs the Secretary to issue "regulations and other guidance relating to the effect of the rules of this section on partnerships with income taken into account by an applicable corporation.''

KPMG observation

This regulatory directive suggests Congressional awareness that the interaction of Corporate AMT and the partnership tax rules is complex. The application of the Former AMT raised a number of vexing issues in the partnership context—including with respect to a partner's basis in its partnership interest ("outside basis"), the partnership's basis in its assets ("inside basis"), gain or loss upon distributions, and the gain or loss upon the sale or exchange of partnership interests.

Some of these issues would need to be addressed when applying the Corporate AMT. Furthermore, aspects of the Corporate AMT, including the rule allowing applicable corporations to claim a credit for Corporate AMT paid against regular tax, subject to certain limitations (discussed above), may introduce additional complexities. For example, it is unclear if there would be outside basis consequences when a corporate partner has Corporate AMT liability as a result of partnership AFSI. Similar, and possibly additional, issues would arise if a corporate partner transferred its interest in Partnership in a non-recognition transaction.

Interaction of Corporate AMT and Pillar Two—KPMG observation

Corporate AMT's application to the U.S. profits of a U.S.-based MNE

The Corporate AMT might be viewed as part of an effort by lawmakers to insulate income earned in the United States from another country's Undertaxed Profits Rule (UTPR), which could apply to U.S.-parented multinational groups with €750 million or more of revenue. Put differently, it could be viewed as an attempt to ensure that any incremental taxes over the regular U.S. corporate tax required by Pillar Two would be collected by the United States and not by a foreign country. However, it seems unlikely to fully achieve that result given that, under the Pillar Two Model Rules, avoiding the application of a UTPR would require establishing that the ETR of the U.S. entities in an MNE Group (excluding DREs and branches that are tax resident or have a taxable presence in another country) is at least 15%, as measured based on the Pillar Two rules.

Nevertheless, the Corporate AMT shares some similarities with the Pillar Two ETR calculation, in that both use financial statement income as the starting point for the tax base and apply 15% as the minimum rate of tax. The scope and technical design of the proposed Corporate AMT, however, deviates from the Pillar Two framework in material ways. With respect to scope, Pillar Two uses a much lower threshold, so that a large population of taxpayers would be outside the scope of the Corporate AMT and within the scope of Pillar Two. As a result, this population of taxpayers with exposure to additional tax under a UTPR would be unaffected by the enactment of the Corporate AMT. Furthermore, even for those taxpayers within the scope of both the Corporate AMT and Pillar Two, there are material differences as to how the two frameworks compute tax liability. For example, the Corporate AMT would allow general business credits to reduce the Corporate AMT liability, whereas Pillar Two generally does not allow these non-refundable credits (with a potential narrow exception for entities to which equity method accounting applies). Another significant difference that could cut either way, depending on the taxpayer and the year, is that Pillar Two (very generally) follows deferred tax accounting for purposes of determining the taxes included in the numerator of the Pillar Two ETR calculation, whereas the Corporate AMT generally compares the tentative minimum tax to current taxes without any reference to book deferred tax accounts. In addition, foreign taxes attributable to foreign branch operations of a U.S. resident would be allowed to reduce the Corporate AMT owed with respect to income that is earned from activities conducted entirely within the United States, which is contrary to the country-by-country approach of Pillar Two. As a result of these and other deviations, Corporate AMT taxpayers could still have an ETR that is lower than 15% for Pillar Two purposes and thus be exposed to the UTPR.

Given the differences, it seems unlikely the Corporate AMT would be considered a Qualified Domestic Minimum

Top-up Tax (QDMTT) under the Pillar Two framework. It is notable, however, that while the Corporate AMT is more favorable than Pillar Two as it relates to general business credits, it is less favorable in other respects, including the treatment of book-tax differences related to stock-based compensation and recovering pre-2020 net operating losses. As discussed below, some of these differences that could drive liability under the Corporate AMT could have knock-on effects in Pillar Two when the AMT credit carryforward is used in later years to reduce tax liability.

Corporate AMT's application to the foreign profits of a U.S.-based MNE

The Corporate AMT, as proposed, is also unlikely to be considered a qualified Income Inclusion Rule (IIR) with respect to its application to foreign earnings. Like the GILTI regime, it aggregates income, losses, and taxes across all CFCs (and similarly allows cross-crediting of the taxes imposed on the operations of a U.S. consolidated group, without regard to whether the operations are conducted in the United States or through a foreign branch), whereas Pillar Two only allows income, losses, and taxes to be aggregated on a country-by-country basis.

Instead, the proposed Corporate AMT, similar to GILTI, is likely be treated as a "CFC Tax Regime" for Pillar Two purposes, so that any taxes paid with respect to foreign earnings would be "pushed down" to the jurisdiction that earned the underlying income, using a to-be-developed allocation method, and taken into account in computing the ETR in that jurisdiction for purposes of the IIR and UTPR. The interaction of CFC Tax Regimes and QDMTTs is not yet resolved.

Other interactions

There may also be an unfavorable interaction between the Corporate AMT's credit carryforward mechanism and the Pillar Two deferred tax accounting rules. In particular, Pillar Two contains a special rule that disregards deferred tax assets related to the generation and use of tax credits. This special rule would seem to disregard the deferred tax asset that is recorded for the Corporate AMT credit carryforward for purposes of computing the Pillar Two ETR. Therefore, if a taxpayer pays Corporate AMT, creates a credit carryforward (and a deferred tax asset related to that carryforward), and then in a future year uses the carryforward, that future year may be exposed to top-up tax under Pillar Two because the reversal of the deferred tax asset related to the Corporate AMT carryforward is disregarded so that it does not increase Covered Taxes for Pillar Two purposes. Similar results are being observed with respect to Pillar Two and other credit carryforwards, including foreign tax credit carryforwards.

Assuming Pillar Two does in fact disregard the deferred tax expense generated from using a Corporate AMT credit carryforward, the result could be especially disadvantageous for taxpayers that owe Corporate AMT in a year when they would not otherwise owe Pillar Two top-up tax with respect to U.S. operations (for example, because of the lack of adjustments in the Corporate AMT for book-tax differences in the treatment of share-based compensation). For these taxpayers, the subsequent use of the Corporate AMT credit to reduce regular tax liability could be the item that pushes the taxpayer into having a Pillar Two ETR that is below 15% with respect to the United States.

Excise tax on stock repurchases

The Senate bill would impose a new 1% excise tax on repurchases of stock by certain publicly traded corporations. Specifically, the excise tax would apply to repurchases of stock by domestic corporations with stock traded on an established securities market ("Covered Corporations").

The JCT has estimated that the excise tax would generate revenue of approximately $73.69 billion over the 10-year budget window.

KPMG observation

The provisions of the excise tax included in the Senate bill are generally the same as those that were included in the House BBBA and the Senate SFC Draft, except that the provisions in the Senate bill would apply to Covered Transactions occurring after December 31, 2022, instead of 2021. "Repurchase" is defined as a redemption within the meaning of section 317(b), which generally includes any acquisition by a corporation of its stock from a shareholder in exchange for property, except for its stock or rights to acquire its stock. Thus, the excise tax would extend to typical stock buy-back programs implemented through traditional open market transactions and through privately negotiated purchases.

The excise tax, however, also would appear to extend to transactions that are treated as constructive redemptions for federal income tax purposes, such as a leveraged buyout of a publicly traded target corporation. In a typical leveraged buyout, an acquirer (A) forms a new wholly owned subsidiary (M) to "reverse merge" into a target corporation (T) with T surviving. Prior to the merger, A provides some equity funds to M, and causes M to borrow additional funds to facilitate the purchase of the T stock. In the merger, the T stock is converted into a right to receive the cash, the M stock is converted into stock of the surviving entity (which becomes wholly owned by A), and T inherits liability for the debt incurred by M. For federal tax purposes, the formation and merger of M is disregarded as transitory, and T is treated as incurring the debt and transferring the borrowed funds to its shareholders in a distribution in redemption of its stock. The excise tax would appear to apply to such a constructive distribution in redemption of stock of a corporation subject to the provision. Furthermore, the Senate bill does not contain any exception for a corporation's acquisition of its stock in exchange for property in an actual or deemed distribution in complete liquidation.

The excise tax would also apply to repurchases by foreign corporations with stock traded on an established securities market if they become surrogate foreign corporations after September 20, 2021 ("Covered SFCs"). A surrogate foreign corporation is defined by reference to the inversion rules of section 7874, which very generally refers to a foreign corporation that directly or indirectly acquires substantially all the assets of a domestic corporation or partnership if the former shareholders or partners (as applicable) own at least 60% of the stock of such foreign corporation and its expanded affiliated group does not have substantial business activities in its jurisdiction (compared to total business activities of the group). Note, however, that adjustments can cause the 60% test to be satisfied even when the former shareholders own significantly less than 60% of the stock of the foreign corporation.

The Senate bill would also authorize the IRS to treat economically similar transactions as repurchases. (We refer to repurchases of stock of Covered Corporations and Covered SFCs, and economically similar transactions, as "Covered Repurchases".)

KPMG observation

The term "established securities market" is broadly defined to include: (1) a national securities exchange registered under section 6 of the Securities Exchange Act of 1934; (2) a national securities exchange exempt from registration under such act because of the limited volume of transactions; (3) a foreign securities exchange that, under the law of the jurisdiction where it is organized, satisfies regulatory requirements analogous to those of such act; (4) a regional or local exchange; and (5) an interdealer quotation system that regularly disseminates firm buy or sell quotations by identified brokers or dealers by electronic means or otherwise.

In addition to Covered Repurchases, the excise tax would apply to certain purchases (treated as Covered

Repurchases) of stock of Covered Corporations and foreign corporations with stock traded on an established securities market (the latter of such corporations, which include both Covered SFCs and other foreign corporations, "Applicable FCs," and all such corporations, "Covered Entities") by "Specified Affiliates" from a person other than the applicable Covered Entity or its Specified Affiliates. A Specified Affiliate would include any corporation or partnership more than 50% of the stock (by vote or value) or interests (capital or profits), respectively, of which is owned (directly or indirectly) by a Covered Entity. However, in the case of an Applicable FC (other than a Covered SFC), the excise tax would only apply to purchases by its domestic Specified Affiliates (directly, or through a foreign partnership) (all purchases of stock treated as Covered Repurchases, together with Covered Repurchases, "Covered Transactions").

The excise tax would be imposed on the value of the stock repurchased (or treated as repurchased). In the case of a Covered Corporation, the amount on which the tax is imposed would be reduced by the value of any stock issued by such corporation during the tax year (including stock issued to employees of the Covered Corporation or Specified Affiliate, whether or not issued pursuant to the exercise of options). By contrast, in the case of a Covered SFC or an Applicable FC, such amount would only be reduced by the value of any stock issued by the applicable Covered Entity to its employees during the tax year. The Senate bill would also create six exceptions to which the tax would not apply, including: (1) to the extent a repurchase is part of a reorganization under section 368(a) and no gain or loss is recognized by the shareholder; (2) if the stock repurchased or an amount of stock equal to the value of such stock is contributed to an employer-sponsored retirement plan, an employee stock ownership plan, or similar plan; (3) if the total value of the stock repurchased during the tax year does not exceed $1 million; (4) repurchases by dealers of securities in the ordinary course of business under regulations; (5) repurchases by regulated investment companies ("RICs") or real estate investment trusts ("REITs"); and (6) repurchases treated as dividends.

The Senate bill would grant authority for regulations to prevent abuse, address special classes of stock and preferred stock, and apply the excise tax to Covered SFCs and Applicable FCs. The excise tax would be non-deductible. The tax would apply to Covered Transactions occurring after December 31, 2022.

KPMG observation

The excise tax would apply to repurchases of "any stock" of a Covered Corporation or a Covered SFC (and purchases of "stock" of a Covered Entity by a Specified Affiliate from a person other than the applicable Covered Entity or its Specified Affiliates), regardless of whether the particular stock that is repurchased is of a class that is traded on an established securities market. While the Senate bill would grant regulatory authority to address special classes of stock and preferred stock, until regulations are promulgated to exclude a particular class of stock, the excise tax would be applicable to Covered Transactions with respect to all stock of Covered Entities regardless of its trading status. Furthermore, until such regulations are promulgated, scheduled redemptions of preferred stock of Covered Corporations and Covered SFCs on maturity would appear to be subject to the excise tax.

KPMG observation

The excise tax would be imposed on the "fair market value" of the stock repurchased (or treated as repurchased). Presumably, such value is to be determined on the date of the applicable Covered Transaction and by the amount paid to repurchase the stock; however, the Senate bill does not expressly state when such value is to be determined. This omission could lead to uncertainty. For example, consider the exception for contributions of an amount of stock equal to the value of the stock repurchased to employer-sponsored retirement plans, employee stock ownership plans, and similar plans. A contribution may not occur on the

same date as the applicable Covered Transaction. For such a contribution, would the value be based on a particular trading price on a particular date (or time of day), an average trading price on a particular date, or a metric such as the average trading price over, say, a trailing three trading day period? The relevant amount could vary, particularly with respect to stock that is thinly traded or that has a volatile price.

In addition, the Senate bill does not provide any exception to the imposition of the tax on the value of the stock repurchased for circumstances in which the amount paid in a Covered Transaction is not equal to such value. For example, stock issued to an employee and with respect to which an election is made under section 83(b) may be subject to forfeiture at a price other than fair market value. Regulations could be written to create special rules for this and similar situations. However, unless and until such regulations are promulgated, the excise tax would apply to the fair market value of the stock repurchased, irrespective of the actual price paid.

Additionally, the exception for contributions of repurchased stock to employer-sponsored retirement plans, employee stock ownership plans, and similar plans contains no express timing restrictions. That is, the Senate bill does not indicate any time period within which repurchased stock must be contributed to such a plan for the repurchase to be eligible for the exception.

Furthermore, the excise tax would not apply to a repurchase "to the extent" that it is part of a reorganization within the meaning of section 368(a) and no gain or loss is recognized by the shareholder by reason of the reorganization. In such a reorganization, under section 354(a)(1), a shareholder does not recognize any gain or loss upon the exchange of stock of a corporation a party to the reorganization solely for stock of such a corporation. However, if the shareholder receives money or other property (commonly referred to as "boot") in the exchange, the shareholder recognizes gain (but not loss) in an amount not exceeding the value of the boot. Thus, in the case of a reorganization with boot, the excise tax would apply at least to the extent that the boot gives rise to the recognition of gain by the shareholder. However, since the exception only applies to the extent that "no" gain or loss is recognized by the shareholder, the excise tax would appear to apply more broadly such that the full amount of boot received by the shareholder is treated as consideration in a Covered Repurchase if the shareholder recognizes any gain on its stock as a result of the reorganization (i.e., even if the amount of gain recognized is less than the amount of boot received). Furthermore, the parties to a reorganization involving a target corporation whose stock is publicly traded are unlikely to know any particular shareholder's tax basis in stock in the target corporation, and thus cannot be expected to know whether a particular shareholder has realized gain or loss (let alone the amount of gain) in the target stock. Without this information, the excise tax can be expected to be imposed on the full amount of boot issued in the reorganization. Moreover, subjecting the full amount of stock acquired with the boot would appear to be consistent with the underlying intent of the excise tax. We note that the reorganization exception could also be interpreted to mean that the tax applies even more broadly to the entire amount of stock consideration received by the shareholder if the shareholder recognizes any gain or loss. However, such interpretation appears inconsistent with the purpose of the excise tax.

Finally, the Senate bill does not appear to contain an exception for a corporation's acquisition of its stock for stock of a controlled corporation in a "split-off" under section 355 to the extent such distribution does not occur in connection with a reorganization under section 368(a)(1)(D).

Extension of limitation on excess business losses of noncorporate taxpayers

Limitation on excess business losses of noncorporate taxpayers

In general, the section 461(l) excess business loss limitation restricts the extent to which trade or business deductions of a noncorporate taxpayer may be used to offset other income of the taxpayer. The excess business loss limitation is calculated by taking aggregate deductions attributable to trades or businesses over the sum of the aggregate gross income or gain attributable to trades or businesses, plus an annual threshold amount. Under current law, any excess business deduction which is suspended is carried over to the taxpayer's next tax year as a net operating loss (NOL).

The current version of section 461(l) was originally enacted through the TCJA. Through the TCJA, the excess business loss limitation applied to any tax year beginning after December 31, 2017, and before January 1, 2026. Later, as part of pandemic relief efforts, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) amended section 461(l) so the excess business loss limitation would only apply for tax years beginning after December 31, 2020, and before January 1, 2026. Thereafter, the American Rescue Plan Act of 2021 (ARPA) extended the application of section 461(l) for one additional year through tax years beginning before January 1, 2027.

Taken together, under current law—post-CARES Act and post-ARPA—the excess business loss regime applies for tax years beginning after December 31, 2020, and before January 1, 2027. The Senate bill would extend the application of section 461(l) for two additional years such that section 461(l) would apply for tax years beginning after December 31, 2020, and before January 1, 2029.

KPMG observation

Virtually all of the individual-related provisions stemming from TCJA are set to sunset as of December 31, 2025. However, as part of a means to increase revenue for the government in 2021 through the enactment of the ARPA, Congress singled out section 461(l) from other TCJA-related provisions by extending the excess business loss limitation for one additional year. In so doing, Congress essentially decoupled the sunset date for section 461(l) from those other TCJA-related tax provisions.

The Senate bill's extension of the application of section 461(l) for another two years, through December 31, 2028, would raise additional revenue for the government, and would create further separation between the sunset date for other TCJA-related provisions and section 461(l). This piecemeal pattern of extending section 461(l) potentially opens the door for future extensions of section 461(l) – as a standalone item separate and apart from other TCJA-related provisions – as the need may arise to raise additional revenue in future legislation.

KPMG observation

Outside of extending the period for which section 461(l) applies by two years, the Senate bill does not make any other modification to the operation of section 461(l) or provide any additional definitional clarity to section 461(l).

Prior proposed changes to section 461(l) included a significant modification to the way the excess business loss would be carried over to a subsequent year. Under the prior proposals, instead of the excess business loss becoming an NOL in the taxpayer's following year, the excess business loss would become a deduction attributable to a trade or business loss which would be subject to the section 461(l) limitation in the taxpayer's subsequent tax year. The Senate bill does not contain such a modification.

Further, additional questions remain concerning the application of section 461(l) even after certain technical corrections and clarifying elements were provided through the CARES Act. The Senate bill does not provide any further clarification for these open questions.

Unlike other individual-related TCJA provisions (which are generally set to sunset as of December 31, 2025), with the Senate extension of section 461(l) out through the end of 2028, there would be more roadway ahead for taxpayers in grappling with section 461(l) than there would be left behind in the rearview mirror. Query if the continued Congressional extension of section 461(l) might increase the urgency for Treasury / IRS to issue regulations.

Enhancement of Internal Revenue Service resources

The Senate bill would provide $78.9 billion in additional funding to the IRS, including $45.6 billion for tax enforcement, $25.3 billion for operations support, $4.75 billion for business systems modernization, and $3.2 billion for taxpayer services. The additional funding would be over the 10-year budget window commencing with the fiscal year ending September 30, 2022, through the fiscal year ending September 30, 2031, and would be in addition to other funding otherwise available to the IRS.

In a footnote to its cost estimate of the bill, CBO indicated that it expects the increase in IRS funding for tax enforcement activities to result in increased revenues. Although those revenues are not included in its official estimate of the Senate bill under current scoring guidelines, the CBO indicated that it estimates that, as a result of the increased spending, revenues would increase by approximately $203.7 billion over the 10-year period. (Listen to a June 24, 2022 KPMG podcast: **Spend money to make money: IRS funding proposals**.)

The Senate bill specifically designates the increase in IRS appropriations to be used as follows:

- $3.2 billion for taxpayer services, including pre-filing assistance and education, filing and account services, and taxpayer advocacy services

- $45.6 billion for tax enforcement activities, including determining and collecting taxes, providing legal and litigation support, conducting criminal investigations, providing digital asset monitoring and compliance activities, enforcing criminal statutes for violations of internal revenue laws and other financial crimes

- $25.3 billion for necessary expenses to support taxpayer service and enforcement programs, including facilities services; headquarters and other IRS-wide administration activities; telecommunications; and information technology development, enhancement, operations, maintenance, and security

- $4.75 billion in additional funding would provide for business systems modernization, including development of callback technology and other technology to provide a more personalized customer service (but not including the operation and maintenance of legacy systems)

In addition, for fiscal year 2022, section 13802 of the Senate bill provides $500 million to the IRS out of any money in the Treasury not otherwise appropriated (to remain available until September 30, 2031) for necessary expenses to carry out Subtitle D of the bill (relating to energy security) and the amendments made by subtitle D.

The Senate bill also designates $15 million of additional funding related to designing an IRS-run free "Direct Efile" tax return system. The bill requires the IRS to deliver to Congress within nine months of the date of enactment a report detailing:

- The cost (including options for differential coverage based on taxpayer adjusted gross income and return complexity) of developing and running a free direct efile tax return system, including costs to build and administer each release, with a focus on multi-lingual and mobile-friendly features and safeguards for taxpayer data;
- Taxpayer opinions, expectations, and level of trust, based on surveys, for such a free direct efile system; and
- The opinions of an independent third-party on the overall feasibility, approach, schedule, cost, organizational design, and IRS capacity to deliver such a direct efile tax return system.

In addition to funding for the IRS, the Senate bill would provide:

- $403 million to the Treasury Inspector General for Tax Administration for necessary expenses in carrying out the Inspector General Act of 1978,
- $104.5 million to the Treasury Department Office of Tax Policy for necessary expenses to carry out functions related to promulgating regulations under the Code of 1986,
- $153 million to the U.S. Tax Court for necessary expenses, and
- $50 million to the Departmental Offices of the Treasury Department for expenses necessary to provide for oversight and implementation support for IRS actions to implement the amendments by the bill

A similar appropriation to enhance IRS funding was included in the House BBBA. The Senate bill differs from the House BBBA, however, in some key respects.

- The Senate bill does not require the IRS Commissioner to submit an operational plan to Congress detailing how the increased IRS funding would be spent. The House BBBA had included a mandate that the IRS Commissioner submit a multi-year operational plan and provide quarterly updates on the plan to Congress, subject to a $100,000 reduction in funding for each day the Commissioner failed to timely comply with those requirements.

- The Senate bill does not include a provision specifically allowing the Treasury Secretary to use the increased IRS funding to take certain personnel actions. The House BBBA had provided that the Treasury Secretary could use the funding made available to the IRS to take certain personnel actions, including utilizing direct hire authority to recruit and appoint qualified applicants, without regard to any notice or preference requirements; to appoint not more than 200 individuals under streamlined critical pay authority to positions critical to taxpayer services, tax enforcement activities, or IRS operations support; and to appoint, without approval of the Office of Personnel Management, not more than 300 individuals to critical pay positions subject to specific statutory caps on basic pay and total annual compensation.

KPMG observation

This bill represents a very significant increase in funding intended to provide the IRS with a sustained investment over the next decade with a clear goal of improving the agency's overall performance. In the short run, however, the increase in funding may place a strain on current IRS operations as the organization manages its multiple ongoing challenges while it simultaneously recruits, hires, trains and assimilates large numbers of new employees and modernizes its computer systems.

Superfund

For periods beginning after December 31, 2022, the bill would permanently reinstate the Hazardous Substance Superfund tax ("Superfund tax") at a rate of 16.4 cents per barrel. The Superfund tax would be indexed for inflation beginning in calendar year 2024.

The revenues from the tax would be dedicated to the Hazardous Substance Superfund Trust Fund.

The JCT has estimated that this proposal would raise approximately $11.7 billion over a 10-year period.

KPMG observation

Upon reinstatement, domestic crude and imported petroleum products would be subject to both the 16.4 cents-per-barrel Superfund tax and the 9 cents-per-barrel Oil Spill Liability Trust Fund Tax ("Oil Spill tax"). Thus, in calendar year 2023, the total tax per barrel would be 25.4 cents per barrel if the Senate bill were enacted in its current form.

Climate-related tax provisions

Basic overview

The climate provisions in the Senate bill would make many of the same, or substantially similar, changes to the clean energy tax incentives as were proposed in the House BBBA. Read the **KPMG report** [PDF 2.5 MB] on the House BBBA.

Notably, however, the Senate bill does not include all of the new or updated incentives proposed in the House BBBA. In particular, it does not include the ability to treat renewable energy assets as "good" assets for publicly traded partnership testing purposes. It also does not include an investment tax credit (ITC) for transmission line buildout and upgrades, although interconnection property with capacity under 5 MW is included as ITC eligible and there are also provisions for loans and grant financing for transmission lines.

Direct pay and transferability

One of the more fundamental changes to the energy space proposed by the House BBBA was the "direct pay" election through which taxpayers could make most energy tax credits refundable. The House BBBA's direct pay

provisions were viewed, at least in part, as a way to reduce reliance on tax equity financing to monetize credits when taxpayers did not have sufficient tax liability on their own to absorb the relevant credits in a timely manner.

The Senate bill also would provide for "direct pay" but in a scaled-back manner as compared to the House BBBA. In particular:

- Direct pay would be available to credit eligible projects owned by certain tax-exempt and government entities
- Direct pay would be available to the other taxpayers only for the following specific credits:
    - Section 45Q credit for carbon capture and sequestration
    - Section 45V credit for clean hydrogen production
    - Section 45X credit for the advanced manufacturing production tax credit

The Senate bill proposes to allow taxpayers to sell their tax credits to third parties. This novel legislative proposal appears to be a trade-off for the more limited direct pay provisions, and likely is intended to reduce the necessity for tax equity financing. Taxpayers would be permitted to transfer all or a portion of certain tax credits to unrelated parties in exchange for cash consideration that would be excluded from the selling taxpayer's income.

Other provisions

The Senate bill also would make various other changes to incentives in the energy space. These include enhancements and modifications to:

- Section 179D energy efficient commercial building deduction
- Credits for electric vehicles and charging stations
- Individual credits for nonbusiness energy property, energy efficiency improvements, and new energy efficient homes

Extension and modification of credit for electricity produced from certain renewable resources

Current law

Wind energy

Under current law, a taxpayer must have begun construction on a wind facility prior to 2022, to qualify for the production tax credit ("PTC"). The PTC is claimed over a 10-year credit period beginning on the date the facility is placed in service. The PTC amount for each tax year during the credit period is the product of the amount of energy produced by the facility and sold to unrelated persons, multiplied by the applicable PTC rate, which is subject to adjustment annually for inflation.

The PTC rate for wind facilities is in the process of phasing down, based on the year that the project began construction:

- Began construction in 2017—80% of the regular PTC rate
- Began construction in 2018—60% of the regular PTC rate
- Began construction in 2019—40% of the regular PTC rate
- Began construction in 2020 or 2021—60% of the regular PTC rate

A taxpayer may elect the ITC in lieu of the PTC for wind facilities. For onshore wind facilities, the ITC rate phases down on a schedule comparable to the PTC.

Special rules apply to offshore wind facilities. A taxpayer that begins construction on an offshore wind farm after 2016 and before 2026 is eligible to claim an ITC at the full statutory credit rate of 30%. Offshore wind facilities that begin construction after 2021 are not currently eligible for the PTC.

Other renewables

Under current law, the PTC is available for geothermal, biomass, trash combustion, landfill gas, hydropower, and wave and tide power if construction of the project began prior to 2022. While these types of qualified facilities are not subject to the phase-down rules applicable to wind facilities, certain of these facilities are only eligible for a reduced PTC equal to 50% of the regular PTC rate.

As with wind facilities, taxpayers may elect the ITC in lieu of the PTC for these facilities.

Legislation

PTC modifications

In the Senate bill, the PTC would be extended and modified in various ways. For all qualified facilities eligible for the extended PTC, the Senate bill would create a multi-tiered credit structure, consisting of a base credit rate of 0.5 cents per kilowatt hour and, alternatively, a bonus credit rate of 2.6 cents per kilowatt hour (after the adjustment for inflation) that satisfy new prevailing wage and apprenticeship requirements, which would be further increased if new domestic content or energy community requirements are satisfied. Projects could continue to elect the ITC instead of the PTC, as under current law.

The extended PTC provisions would apply to wind (including offshore wind), geothermal, biomass, trash combustion, landfill gas, hydropower, and wave and tide power projects that are placed in service after 2021 and begin construction prior to 2025. In addition, the Senate bill would revive the PTC eligibility of solar energy facilities that are placed in service after 2021 and begin construction prior to 2025. The Senate bill would also expand qualified hydroelectric and marine and hydrokinetic energy to include energy derived from pressurized water used in a pipeline for the distribution of water for agricultural, municipal, or industrial consumption, and not primarily for the generation of electricity.

Qualified hydroelectric and marine and hydrokinetic energy facilities would no longer be subject to the 50% PTC rate reduction. However, open-loop biomass, landfill gas and trash combustion facilities would continue to be subject to the 50% rate reduction.

The Senate bill would also narrow the rule requiring the reduction of PTCs for other government subsidized financing. Under current law, the PTC is required to be reduced by the lesser of 50% or the ratio (expressed as a percentage) of government grants, tax-exempt bond financing and any other subsidized financing to total capital expenditures. Under the Senate bill, the reduction would be reduced to the lesser of: (1) 15% or (2) the percentage of tax-exempt bond financing relative to total capital expenditures. This provision is effective for all facilities that begin construction after enactment of the legislation.

A new emission-based investment tax credit would apply to projects that begin construction after 2024. See Clean Electricity Production and Investment Credits.

Prevailing wage and apprenticeship requirements

In order to claim the PTC at the bonus credit rate, the taxpayer would have to satisfy:

- A prevailing wage requirement for the full construction period and for the duration of the 10-year PTC credit period, and
- Apprenticeship requirements during the construction of the project

For purposes of the PTC, and for other energy credit provisions in the Senate bill, the prevailing wage requirement means that taxpayers must ensure that any laborers and mechanics employed by contractors and subcontractors are paid prevailing wages during construction and, in some cases, for the alteration and repair of such project for a period of time after the project is placed into service. If a taxpayer fails to satisfy these requirements, the taxpayer may cure the failure by compensating each worker the difference between wages paid and the prevailing wage, plus interest, in addition to paying a $5,000 penalty to the Treasury for each worker paid below the prevailing wage during the tax year. If the failure to pay prevailing wages is due to intentional disregard, the taxpayer must pay three times the pay differential to laborers and pay a $10,000 penalty per worker within 180 days of the date of determination of noncompliance (hereinafter the "Prevailing Wage Requirement").

For purposes of the PTC and other energy credit provisions in the Senate bill, the apprenticeship requirement requires taxpayers to ensure that no fewer than the applicable percentage of total labor hours are performed by qualified apprentices. The applicable percentage for purposes of this requirement would be 10% for projects for which construction begins in 2022. This rate would be increased to 12.5% in 2023, and 15% thereafter. In the event a taxpayer fails to satisfy these requirements, the taxpayer may cure the failure by paying a $50 penalty for each labor hour for which the requirement is not satisfied ($500 if the government determines that the failure to follow the requirement was due to intentional disregard). There is also an exemption process in the event there is a lack of available qualified apprentices. (Hereinafter the "Apprenticeship Requirement").

Projects that

- commence construction prior to 60 days after the date that the government issues prevailing wage or apprenticeship guidance ("Safe Harbor Period"), or
- have a maximum net output of less than one megawatt

would be treated as eligible for the bonus rate even if the Prevailing Wage and Apprenticeship Requirements aren't satisfied

Domestic content and energy community rules

For purposes of the PTC, and for certain other energy credit provisions in the Senate bill, the domestic content provision would provide a credit increase of 10% of the amount otherwise allowable with respect to such facility (e.g., from 2.6 cents per kilowatt hour to 2.86 cents (before rounding) per kilowatt hour).

The domestic content rule requires taxpayers to ensure that facilities are composed of steel, iron, or products manufactured in the United States. For purposes of these requirements, a manufactured product is deemed to have been manufactured in the United States if an applicable percentage of the total cost of the components of such product is attributable to components that are mined, produced, or manufactured in the United States. The applicable percentage would be 40%, except for offshore wind, which would be 20%. These rules are to be applied in a manner consistent with the United States' obligations under international rules ("Domestic Content Rules").

The Senate bill would also provide a credit increase of up to 10% of the amount otherwise allowable for a facility

located in an energy community. An energy community includes (1) a brownfield site, (2) an area which has or had a certain amount of employment or tax revenues related to the extraction, processing, transport, or storage of coal, oil, or natural gas and has an above-average unemployment rate, or (3) a census tract or adjacent area in which a coal mine has closed after 1999 or a coal-fired electric generating unit has been retired after 2009.

Transferability and direct pay

Notably, for tax years beginning after 2022, the Senate bill provides that a taxpayer may elect to transfer the PTC (or any portion of the PTC) to an unrelated taxpayer for a cash payment and exclude such sale proceeds from gross income. The transferability election must be made annually and separately with respect to each facility.

In addition, certain tax-exempt or governmental entities may elect for the PTC to be considered a direct payment of tax and essentially refundable.

Extension and modification of energy credit

Current law

Solar energy

Under current law, solar energy facilities are eligible for an investment tax credit (ITC) based on a percentage of eligible capitalized costs. The ITC is a one-time credit claimed in the year the eligible property is placed in service and is subject to recapture in declining amounts over a five-year period if the property ceases to be eligible for the ITC or the taxpayer claiming the credit disposes of the property during the recapture period.

Similar to the PTC, the ITC rate for solar facilities is in the process of phasing down, based on the year that the project began construction:

- Began construction in 2020, 2021 or 2022—26% ITC rate
- Began construction in 2023—22% ITC rate
- Began construction in 2024 or later—10% ITC rate

Any project placed in service after 2025, no matter when construction began, is eligible for a 10% ITC.

Other technologies

Fuel cell powerplants, fiber optic solar property, waste energy recovery property and small wind projects qualify for a 26% ITC rate if construction begins in 2021 or 2022, and a 22% ITC rate if construction begins in 2023. No credit is available for projects that are placed in service after 2025 or that begin construction after 2023.

A 10% ITC is available for combined heat and power property, microturbines and geothermal heat pumps that applies if construction begins prior to 2024.

Legislation

Similar to the PTC, the Senate bill would extend and modify the ITC in various ways. For all qualified energy property eligible for the extended ITC, the Senate bill would create a multi-tiered credit structure, consisting of a base credit rate of 6% of the basis of qualified energy property (2% for microturbines) and, alternatively, a bonus credit rate of 30% of the basis of qualified energy property (10% for microturbines) that satisfy new prevailing

wage and apprenticeship requirements, which would be further increased if new domestic content or energy community requirements are satisfied.

For solar, fuel cell, microturbines, combined heat and power system property, small wind, and waste energy recovery property, the ITC would be extended to projects that are placed in service after 2021 and begin construction prior to 2025. For geothermal heat pumps, the credit would be extended to projects that are placed in service after 2021 and begin construction prior to 2035, provided that the credit rate would be phased down to 5.2% for facilities that commence construction in 2033 and 4.4% for facilities that commence construction in 2034. The bonus credit rate for geothermal heat pumps similarly would phase down to 26% in 2033 and 22% in 2034.

Qualified energy property eligible for the ITC extension would be expanded to include energy storage technology (including thermal energy storage property), linear generators, microgrid controllers, dynamic glass, interconnection property and biogas property. The Senate bill also provides that certain taxpayers may elect to have energy storage technology (as defined in proposed section 48(c)(6)) treated not as public utility property under Section 50(d)(2), so long as the energy storage technology has a maximum capacity of more than 500 kilowatt hours. For property that is not currently eligible for the ITC, the Senate bill provision would apply to property placed in service after 2022.

The Senate bill would reinstate a reduction of the ITC for other tax-subsidized financing. Similar to the PTC provision, the Senate bill would reduce the ITC by the lesser of: (1) 15% (not percentage points) or (2) the percentage of tax-exempt bond financing relative to total capital expenditures. This provision is effective for all facilities that begin construction after enactment of the legislation

A new emission-based investment tax credit would apply to projects that begin construction after 2024. Read **Clean electricity production and investment credits**.

Prevailing wage and apprenticeship requirements

In order to claim the ITC at the bonus credit rate, the taxpayer would have to satisfy:

- Prevailing wage requirement and
- Apprenticeship requirement

These requirements are described under **Extension and modification of credit for electricity produced from certain renewable resources**. The 30% bonus rate would be available to eligible projects even if the taxpayer doesn't satisfy these rules as long as they begin construction during the Safe Harbor Period. Notably, the Prevailing Wage Requirement applies to alterations and repairs only during the five-year recapture period, as compared to the 10-year PTC credit period.

The Senate bill provides for a recapture of the ITC if the Prevailing Wage Requirement is not followed for alterations and repairs during the five-year period after the completion of construction.

Domestic content and energy community rules

The Senate bill provision would apply the Domestic Content Rules to the ITC. If the project meets those requirements, the Senate bill would provide a base credit increase of two percentage points of the amount otherwise allowable, or a bonus credit increase of 10 percentage points to the amount otherwise allowable with respect to such facility. The Domestic Content Rules are explained in the **Extension and modification of credit for electricity produced from certain renewable resources**.

The Senate bill would also increase the available ITC for projects that are located in an energy community. An

energy community includes (1) a brownfield site, (2) an area which has or had a certain amount of employment or tax revenues related to the extraction, processing, transport, or storage of coal, oil, or natural gas and has an above-average unemployment rate, or (3) a census tract or adjacent area in which a coal mine has closed after 1999 or a coal-fired electric generating unit has been retired after 2009. If the project meets the energy community requirements, the Senate bill would provide a base credit increase of two percentage points of the amount otherwise allowable, or a bonus credit increase of 10 percentage points of the amount otherwise allowable with respect to such facility.

Transferability and direct pay

The credit would be transferable for projects placed in service after 2022.

Certain federal, state and local governments, and certain tax-exempt entities could elect to treat the credit as refundable.

KPMG observation

The Senate bill would make sweeping changes to the ITC and PTC. Most significantly, the legislation would link eligibility for full credit rates to requirements to pay prevailing wages and provide apprenticeships. It would also provide an increased credit for projects that satisfy domestic content requirements. Likewise, the ability to transfer credits for cash payments would likely have a radical impact on the manner in which the capital costs of these projects are financed.

These Prevailing Wage and Apprenticeship Requirements would likely affect the economics of developing these projects—accessing the higher credit rates would likely result in projects that are also more expensive to build, while failure to qualify for the higher credit rates would result in a significantly lower credit amount than under the current regimes. This is particularly true for offshore wind facilities under development, which currently benefit from special rules. For the ITC, it will be interesting to see how meeting labor and domestic content requirements could, depending on the cost, increase ITC eligible basis. Furthermore, the need to substantiate and adequately monitor compliance with these standards would be new and potentially difficult for both taxpayers and the IRS. These requirements will be closely watched as this legislative process advances and IRS implementation begins.

The expansion of PTC eligibility to solar energy projects likely would provide welcome flexibility for projects for which the PTC would be more valuable than the ITC over the 10-year credit period; however, the PTC requirement that electricity is ultimately sold to third parties would make this option unavailable to solar projects that generate energy for use by its owner. Additionally, because the PTC is not subject to normalization rules, the option to claim the PTC in lieu of the ITC may be favored by regulated utilities developing solar projects. The normalization rules require regulated utilities to spread the benefit of investment tax credits and accelerated depreciation over the useful life of an asset. The normalization rules are intended to allow utilities to retain the economic benefit of the tax incentives to make additional investments, rather than immediately pass the benefits on to ratepayers. It is argued, however, that the rules often have the effect of making it less cost effective for utilities to make their own ITC eligible investments in comparison to unregulated entities. Also beneficial to regulated utilities is the election available to elect out of the normalization rules for energy storage projects in excess of 500 kilowatt hours.

The direct pay and transferability features added to the ITC and PTC (and other credits) by the Senate bill are notable and would certainly result in changes to the way credits are monetized. For purposes of the PTC and ITC, direct pay is only available to tax exempts and certain government entities, which is a far narrower application of direct pay as compared to the House passed Build Back Better Act. Direct pay in this context

would, however, incentivize entities to develop and install renewable energy who have never before had access to these incentives. Transferability, on the other hand, is available to all taxpayers who are otherwise eligible to claim the ITC and PTC. Transferability has never been available for federal tax credits and it remains to be seen how the market for the tax credits and the associated tax credit sale transactions develop. It also remains to be seen how transferability would impact the use of tax equity financing.

Finally, the effective dates of the changes in the legislation should be considered carefully. For the most part, the changes would be effective for projects that are placed in service after December 31, 2021, but for those newly eligible projects, it is effective for projects that are placed in service after December 31, 2022. Thus, the new regime would apply to many projects already under development and construction that may have been financed under assumptions based on current law. Developers would need to consider the impact of the effective dates on change in law provisions in executed tax equity financing arrangements and the impact of credit rates on model assumptions. The Senate bill helpfully provides quasi-grandfathering rule that effectively exempts projects that are under construction before guidance is issued on the Prevailing Wage and Apprenticeship Requirements from those requirements in order to qualify for the bonus rate.

Increase in energy credit for solar and wind facilities placed in service in connection with low-income communities

The Senate bill would add a provision for an enhanced ITC for solar and wind projects (including associated energy storage technology) with a maximum output of less than 5 megawatts (alternating current) that receive an allocation of environmental justice solar capacity limitation from the Secretary.

The annual capacity limitation would be 1.8 gigawatts for calendar years 2023 and 2024 and zero for calendar years thereafter. The annual capacity limitation would be increased by the amount of any unused allocations from the preceding calendar year, but not beyond 2024. Projects receiving an allocation of environmental justice solar capacity limitation would increase their energy credit percentage by 10 percentage points credit if located in a low-income community (as defined within the New Markets Tax Credit program under section 45D) or by 20 percentage points credit if such project is a qualifying low-income residential building project or a low-income economic benefit project. This section would take effect January 1, 2023.

The credit would be transferable for projects placed in service after 2022.

Certain federal, state and local governments and certain tax-exempt entities could elect to treat the credit as refundable.

Extension and modification of credit for carbon oxide sequestration

The Senate bill would extend and modify the credit for carbon oxide sequestration facilities.

Current law

Under current law, section 45Q allows credits to taxpayers who capture and sequester qualifying carbon oxide. The amount of the credit depends on how the captured carbon oxide is used. For carbon oxide disposed of in permanent storage and not used in an enhanced oil recovery (EOR) project, the credit increases to $50 per metric ton by 2026 and is adjusted for inflation in later years. For carbon oxide that is used as a tertiary injectant in an EOR project or utilized in a commercial product or process, the credit increases to $35 per metric ton in 2026 and

is adjusted for inflation in later years.

Under section 45Q, facilities must meet certain minimum capture thresholds to claim the credit. For qualified facilities other than electric generating facilities, taxpayers generally must capture and sequester 100,000 metric tons of carbon oxide per tax year. For electric generating facilities, taxpayers must capture and sequester at least 500,000 metric tons of carbon oxide per tax year. A lower threshold of 25,000 metric tons is available if the carbon oxide is deployed in utilization projects. Qualified facilities must begin construction prior to January 1, 2026. Taxpayers may claim these credits for a 12-year period from the date the carbon capture equipment was originally placed in service.

Legislation

The Senate bill would extend the section 45Q credit for projects that commence construction prior to 2033.

The credit rates are as follows:

- Secure geological storage: Base credit rate of $17; bonus credit rate of $85 per metric ton
- EOR projects or utilization: Base credit rate of $12; bonus credit rate of $60 per metric ton
- Direct air capture (secure storage): Base rate of $36; bonus rate of $180 per metric ton
- Direct air capture (EOR/utilization): Base rate of $26; bonus rate of $130 per metric ton

In order to claim the section 45Q credit at the bonus credit rate, taxpayers would have to satisfy the:

- Prevailing Wage Requirement for the 12-year credit period, and
- Apprenticeship Requirements during the construction of the project

Projects that commence construction prior to 60 days after the Secretary publishes guidance with respect to these requirements would be treated as eligible for the bonus rate if such carbon capture equipment is installed at a qualified facility which also began construction prior to the 60-day date.

In addition, in the case of a qualified facility placed in service before 2023, for which additional carbon capture equipment is placed in service after 2022, the Senate bill would provide the new credit rates for the incremental increase in the amount of qualified carbon oxide captured with additional carbon capture equipment installed at a qualified facility.

The Senate bill would also modify the minimum capture thresholds under section 45Q as follows:

- Direct air capture facilities must capture no less than 1,000 metric tons of carbon oxide per year.
- Electricity generating facilities must capture no less than 18,750 metric tons of carbon oxide and, with respect to any carbon capture equipment for the applicable electric generating unit, have a capture design capacity of not less than 75% of baseline carbon oxide production.
- Other industrial facilities must capture no less than 12,500 metric tons of carbon oxide.

These changes are effective for facilities or equipment which begins construction after enactment of the legislation.

The Senate bill also adds definitions for an applicable electric generating unit and baseline carbon oxide production.

The Senate bill would provide for a reduction of the credit in the case of projects financed with tax exempt bonds.

The Senate bill would sunset the prior section 45Q credit related to carbon capture equipment placed in service before February 9, 2018, at the earlier of 1) January 1, 2023, or 2) the end of the calendar year when the Secretary, in consultation with the Administrator of the Environmental Protection Agency, certifies that a total of 75 million metric tons of qualified carbon oxide have been taken into account.

The Senate bill would allow an election to have the 12-year credit period begin on the first day of the first tax year in which the credit is claimed if the carbon capture equipment is placed in service on or after February 9, 2018, no taxpayer has claimed the credit with respect to such carbon capture equipment for any prior tax year, the qualified facility is in a federally-declared disaster area, and the disaster results in a cessation of the operation of the facility after the original placed in service date. This provision would apply to carbon oxide captured and disposed of after 2021.

Notably, for carbon capture equipment placed in service after 2022, the section 45Q credit would be refundable under a direct pay election.

If a taxpayer elects refundability, it must do so in the first year that the eligible equipment is placed in service. The election remains in effect for five years unless the taxpayer revokes the election. If the taxpayer does so, it cannot make another election until year six. The election is made separately for each project. Such election may only be made with respect to any tax years beginning before 2033.

In addition, the Senate bill provides that a taxpayer may elect to transfer the credit (or any portion of the credit) to an unrelated taxpayer and exclude such sale proceeds from gross income. For any tax years for which a direct pay election is made, taxpayers may not also elect to transfer the credit. The election for transferability would be made annually and with respect to each facility for which the credit is determined.

Unless otherwise noted, these Senate bill provisions would be effective for facilities or equipment the construction of which begins after 2022.

KPMG observation

Carbon capture projects continue to generate significant interest from developers and investors. The economics of these projects in most cases rely on the availability of a subsidy because for many of these projects there is no revenue stream associated with the capture activity.

The Senate bill will significantly increase credit rates if certain prevailing wage and apprenticeship requirements are met. Relatedly, however, the credit rate would decrease if proposed prevailing wage and apprenticeship requirements are not met.

In addition, the availability of direct pay would be a positive development if projects are able to satisfy the prevailing and wage and apprenticeship requirements. Moreover, taxpayers could elect to transfer the credit to an unrelated taxpayer for tax-exempt gross income, in lieu of direct pay. For section 45Q, the sheer volume of potential tax credits available for these projects almost necessitates the use of tax equity. Without the option of refundability and transferability, however, typical tax equity investors have been proceeding carefully for a variety of reasons, including novel technology, offtake and storage uncertainty, and commodity price risk. For developers, the options of direct pay or a transferable section 45Q tax credit could make these projects significantly less complicated to finance.

Also note that the Senate bill does not include the availability of an increased credit for domestic content.

In addition, the proposed modifications to the minimum capture thresholds would be a welcome change for many taxpayers. The current law minimum capture thresholds have proven difficult to satisfy for some projects.

The effective date of the increased credit rates should be carefully noted – the increased rates are effective for facilities or equipment placed in service after 2022.

Zero-emission nuclear power production credit

The Senate bill includes a new credit under section 45U for the production of electricity from an existing qualified nuclear power facility for a 10-year period beginning with electricity produced and sold after 2023.

A qualified nuclear power facility is any nuclear facility that is owned by the taxpayer, that uses nuclear energy to produce electricity, was not previously awarded a credit allocation under section 45J and is placed in service before the date of enactment.

If Prevailing Wage Requirements are followed for alternations and repairs during the 10-year credit period a credit equal to 1.5 cents per kilowatt hour is available. The credit rate is reduced as the sales price of electricity increases. The phase-out operates to reduce the credit by 16% of the excess of gross receipts from electricity produced and sold over the product of 2.5 cents and the amount of electricity sold. Certain adjustments to the calculation are required for amounts received and reductions made with respect to the qualified nuclear power facility from a zero-emission credit program.

If the Prevailing Wage Requirements are not satisfied, a credit equal to 0.3 cents per kilowatt hour is available and is subject to the same reduction formula. Rates will be inflation adjusted.

The Senate bill provides that a taxpayer may elect to transfer the 45U credit (or any portion of the credit) to an unrelated taxpayer and exclude such sale proceeds from gross income. In addition, certain tax-exempt or governmental entities may elect for the 45U credit to be considered a direct payment of tax and essentially refundable.

This provision would terminate for tax years beginning after 2032.

Incentives for diesel and alternative fuels

Extension of second-generation biofuel incentive

The Senate bill would extend the second-generation biofuel producer nonrefundable income tax credit of up to $1.01 per gallon to biofuel production that occurs after 2021 and prior to 2025.

Sustainable aviation fuel credit

For periods beginning after December 31, 2022, and before January 1, 2025, the bill would provide tax incentives for each gallon of sustainable aviation fuel in a qualified mixture that is sold for use or used as a fuel in aviation during the tax year. The credit would be:

- $1.25 per gallon of sustainable aviation fuel that has been certified as having a lifecycle greenhouse gas

emissions reduction percentage of at least 50% in comparison with petroleum-based jet fuel, pursuant to specified standards, plus

- A supplementary credit of up to $0.50 per gallon for each percentage point by which the lifecycle greenhouse gas emissions reduction percentage exceeds 50%

The bill provides that "qualified mixture" would mean a mixture of sustainable aviation fuel and kerosene that is produced in the United States, in the ordinary course of the producer's trade of business, for sale or use in an aircraft and is transferred into the fuel supply tank of the aircraft in the United States. "Sustainable aviation fuel" would mean liquid fuel, excluding the kerosene portion, that meets ASTM International Standard D7566 or the Fischer Tropsch provisions of ASTM International Standard D1655, Annex A1; however, it is not derived from palm fatty acid distillates, petroleum, or coprocessing specified applicable material in certain cases. Sustainable aviation fuel is excluded from the definitions of biodiesel and renewable diesel.

The lifecycle greenhouse gas emissions reduction percentage would be determined, in comparison with petroleum-based jet fuel, in accordance with the most recent Carbon Offsetting and Reduction Scheme for International Aviation which has been adopted by the International Civil Aviation Organization with the agreement of the United States, or any similar methodology which satisfies the criteria under section 211(o)(1)(H) of the Clean Air Act (42 U.S.C. 7545(o)(1)(H)).

The incentive would be claimed by the mixture producer in only one of the following ways:

- A nonrefundable general business tax credit under new section 40B,
- An excise tax credit against section 4081 excise tax (and payment in excess of excise tax liability) under sections 6426 and 6427, or
- A refundable income tax credit under section 34.

The producer would be required to be registered by the IRS under section 4101 as a condition to allowance of the incentives.

The section 40B credit would be included in income under section 87.

The JCT has estimated that this proposal would lose approximately $49 million over a 10-year period.

KPMG observation

Beginning in 2025, upon expiration of the sustainable aviation fuel credit under section 40B and the excise tax credit under section 6426, a credit for sustainable aviation fuel would apply in the new "clean fuel production credit" under section 45Z.

Clean hydrogen

The Senate bill would create a new tax credit for the production of clean hydrogen produced by a taxpayer at a qualified clean hydrogen production facility during the 10-year period beginning on the date such facility is placed in service. The new tax credit, the "clean hydrogen production credit" under new section 45V, would be effective for hydrogen produced after 2022.

For any tax year, the credit would be an amount equal to the product of:

- The applicable amount multiplied by
- The kilograms of qualified clean hydrogen produced by the taxpayer at a qualified clean hydrogen production facility

The base credit would be an amount equal to $0.60. There would be a bonus credit of $3.00 if Prevailing Wage and Apprenticeship Requirements were satisfied. An explanation of these rules can be found under Extension and modification of credit for electricity produced from certain renewable resources

Projects that began construction prior to the date that is 60 days after the Secretary publishes guidance with respect to Prevailing Wage and Apprenticeship Requirements would be treated as eligible for the bonus rate.

The credit rate would be indexed for inflation.

The applicable percentage would be as follows:

- 20% for qualified clean hydrogen produced through a process that results in a lifecycle greenhouse gas emissions rate of 2.5 kg of CO_2-e to 4 kg of CO_2-e per kg of hydrogen;
- 25% for qualified clean hydrogen produced through a process that results in a lifecycle greenhouse gas emissions rate of 1.5 kg of CO_2-e to 2.5 kg of CO_2-e per kg of hydrogen;
- 33.4% for qualified clean hydrogen produced through a process that results in a lifecycle greenhouse gas emissions rate of 0.45 kg of CO_2-e to 1.5 kg of CO2-e per kg of hydrogen; and
- 100% for qualified clean hydrogen produced through a process that results in a lifecycle greenhouse gas emissions rate of less than 0.45 kg of CO_2-e per kg of hydrogen.

The Senate bill would provide a series of definitions for purposes of new section 45V.

- The term “lifecycle greenhouse gas emissions” would have the same meaning given such term under subparagraph (H) of section 211(o)(1) of the Clean Air Act as in effect on the date of enactment of this bill. The term would include only emissions through the point of production (well-to-gate).

- “Qualified clean hydrogen” would mean hydrogen that is produced through a process that results in a lifecycle greenhouse gas emissions rate of not greater than 4 kg of CO_2-e per kg of hydrogen.

    - If a lifecycle greenhouse gas emissions rate has not been determined for a taxpayer’s hydrogen production process, a taxpayer may file a petition with the Secretary of the Treasury for determination of the emissions rate.

    - The hydrogen must be produced in the United States or a possession of the United States in the ordinary course of a trade or business of the taxpayer for sale or use, as verified by an unrelated third party.

- A “qualified clean hydrogen production facility” is a facility owned by the taxpayer that produces qualified clean hydrogen.

A qualified clean hydrogen facility would have to begin construction by December 31, 2033, to be eligible for the clean hydrogen production credit.

The Senate bill allows a facility originally placed in service before January 1, 2023, that did not originally produce clean hydrogen, and is subsequently modified to produce qualified clean hydrogen, to be deemed placed in service as of the date the modified property is placed in service.

The Senate bill would permit more than one taxpayer to have an ownership interest in the facility and provides for the allocation of the credit in proportion to respective ownership interests in the gross sales from the facility.

For qualified clean hydrogen production facilities placed in service after 2022, taxpayers may elect to receive a direct payment of this credit. Such election must be made separately with respect to each facility, be made for the tax year in which the facility is placed in service (or within one year of the date of enactment) and would apply to such tax year and four subsequent tax years. Such election may only be made with respect to any tax years beginning before 2033.

In addition, the Senate bill provides that a taxpayer may elect to transfer the credit (or any portion of the credit) to an unrelated taxpayer and exclude such sale proceeds from gross income. For any tax years for which a direct pay election is made, taxpayers may not also elect to transfer the credit. The election for transferability would be made annually and with respect to each facility for which the credit is determined.

The bill would provide for a reduction of the credit in the case of projects financed with tax exempt bonds and beginning construction after 2021.

Notably, the Senate bill would permit a taxpayer to receive both the section 45 credit for electricity produced from renewable resources *and* the credit for the production of clean hydrogen if such electricity is used at a qualified clean hydrogen production facility to produce qualified clean hydrogen. The electricity would be treated as sold to an unrelated person if such electricity were used at a qualified clean hydrogen energy facility to produce clean hydrogen. This provision applies to electricity produced after 2022.

In lieu of the clean hydrogen production credit, the Senate bill would permit a taxpayer to make an irrevocable election to treat specified clean hydrogen facilities (or any portion of such facility) as energy property under section 48. The energy percentage with respect to such property would range from 1.2% to 6% (6% to 30% under the bonus rate) depending on the type of qualified clean hydrogen that the facility is designed and reasonably expected to produce. Specified clean hydrogen production facilities would include facilities placed in service after 2022, and with respect to which no credit under sections 45Q or 45V have been allowed. For property which begins construction prior to January 1, 2023, only the basis attributable to construction, reconstruction, or erection after December 31, 2022, is includible.

The Senate bill would prohibit the clean hydrogen production credit to be claimed with respect to any qualified clean hydrogen produced at a facility which includes carbon capture equipment for which a section 45Q credit is allowed for the tax year or any prior year.

The Senate bill would terminate the alternative fuel excise tax credit as it relates to hydrogen for fuel sold or used after 2022.

The Senate bill would require the Secretary to issue regulations or guidance to carry out the section, including for determining lifecycle greenhouse gas emissions, no later than one year after the date of enactment.

KPMG observation

The new tax credit for clean hydrogen production incentivizes the development of clean hydrogen as a low-carbon alternative energy source.

The credit rate varies based on the lifecycle greenhouse gas emissions rate of the production process, with the highest credit available of $3 per kilogram of qualified clean hydrogen produced by the taxpayer if the

production process results in a lifecycle greenhouse gas emissions rate of less than 0.45 kg of CO_2-e per kg of hydrogen and prevailing wage and apprenticeship requirements are met. The Senate bill provides that the lifecycle greenhouse gas emission rate would include only emissions through the point of production (well-to-gate).

Notably, a taxpayer who produces electricity from green energy and uses such electricity in the production of clean hydrogen would be eligible for both the section 45 credit and the clean energy hydrogen production credit. The Senate bill provides that, in such a case, the electricity shall be treated as sold by a taxpayer to an unrelated person, which is important because the section 45 credit generally is not available for a taxpayer who produces energy for its own account.

In addition, the availability of direct pay would be a positive development for these projects and may accelerate the development of this alternative energy source. In lieu of the direct pay option, these credits may also be transferred to an unrelated taxpayer for tax-exempt income. This optionality reduces the need for tax-equity financing and provides flexibility for developers seeking financing.

Extension, increase, and modifications of nonbusiness energy property credit

Current law section 25C provides a tax credit for certain expenditures to improve the energy efficiency of a taxpayer's principal residence. Two types of property qualify for the credit: (1) Qualified Energy Efficiency Improvements; and (2) Residential Energy Property Expenditures. The section 25C credit is equal to the sum of 10% of the cost of qualified energy efficiency improvements and eligible costs for residential energy property expenditures, subject to a limit of a $500 nonrefundable tax credit for the taxpayer's lifetime. Under current law, the section 25C credit expired for property placed in service after 2021.

The Senate bill would provide for general modifications as well as expansions to the nonbusiness energy property credit under section 25C. The provisions are as follows:

- Increase the credit percentage from 10% to 30% for installing qualified energy efficiency improvements
- Replacement of the lifetime cap on credits with a $1,200 annual credit limitation, with a $2,000 limitation applicable to an electric heat pump water heater, an electric heat pump, or a biomass stove
- Update to the rules to reflect advances in energy efficiency, while also removing eligibility of roofs and advanced main air circulating fans
- Require for taxpayers and manufacturers to comply with reporting the identification number of certain property placed in service in order to access the credit
- Expand of the credit to cover the costs of home energy audits with a 30% credit available for such costs, up to a maximum credit of $150

The Senate bill generally would be effective for property placed in service after 2021, and prior to 2033 but modifications to the credit would be effective for property placed in service after 2022 and the identification number requirement would be effective for property placed in service after 2024.

Residential energy efficient property

Current law section 25D provides a credit for installing renewable energy property in a residence. Generally, the credit is 26% if property is placed in service in 2021 or 2022, 22% if placed in service in 2023, with a complete phaseout thereafter. Property eligible for the section 25D credit includes solar electric, solar water heating, fuel

cell, small wind, biomass fuel property or geothermal heat pump properties.

The Senate bill would extend the section 25D credit for 11 years, to apply to property placed in service prior to 2035. The phaseout rules would be modified to provide a 30% credit for property placed in service prior to 2033, a 26% credit for property placed in service in 2033, and a 22% credit for property placed in service in 2034.

The Senate bill also would add qualified battery storage technology expenditures to the list of expenditures that are eligible for the section 25D credit. A qualified battery storage technology expenditure is an expenditure for battery storage technology (1) installed in connection with a dwelling unit located in the United States used as a residence by the taxpayer and that (2) has a capacity of not less than three kilowatt hours.

The Senate bill would be effective for expenditures made after 2021, except that the expansion of the credit to battery storage technology would be effective for expenditures after 2022.

Energy efficient commercial buildings deduction

Current law section 179D provides a tax deduction for energy efficient commercial building property. The maximum allowable section 179D deduction is $1.80 per square foot. This deduction was made permanent in 2020.

The Senate bill would make three meaningful changes to section 179D:

- Modification of efficiency standard—the Senate bill would only require a building to increase its efficiency relative to a reference building by 25%, as compared to 50% under current law.

- Maximum amount of deduction—the Senate bill would change the maximum energy efficient commercial buildings deduction to an amount equal to $0.50 per square foot but increased (but not above $1.00) by $0.02 for each percentage point by which the total annual energy and power costs for the building are certified to be reduced by a percentage greater than 25%. There is a bonus credit rate of $2.50 per square foot, increased by $0.10 per square foot for every percentage point by which designed energy cost savings exceed 25% against the reference standard, not to exceed $5.00 per square foot. The maximum amount represents the total section 179D deduction that may be claimed for a building for the current tax year plus the three preceding tax years.

- Alternative deduction for energy efficient retrofit building property—the Senate bill would allow a taxpayer to elect to take a deduction for the tax year which includes the date of a building's qualifying final certification with respect to a qualified retrofit plan. The amount of the deduction is equal to the lesser of (1) the maximum amount described above, or (2) the aggregate adjusted basis of energy efficient retrofit building property placed in service by the taxpayer pursuant to such qualified retrofit plan.

Energy efficient building property is depreciable (or amortizable) property installed on or in any qualified building, which is installed as part of the interior lighting systems, the heating, cooling, ventilation, and hot water systems, or the building envelope, and which is certified under rules provided in the Code. A qualifying building must be located in the United States and be at least five years old before the establishment of the qualified retrofit plan with respect to such building.

A qualified retrofit plan is a written plan prepared by a qualified professional which specifies modifications to a building which, in the aggregate, are expected to reduce such building's energy usage intensity by 25% or more in comparison to the baseline energy usage intensity of such building. The baseline energy usage intensity means, simply, the energy usage intensity certified by a qualified professional prior to the retrofit, with potential

adjustments to take weather into account.

For tax-exempt entities, the Senate bill would offer the ability to allocate the deduction to the person primarily responsible for designing the property in lieu of the owner of the property (effectively giving the tax-exempt entity a discount).

To claim the bonus deduction amount, taxpayers would have to satisfy:

- The Prevailing Wage Requirement and
- Apprenticeship Requirements

The requirements are described in more detail in **Extension and modification of credit for electricity produced from certain renewable resources**.

The Senate bill provides that for purposes of computing the earnings and profits of a REIT, any amount deductible under section 179D would be allowed in the year in which the property giving rise to such deduction is placed in service or, in the case of energy efficient building retrofit property, the year in which the qualifying final certification is made.

The modifications to section 179D would be effective for tax years beginning after 2022. The alternative deduction for energy efficient retrofit property would be effective for property placed in service after 2022(in tax years ending after December 31, 2022) if such property were placed in service pursuant to a qualified retrofit plan established after 2022.

Extension, increase, and modifications of new energy efficient home credit

Current law section 45L provided a tax credit for the construction of new energy efficient homes that were acquired on or before December 31, 2021. The section 45L credit was $2,000 per dwelling unit, generally.

For single family homes, the Senate bill would extend the section 45L credit to homes that are acquired prior to 2033 and increase the credit to $2,500, generally, for energy efficient single family and manufactured new homes meeting certain Energy Star requirements. The credit can increase to $5,000 for eligible single family and manufactured new homes certified as zero energy ready under the Department of Energy Zero Energy Ready Home Program.

For multifamily homes, there is a base credit of $500 and a bonus credit of $2,500 for multifamily units which meet certain Energy Star requirements. The credit can increase to a base credit of $1,000 and a bonus credit of $5,000 for eligible multifamily units certified as zero energy ready under the Department of Energy Zero Energy Ready Home Program.

To claim the bonus credit amount for a multifamily unit, taxpayers would have to satisfy the Prevailing Wage Requirements for the full construction period. These requirements are described in Extension and modification of credit for electricity produced from certain renewable resources.

The Senate bill further provides that there is no basis reduction for the section 45L credit for purposes of calculating the low-income housing credit under section 42.

The Senate bill would be effective for dwelling units acquired after 2021, and the modifications would be effective for dwelling units acquired after 2022.

Unlike most of the other available credits this credit would not be transferable. It would also not be refundable.

Clean vehicle credit

Under current law, a taxpayer than places in service a qualified plus-in electric vehicle is eligible for a tax credit of between $2,500-$7,500. The credit phases out beginning with the second calendar quarter following the calendar quarter in which vehicles manufactured by the manufacturer exceed 200,000 ("200,000 limitation").

The Senate bill would remove the 200,000 limitation with respect to vehicles placed in service after 2022.

The Senate bill would bifurcate the $7,500 credit into two components:

- $3,750 if critical minerals requirements are satisfied; plus
- $3,750 if battery component requirements are satisfied.

The critical minerals requirements provide that the applicable critical minerals in a battery must be (1) extracted in the United States or a country with which the United States has a free trade agreement in effect, or (2) recycled in North America. The value of "good" minerals must be equal or greater to an applicable percentage. The applicable percentages for the critical minerals requirement are as follows:

- 2023—40%
- 2024—50%
- 2025—60%
- 2026—70%
- 2027 and later—80%

This provision would go into effect as soon as the IRS issues guidance on the requirement which the statute states is to be no later than December 31, 2022.

The battery component requirements provide that the percentage of the value of the components contained in such battery that were manufactured or assembled in North America must be equal to or greater than the applicable percentage. The applicable percentages for the battery component requirement are as follows:

- 2023—50%
- 2024-2025—60%
- 2026—70%
- 2027—80%
- 2028—90%
- 2029 and later—100%

This provision would also go into effect as soon as the IRS issues guidance on the requirement which the statute states is to be no later than December 31, 2022.

The Senate bill would also expand the definition of eligible vehicles to include fuel cell motor vehicles.

The provision does not provide a credit after 2024 for any vehicle with any critical minerals that were extracted processed or recycled by a foreign entity of concern (as defined in 42 U.S.C. 18741(a)(5)). It also does not provide a credit after 2023 for any vehicle with any battery components manufactured or assembled by a foreign entity of

concern.

The Senate bill would increase the required capacity of a battery from four to seven kilowatt hours.

No credit would be available unless final assembly of the vehicle occurred in North Americas. This provision would be effective as of the date of enactment.

Final assembly is defined as the process by which a manufacturer produces a new eligible vehicle at, or through the use of, a plant, factory, or other place from which the vehicle is delivered to a dealer or importer with all component parts necessary for the mechanical operation of the vehicle included with the vehicle, whether or not the component parts are permanently installed in or on the vehicle.

There would be income limits on who could claim the credit, tested based on the lesser of current or prior year modified adjusted gross income (MAGI). The limits (with no phaseout provision) are:

- Joint return—$300,000
- Head of household—$225,000
- All others—$150,000

No credit would be allowed for a vehicle if the manufacturer's suggested retail price exceeds the applicable limitation, which would be as follows:

- Vans—$80,000
- SUVs—$80,000
- Pick-up trucks—$80,000
- Other vehicles (including sedans)—$55,000

The Senate bill would eliminate the credit for two- and three-wheeled plug-in electric vehicles.

The taxpayer could elect to transfer the credit to the vehicle dealer, provided the dealer is registered as an eligible entity with the Secretary and complies with certain reporting obligations. The Secretary would establish a program to make advance payments to any eligible dealer equal to the cumulative amount of transferred credits.

The advance payments made by the IRS to a dealer transferee would be adjusted upward to reflect certain budget sequestration haircuts that otherwise apply to refundable credits. This would have the effect of making the dealer whole for any such sequestration amounts.

No credit would be allowed under this provision for vehicles placed in service after 2032.

The provision allowing for transfer of the credit would be effective for vehicles placed in service after 2023.

The Senate bill provides transition relief that would allow buyers to take a credit under current section 30D for eligible vehicles purchased—or for which there is a written binding contract to purchase—prior to the date of enactment and that are placed in service after the date of enactment.

KPMG observation

While the removal of 200,000 limitation would be beneficial for manufacturers of electric vehicles, the other proposed amendments to Section 30D would limit credit eligibility significantly. The critical minerals and

battery component requirements may cause it to be difficult for manufacturers to produce electric vehicles that are credit eligible. Additionally, the immediate effective date of the North American assembly requirement may also make it difficult to produce credit-eligible electric vehicles. Finally, each of the MSRP and MAGI caps limit the pool of eligible electric vehicles and the population eligible to receive a credit.

Credit for previously owned clean vehicles

Current law does not provide a credit for used electric or fuel cell vehicles ("clean vehicles"). The Senate bill would add such a credit in new Section 25E. The credit would be the lesser of:

- $4,000, or
- 30% of the sale price.

A "previously-owned clean vehicle," or "POCV," would be a vehicle:

- That has a model year at least two years earlier than the calendar year of acquisition (*e.g.*, 2021 or older if acquired in 2023),
- Where the original use commenced with someone other than the buyer,
- Which is acquired in a qualified sale (by a dealer for $25,000 or less where a credit has not yet been taken with respect to the POCV), and
- Which meets similar design requirements as those set forth in sections 30D or 30B.

The acquirer would have to be a qualified buyer, meaning a taxpayer:

- Who is an individual,
- Who purchases the POCV for use and not for resale,
- With respect to whom no deduction is allowable with respect to another taxpayer under section 151 (relating to personal exemptions and dependents), and
- Who has not been allowed a credit under proposed section 25E during the prior three-year period.

There would be income limits on who could receive a section 25E credit, tested based on the lesser of current or prior year modified adjusted gross income. The limits (with no phaseout provision) are:

- Joint return—$150,000
- Head of household—$112,500
- All others—$75,000

No section 25E credit would be allowed for any POCV acquired after 2032.

Dealer transfer provisions similar to those discussed above for purposes of section 30D would also be available for section 25E credits.

This provision would generally be effective for vehicles acquired after 2022. The provision allowing for transfer of the credit would be effective for vehicles acquired after 2023.

Qualified commercial clean vehicles

This Senate bill would create a new section 45W credit for qualified commercial clean vehicles (QCCVs) acquired for use or lease by the taxpayer (and not for resale). The amount of credit allowed by this provision with respect to a QCCV would be equal to the lesser of (1) 15% of the basis of such vehicle (30% in the case of a vehicle not powered by a gasoline or diesel internal combustion engine) or (2) the incremental cost of such vehicle. The incremental cost of any QCCV is an amount equal to the excess of the purchase price for such vehicle over such price of a comparable vehicle (i.e., any vehicle that is powered solely by a gasoline or diesel internal combustion engine and which is comparable in size and use to such vehicle). The Senate bill requires the Secretary to issue guidance on how to determine the incremental cost of any QCCV.

The maximum credit for QCCVs with a gross vehicle weight rating of less than 14,000 pounds would be $7,500. The amount would increase to $40,000 for all other eligible QCCVs.

Certain federal, state and local governments and certain tax-exempt entities could elect to treat the credit as refundable. The credit would not be transferable.

QCCVs would include (1) motor vehicles for purposes of Title II of the Clean Air Act that are manufactured primarily for use on public streets, roads, and highways (but not a rail or rails), and (2) mobile machinery as defined in section 4053(8) (including vehicles that are not designed to perform a function of transporting a load over the public highways). Further the QCCV must be propelled to a significant extent by an electric motor which draws electricity from a battery which has a capacity of not less than 15 kilowatt hours (or seven kilowatt hours in the case of a QCCV with a gross vehicle weight rating of less than 14,000 pounds) or is a fuel cell vehicle based upon the requirements of section 30B. Finally, the QCCV must be of a character subject to the allowance for depreciation (with an exception for tax-exempt entities).

This provision would apply to QCCVs acquired after 2022 and before 2033.

KPMG observation

The addition of a provision allowing taxpayers who acquire electric vehicles and lease them to individuals is favorable for automotive dealers who offer cars for lease.

This QCCV provision is extremely favorable to non-individual taxpayers in contrast to the section 30D credit. There is no critical minerals requirement, battery component requirement, North American assembly requirement, adjusted gross income cap, or MSRP cap.

Alternative fuel refueling property credit

Under prior law, taxpayers were eligible to claim an income tax credit for up to 30% of the cost of electric vehicle recharging stations. The credit is capped at $30,000 per location per year for business taxpayers and $1,000 for recharging stations installed at an individual's residence. The credit is not available for recharging stations placed in service after 2021.

The Senate bill would extend the expiration date for the alternative fuel refueling property credit to property placed in service prior to 2033.

The Senate bill would eliminate the per-location limitation. It would also increase the per item limitation to

$100,000 (from $30,000) for depreciable property. The credit cap would remain at $1,000 for recharging stations at personal residences.

However, the legislation would impose new restrictions.

First, the credit percentage would be only 6% of a taxpayer's expenditures ("base rate") unless the taxpayer satisfies the Prevailing Wage and Apprenticeship Requirements during construction in which case the credit percentage would be 30% ("bonus rate"). These rules are described in Extension and modification of credit for electricity produced from certain renewable resources.

Note that the 30% bonus rate would be available to eligible projects even if they don't satisfy the Prevailing Wage and Apprenticeship Requirements as long as they begin construction prior to 60 days after guidance on these new requirements is issued.

Second, the Senate bill also adds a requirement that the property must be located in an eligible census tract to be eligible for the credit. An eligible census tract is one either (1) described in section 45D(c) (low-income communities for purposes of the New Market Tax Credit), or (2) is not in an urban area (a census tract defined as an urban area by the Secretary of Commerce in the most recent decennial census).

The credit would be transferable for projects placed in service after 2022.

Certain federal, state and local governments and certain tax-exempt entities could elect to treat the credit as refundable.

The Senate bill would be effective for property placed in service after 2021, but the modifications to the provision would be effective for property placed in service after 2022.

KPMG observation

Given the census tract requirements, it appears the Senate bill intends to promote charging station infrastructure only in low-income communities and for long distance travel and believes that "urban area" infrastructure is sufficiently built-out (or on track to be built-out) such that it no longer needs to be incentivized.

Extension of the advanced energy project credit

The Senate bill would extend and expand the qualified advanced energy property (QAEP) credit.

The QAEP credit under section 48C is a 30% investment tax credit that is available for the construction, re-equipping, or expansion of a manufacturing facility that constructs QAEP. Included in the existing definition of QAEP is property such as solar, wind and other renewable energy component property, electric grids, carbon dioxide capture and sequestration property, and plug-in electric vehicles (EVs) and component parts, among other eligible property. QAEP credits were first enacted as part of the *American Recovery and Reinvestment Act of 2009,* and $2.3 billion in QAEP credits were originally authorized. All of the credits were allocated by Treasury in two separate allocation rounds.

The Senate bill would allow the Secretary to allocate an additional $10 billion in credits, with $4 billion of the allocation dedicated to projects in energy communities. An energy community includes (1) a brownfield site, (2) an area which has or had a certain amount of employment or tax revenues related to the extraction, processing,

transport, or storage of coal, oil, or natural gas and has an above-average unemployment rate, or (3) a census tract or adjacent area in which a coal mine has closed after 1999 or a coal-fired electric generating unit has been retired after 2009.

In order for a project to be eligible for the 30% advanced energy project credit, taxpayers must satisfy

- Prevailing Wage Requirements
- Apprenticeship Requirements

There requirements are explained in the discussion of the extension and modification of credit for electricity produced from certain renewable resources.

A 6% credit is available to projects which do not meet the Prevailing Wage and Apprenticeship Requirements.

The credit is broadened in a number of ways:

- Adds facilities that recycle QAEP;
- Adds projects to re-equip an industrial facility with equipment designed to reduce emissions by at least 20% through carbon capture or other technologies;
- Adds projects to re-equip, expand, or establish an industrial facility for the processing, refining, or recycling of critical minerals; and
- Expands QAEP to include hydroelectric property, all EV or fuel cell vehicles and associated components, materials, and charging or refueling infrastructure, and certain hybrid vehicles and components.

Similar requirements to the original credit would apply, with a few notable changes. There is a requirement that the property be placed in service within two years of the date of the allocation, and certain substantiation must be provided to the IRS.

The selection criteria remain unchanged. The Secretary would consider only projects that have a reasonable expectation of commercial viability and consider projects based on domestic job creation, net impact in reducing greenhouse gas emissions, expectation of commercial deployment, cost of energy and reduction in energy consumption or emissions, and time from certification to project completion.

Taxpayers could elect to transfer the credit to an unrelated taxpayer. In addition, certain tax-exempt or governmental entities may elect for the credit to be considered a direct payment of tax and essentially refundable.

The basis of such property is reduced by the amount of the credit.

Taxpayers may not claim the section 48C credit and any of the following credits: the ITC, the qualifying advanced coal project credit, qualifying gasification project credit, the clean electricity investment credit, the credit for carbon sequestration, or the credit for production of clean hydrogen with respect to the same investment.

This provision would be effective January 1, 2023.

KPMG observation

The section 48C credit was traditionally targeted to taxpayers that manufacture certain QAEP, including solar, wind and other renewable energy component property, electric grids, carbon dioxide capture and sequestration property, and plug-in electric vehicles and component parts. The Senate bill provides a large

($10 billion) allocation for these manufacturing facilities, but also expands the credit in notable ways. Industrial facilities that install carbon capture equipment or other technologies to reduce greenhouse gas emissions by at least 20% could now qualify, in addition to facilities for the processing, refining, or recycling of critical minerals. Moreover, the definition of QAEP is broadened for hydropower and all EVs and related components, materials, and charging infrastructure.

To qualify for the credit, taxpayers must apply and be awarded an allocation. In addition, to qualify for the 30% credit, the Prevailing Wage and Apprenticeship Requirements must be met. Nevertheless, the substantial allocation amount, broader QAEP categories, and transferability could make section 48C a very significant opportunity for many taxpayers.

Advanced manufacturing production credit

The Senate bill provides a new production tax credit under section 45X for each eligible component that is produced in the US and sold to unrelated third parties as part of the taxpayer's business. Eligible components include solar, wind and EV parts, including solar polysilicon, wafers, cells, and modules, wind blades, nacelles, towers, and offshore foundations, electrode active materials, battery cells, battery modules, and certain critical minerals.

The credit amounts are generally determined on a mass or watt capacity basis depending on the type of component. For example, in the case of a solar module the credit is equal to the product of $0.07 multiplied by the capacity of the module (expressed on a per direct current watt basis). For electrode active materials and applicable critical minerals, the credit would be equal to 10% of the production costs incurred by the taxpayer.

There are no Prevailing Wage or Apprenticeship Requirements for this credit.

The credit is not allowed for components produced at a facility receiving a section 48C credit. Taxpayers could elect to make the credit refundable through a direct pay mechanism. Such election would apply to the tax year and four subsequent tax years. Such election cannot be made with respect to any tax years beginning after 2033. In addition, the Senate bill provides that a taxpayer may elect to transfer the credit (or any portion of the credit) to an unrelated taxpayer and exclude such sale proceeds from gross income. For any tax years for which a direct pay election is made, taxpayers may not also elect to transfer the credit.

For components sold after 2029, the credit is reduced by 25% each year, and would be unavailable for components sold in 2033 and beyond. The credit is not reduced, however, for the production of critical minerals.

This credit is available for components produced and sold after 2022.

KPMG observation

The section 45X credit is intended to boost domestic production of wind, solar, and EV components and is likely designed to coordinate with the Domestic Content Requirements which would apply for investment tax credits and productions tax credits available to wind and solar. It will be interesting to watch whether this credit offers enough of an incentive to result in a sufficient amount of domestically produced wind, solar, and EV components to satisfy demand and make the Domestic Content Requirements for other credits achievable.

Clean electricity production and investment credits

The Senate bill would create a new emissions-based incentive for electric generating facilities, effective for facilities placed in service after 2024.

Taxpayers can choose between a PTC under new section 45Y ("Section 45Y PTC") or an ITC under new section 48E ("Section 48E ITC").

Any power facility with any technology can qualify for the credits, so long as the facility's greenhouse gas emissions rates are at or below zero. For this purpose, the greenhouse gas emissions rate means the amount of greenhouse gases emitted into the atmosphere by a facility in the production of electricity, expressed as grams of CO2e per kilowatt. In the case of a facility which produces electricity through combustion or gasification, such as a biomass facility, the greenhouse gas emissions rate for such facility must be equal to the net rate of greenhouse gases emitted into the atmosphere by such facility taking into account lifecycle greenhouse gas emissions.

Section 48E ITC would be available for tangible property used for the generation of electricity, qualified interconnection property, and energy storage property.

The Secretary would publish annually a table that sets forth the greenhouse gas emissions rates for types or categories of facilities. In the case of any facility for which an emissions rate has not been established, a taxpayer may file a petition with the Secretary for determination of the emissions rate with respect to the facility.

For purposes of the determination of the emissions rate, any greenhouse gases emitted into the atmosphere by a facility do not include qualified carbon dioxide that is captured by the taxpayer and sequestered.

Section 45Y PTC

For the Section 45Y PTC, the base rate would 0.3 cents per kilowatt hour and the bonus rate would be 1.5 cents per kilowatt hour. The Section 45Y PTC rate would be adjusted for inflation after 2024.

The bonus rate would be available to:

- Facilities with a capacity of less than 1 megawatt,
- Facilities that satisfy the Prevailing Wage and Apprenticeship Requirements, and
- Projects that began construction prior to the date that is 60 days after the Secretary publishes guidance with respect to these requirements.

The Prevailing Wage and Apprenticeship Requirements are addressed in the discussion of the extension and modification of credit for electricity produced from certain renewable resources.

Similar to the proposed extension of the PTC rules, facilities that satisfy the Domestic Content Requirements would be eligible for up to a 10% increase in the Section 45Y PTC rate. The Domestic Content Requirements are discussed under Extension and modification of credit for electricity produced from certain renewable resources.

The Senate bill would also provide a 10% increase in the Section 45Y PTC rate for a facility located in an energy community. An energy community includes (1) a brownfield site, (2) an area which has or had a certain amount of employment or tax revenues related to the extraction, processing, transport, or storage of coal, oil, or natural gas and has an above-average unemployment rate, or (3) a census tract or adjacent area in which a coal mine has closed after 1999 or a coal-fired electric generating unit has been retired after 2009.

The Section 45Y PTC would be available for a 10-year period beginning with the date the facility is placed in

service. If a taxpayer places in service a "new unit" or an addition to capacity to an existing facility after 2024, the new unit or addition would qualify for a new 10-year Section 45Y PTC period to the extent of the increased amount of electricity produced.

Section 48E ITC

For the Section 48E ITC, the base rate would be 6% and the bonus rate would be 30%. The rules are similar to the Section 45Y PTC for the Prevailing Wage and Apprenticeship Requirements except that the Prevailing Wage Requirements would apply for five years instead of 10.

Similar to the extension of the ITC rules, facilities that satisfy the Domestic Content Requirements but not the Prevailing Wage and Apprenticeship Requirements would be eligible for a two-percentage point increase in the Section 48E ITC rate; and facilities that satisfy both the Domestic Content Requirements and the Prevailing Wage and Apprenticeship Requirements would be eligible for a 10-percentage point increase in the Section 48E ITC rate.

For facilities that are located in an energy community, facilities that do not satisfy the Prevailing Wage or Apprenticeship Requirements would be eligible for a two-percentage point increase in the Section 48E ITC rate; and facilities that satisfy the Prevailing Wage and Apprenticeship Requirements would be eligible for a 10-percentage point increase in the Section 48E ITC rate.

Similar to the extension of the ITC rules, the Section 48E ITC would provide a mechanism for taxpayers to apply for an increase in the Section 48E ITC rate—either 10 or 20 percentage points– if they build facilities in eligible low-income communities.

The Section 48E ITC would be claimed in the year the asset was placed in service. If a taxpayer places in service a "new unit," to an existing facility and new unit was placed in service after 2024, the new unit would qualify for the Section 48F ITC. If the Secretary determines that the actual greenhouse gas emissions rate for a qualified facility was greater than 10 grams of CO2e per kilowatt after the placed in-service date, any property for which a section 48E ITC was allowed could be subject to ITC recapture if the determination occurs in the first 60 months after the facility is originally placed in service.

Section 45Y PTC and Section 48E ITC

The Section 45Y PTC and Section 48E ITC would phase out for projects that begin construction two years following the applicable year, which is the later of:

- The year in which annual greenhouse gas emissions from the production of electricity in the United States is equal to or less than 25% of the annual greenhouse gas emissions from the production of electricity for calendar year 2022, or
- 2032.

The applicable Section 45Y PTC rate or Section 48E ITC rate would be 75% during the second year after the applicable year (possibly 2034 depending on emissions reductions) and 50% for the third year after the applicable year (possibly 2035, depending on emissions reductions). The credits would be unavailable for facilities that begin construction four years or more after the applicable year.

Facilities financed with tax-exempt bonds would be subject to the same reduction as stated under the Extension and modification of credit for electricity produced from certain renewable resources.

Notably, for tax years beginning after 2022, the Senate bill provides that a taxpayer may elect to transfer the Section 45Y PTC or Section 48E ITC (or any portion of the credits) to an unrelated taxpayer and exclude such sale

proceeds from gross income. The transferability election must be made annually and separately with respect to each facility.

In addition, certain tax-exempt or governmental entities may elect for the Section 45Y PTC or Section 48E ITC to be considered a direct payment of tax and essentially refundable.

An otherwise eligible facility can claim either the section 45Y PTC or the Section 48E ITC, but not both.

Facilities that claim either the Section 45Y PTC or the Section 48E ITC cannot claim the PTC, ITC, carbon oxide sequestration credit, the credit for production from advanced nuclear power facilities, the zero-emission nuclear power production credit, or the qualifying advanced coal production credit.

These provisions would be effective for property and facilities placed in service after 2024.

KPMG observation

Section 45Y and section 48E are intended to enact a technology-neutral regime to encourage the production of electricity. These credits take effect after the expiration of the PTC and ITC.

This change may have the effect of making some technologies that are eligible for existing PTCs or ITCs ineligible for the Section 45Y PTC or Section 48E ITC. For instance, under the PTC rules, biomass facilities are allowed to burn fossil fuel in an amount necessary for flame startup and stabilization. However, under section 45Y PTC, such combustion activities might prevent the facility from having net-zero carbon emissions equivalents. Landfill gas facilities might similarly fail to satisfy the net-zero carbon emissions equivalents if the fuel source, methane gas, is not completely disposed of as part of the combustion process and/or some is released during the production process.

Cost recovery for qualified facilities, qualified property, and energy storage technology

The Senate bill provides that any facility described in the clean electricity production credit, any qualified property or grid improvement property described in the clean electricity investment credit, and energy storage technology would be treated as five-year property under the general depreciation system for purposes of section 168 of the Internal Revenue Code.

The provision would apply to facilities and property placed in service after 2024.

KPMG observation

The Senate bill would provide that qualified clean electricity facilities, grid improvement property, and energy storage would be eligible for depreciation over five years, similar to other renewable energy property. This would accelerate cost recovery for expenses to construct this type of facility and provide another incentive for construction.

Clean fuel production credit

The Senate bill would create a technology-neutral incentive for the domestic production of clean fuels.

The new "clean fuel production credit" under section 45Z would be equal to the product of:

- The applicable amount per gallon with respect to any transportation fuel produced at a qualified facility and sold by the taxpayer to an unrelated person for use in the production of a fuel mixture, for use in a trade or business, or for sale at retail and
- The emissions factor of such fuel.

The applicable amount would be $0.20 per gallon ($0.35 in the case of sustainable aviation fuel) or $1.00 per gallon ($1.75 in the case of sustainable aviation fuel) for taxpayers who meet Prevailing Wage and Apprenticeship Requirements. Those requirements are described under Extension and modification of credit for electricity produced from certain renewable resources**.**

These amounts would be adjusted for inflation after 2024.

The Treasury Department would be required to annually publish emissions rates for fuels that are produced using similar feedstocks and production pathways that taxpayers would use for purposes of determining their credit rates. This emissions rate would then be used to compute the emissions factor, with a credit provided for fuels with emissions below 50 kg CO_2e per mmBtu. The lower the emissions rate, the higher the credit would be.

For facilities placed in service before January 1, 2025, Prevailing Wage Requirements would not be required to be met during construction of the facility. Prevailing Wage Requirements would need to be met for any alteration or repair of the facility to qualify for the bonus rate for any tax years beginning thereafter.

Qualifying production would be restricted to production in the United States.

No credit would be allowed at a facility which includes property for which a credit is allowed under section 45Q, 45V, or the section 48 ITC for clean hydrogen production facilities during the tax year.

Fuels would be required to be transportation grade—suitable for use in a highway vehicle or aircraft—but could be used for any business purpose, including as transportation fuel, industrial fuel, or for residential or commercial heat. No credit would be allowed for non-aviation fuel which is derived from coprocessing biomass with a feedstock which is not biomass.

Taxpayers could elect to transfer the credit to an unrelated taxpayer for tax-exempt gross income. In addition, certain tax-exempt or governmental entities may elect for the credit to be considered a direct payment of tax and essentially refundable.

The credit would apply to transportation fuel produced after 2024 and would be unavailable for fuel sold after 2027.

KPMG observation

This Senate bill would create an incentive for the domestic production of clean fuels. The credit would not be effective, however, until 2025. In addition, the credit would be unavailable for fuel sold after 2027.

The credit for sustainable aviation fuel credit under section 40B would apply to fuel sold after, 2022, and before 2025.

Three-year carryback for certain general business credits

Under current law, general business credits (GBCs) can be carried back one year and forward 20 years. There is a special provision that states that new credits cannot be carried back to a year prior to the effective date for such credit.

The legislation would provide a three-year carryback for certain credits in the legislation and would remove the rule that new credits cannot be carried back to a year before they became effective. It also increases the carryforward period two years.

Credits eligible for the new carryback and carryforward rules

- Alternative fuel vehicle property under section 30C
- Renewable electricity production credit under section 45 (for facilities are originally placed in service after 2022)
- Carbon oxide sequestration credit under section 45Q (for facilities originally placed in service after 2022)
- Zero-emission nuclear power production credit under section 45U
- Clean hydrogen credit under section 45V (for facilities originally placed in service after 2022)
- In the case of a tax-exempt entity, the qualified commercial vehicle credit under section 45W
- Credit for advanced manufacturing production under section 45X
- Clean electricity production credit under section 45Z
- Energy credit under section 48
- Qualifying advanced energy project credit under section 48C
- Clean electricity investment credit under section 48E

The provision would be effective for tax years beginning after 2022.

Healthcare-related tax provisions

Extend the American Rescue Plan Act expansion of premium tax credits

The premium tax credit (for simplicity's sake, the PTC, not to be confused with the Section 45 Production Tax Credit) is provided to certain individuals who purchase health insurance through a marketplace exchange established under the Patient Protection and Affordable Care Act (ACA), P.L. 111-148. The PTC is a refundable credit and may be payable in advance directly to the insurer. Eligibility for an advance payment of the PTC is based on household income and family size, determined by reference to an individual's most recent available year of tax data. As the advance payment of the PTC is based on prior year tax data, some taxpayers must reconcile their PTC by either paying back the advance payment (because actual income exceeded estimated income) or receiving a refund (because actual income was less than the estimated income).

Prior to the changes introduced by American Rescue Plan Act of 2021 (ARPA), P.L. 117-2, the PTC was generally available to individuals with household income between 100% and 400% of the federal poverty line.

For 2021 and 2022, ARPA modified the PTC by reducing the percentage of annual income that households are required to contribute towards the premium and making certain individuals with income above 400% of the federal poverty line eligible for the credit. ARPA also suspended the requirement that taxpayers repay excess advance PTC payments for tax year 2020.

The bill would expand the PTC by extending the applicable contribution percentages of household income used for determining the PTC through 2025 and extending eligibility to certain taxpayers with household income above 400% of the federal poverty line through 2025. In addition, the proposal provides that applicable contribution percentages would not be indexed until 2026.

The proposal would be effective for tax years beginning after December 31, 2022, and would sunset on December 31, 2025.

Cost estimates of this provision are provided by the CBO.

KPMG observation

While ARPA suspended the requirement that taxpayers increase their tax liability by all (or a portion of) their excess advance payments of the PTC for tax year 2020, the bill does not include any further extension of this temporary suspension.

Drug price negotiation program excise tax

The Senate bill would create a Drug Price Negotiation Program, to negotiate the price of certain high-spend prescription drugs for Medicare beneficiaries. The negotiated pricing would go into effect in 2026 for up to 10 negotiation-eligible drugs designated by the Secretary of Health and Human Services (HHS), increasing to up to 20 drugs by 2029. The manufacturer of a designated drug would be required to enter into a negotiation agreement with the FDA and submit certain specified information. The Secretary of HHS would then make a price offer; if the manufacturer does not accept the offered price, negotiations would ensue to arrive at a “maximum fair price” for Medicare beneficiaries.

To enforce compliance with the Drug Price Negotiation Program, the bill introduces a non-deductible excise tax that would apply if a manufacturer does not, within the time required, enter into a negotiation agreement, submit the required information, or agree to a maximum fair price. The excise tax—which is based on a formula that varies depending on the length of noncompliance—ranges from a rate of 185.71% to 1,900% and applies to sales by manufacturers, producers and importers. The tax would not apply to drugs sold for export. The first potential date of noncompliance to which the excise tax could apply is October 2, 2023. An anti-abuse rule would apply in cases where a sale it timed to avoid the excise tax.

Other

Increase in research credit against payroll tax for small businesses.

The Senate bill would increase the maximum Code section 41(h) research tax credit payroll offset election by $250,000, so the maximum amount per year would double from the current $250,000 to a new maximum of $500,000. These changes would be effective for tax years beginning after December 31, 2022.

To make a Code section 41(h) payroll election, a taxpayer must be a qualified small business (QSB). A QSB is a corporation (including an S corporation) or partnership with:

- Gross receipts of less than $5 million for the tax year, and
- No gross receipts for any tax year before the five-tax-year period ending with the tax year.

Any other person may be considered a QSB if the person meets the requirements of (1) and (2) above, taking into account the aggregate gross receipts received in all trades or businesses. The term "gross receipts" for purposes of determining whether a business is a QSB means gross receipts as determined under Code section 448(c)(3) (without regard to subparagraph (A) thereof) and Code regulations sections 1.448-1T(f)(2)(iii) and (iv). The definition of gross receipts under Code section 41(c)(6) and Code regulations section 1.41-3(c) (which includes a de minimis exception) doesn't apply for this purpose. Any reference to trade or business also includes a reference to any predecessor of the trade or business. Also, if a trade or business had a tax year of less than 12 months, the gross receipts must be annualized by multiplying the gross receipts for the short period by 12 and dividing the result by the number of months in the short period. A QSB doesn't include a tax-exempt organization under Code section 501.

Currently, the credit is taken against the employer portion of Old Age, Survivors and Disability Insurance (OASDI) employment taxes. The Senate bill modifies Code section 3111(f) to allow the credit to be taken first against the employer portion of the OASDI tax (6.2%) and then against the employer portion of the Hospital Insurance (HI) tax (1.45%). If the credit exceeds the payroll tax, then the credit is rolled forward to the next quarter.

Code section 41(h)(4)(B)(ii) limits the number of tax years for which a QSB can make a payroll election to five years. IRS Notice 2017-23 also provides additional guidance regarding the previous version of the section 41(h) payroll R&D payroll offset credit.

KPMG observation

The Senate bill currently contains no deferral or repeal of the TCJA provision that modified Code section 174. Absent a legislative change, for tax years beginning after December 31, 2021, Code section 174 subjects research and experimentation (R&E) costs to mandatory capitalization; beginning in 2022, the costs associated with U.S.-based R&E activities are required to be capitalized and amortized over a five-year period beginning with the midpoint of the tax year in which the R&E costs were paid or incurred. For R&E activities that are conducted outside of the U.S. or a U.S. possession, the applicable amortization period is 15 years, also with a midpoint rule. The TCJA also contained a conforming amendment to the definition of "qualified research" in section 41(d)(1)(A).

Extension of tax to fund Black Lung Disability Trust Fund

In general, an excise tax is imposed on the producer's sale of coal from mines located in the United States. The bill would permanently extend the increased excise tax rates of $1.10 per ton for coal from an underground mine or $0.55 per ton for coal from a surface mine. The total amount of tax is not to exceed 4.4% of the price at which such ton of coal was sold by the producer. The tax funds the Black Lung Disability Trust Fund.

The provision would be effective for sales occurring in calendar quarters beginning after the date that is one day after the date of enactment.

The JCT has estimated this proposal would increase revenue by approximately $1.2 billion over the 10-year budget window.

Impact of the Senate bill on accounting for income taxes

The Senate bill may impact an entity's recognition and measurement of income tax-related balances in the current or future periods, if enacted. The tax effects of changes in tax laws are reflected in the financial statements beginning in the interim period that includes the date of enactment.

As entities assess the impact of the Senate bill, there may be elements where it is not entirely clear how the taxing authority or a court would interpret the language in the statute, if enacted. Accordingly, entities should consider the impact the legislation would have on accounting for uncertainty in income taxes. Although there may be anticipation that future regulations or other administrative guidance will resolve some of the uncertainties, until that guidance is promulgated, there may be a period of time where only the language in the statute is able to be evaluated. If tax positions arise that are expected to be reported on a tax return that are not highly certain to be sustained upon examination based on the technical merits that exist at the balance sheet date, an entity should assess the tax position in accordance with the recognition and measurement criteria within ASC 740 to determine the appropriate amount of tax benefit to be reflected within the financial statements.

This discussion highlights selected areas of accounting for income taxes that entities may see impacted by the changes in tax laws included in the Senate bill but is not all inclusive.

Changes in tax laws

Subsequent to the adoption of ASU 2019-12, *Simplifying the Accounting for Income Taxes*, the tax effect of changes in tax laws on income taxes receivable (payable) for the current year is recognized in the estimated annual effective tax rate in the period that includes the enactment date, even if the change is effective in a later reporting period. To the extent income taxes receivable (payable) of prior years are adjusted as a result of changes in tax laws, such impacts are recognized in income tax expense (benefit) from continuing operations as of the date of enactment.

The intraperiod tax allocation of the tax effect of changes in tax laws on the measurement of deferred tax assets (liabilities), including the reevaluation of a valuation allowance for deferred tax assets, should be based on enactment date temporary differences and allocated entirely to income tax expense (benefit) from continuing operations. The tax effect of changes in tax laws on deferred taxes is a discrete event recognized in the interim period that includes the enactment date of the change, even though the changes may not be effective until future periods.

KPMG observation

The Senate bill does not include a change to the U.S. federal corporate statutory income tax rate; accordingly, many entities may not recognize an adjustment to income taxes as of the date of enactment. However, for those entities that are impacted by the legislation, the most significant change to deferred taxes may be adjustments to the valuation allowance as noted in the observations below.

Even though deferred taxes are not generally determined on a daily basis, reasonable effort should be made to estimate temporary differences and the related deferred tax amounts, including valuation allowances, as of the enactment date as part of establishing the amount of the enactment date adjustment to allocate to continuing operations.

While the amount of the adjustment to deferred taxes allocated to continuing operations and the amount disclosed as a result of a change in tax laws is measured using enactment date balances, solely for interim period income taxes calculations, we believe entities have an accounting policy choice as to which date's deferred taxes are used in determining the discrete amount. We believe an entity may determine the discrete amount associated with ordinary income items used for interim accounting based on the deferred taxes as of either the date of enactment or the amount at the beginning of the year.

The allocation of income tax expense (benefit) directly to continuing operations may result in residual tax effects within accumulated other comprehensive income. Residual tax effects are generally released when the item giving rise to the tax effect is disposed of, liquidated or terminated and the release should be consistent with an entity's existing policy on releasing such effects. Entities should disclose a description of the accounting policy for releasing income tax effects from accumulated other comprehensive income.

Corporate alternative minimum tax

The Senate bill includes a new corporate alternative minimum tax (AMT) based on 15% of adjusted financial statement income (AFSI) for applicable corporations. Applicable corporations include U.S. parented corporations with a three-year average annual AFSI in excess of $1 billion, amongst other requirements. Corporations that are part of a foreign-parented multinational group are also considered applicable corporations if the group has a three-year average annual AFSI in excess of $1 billion with an additional requirement of an average of $100 million of U.S.-related AFSI, amongst other requirements.

Under the Senate bill, an applicable corporation's minimum tax would be equal to the amount by which the tentative minimum tax (15% of AFSI reduced by AMT foreign tax credits) exceeds the corporation's regular tax for the year, including BEAT, but prior to the consideration of general business credits. AFSI is the net income or loss of the taxpayer stated on the taxpayers' applicable financial statement with a variety of modifications. An applicable financial statement includes a corporation's Form 10-K filed with the Securities and Exchange Commission (SEC), certain audited financial statements, and certain other similar financial statements filed with a federal agency.

Under the Senate bill, a taxpayer would be allowed to claim a credit for AMT paid against regular tax in future years, but the credit could not reduce that future year's tax liability below the computed minimum tax for that year.

KPMG observation

ASC 740 provides that the applicable tax rate used in the measurement of deferred taxes should be based on the regular tax system, not the AMT system on the premise that no one can predict whether an entity will

always be an AMT taxpayer and it would be counterintuitive if the addition of AMT tax provisions to the tax law were to have the effect of reducing the amount of an entity's income tax expense for financial reporting. The literature also notes that it may be counterintuitive to assume that an entity would permit its minimum tax credit carryforward to expire unused at the end of the life of the entity. As such, similar to the U.S. AMT system prior to the TCJA, it is generally expected that taxes paid under the new AMT system will be recognized in the determination of current tax expense (benefit), and a deferred tax asset will be recognized for any minimum tax credit carryforward. The deferred tax asset for the minimum tax credit carryforward should be evaluated using the more-likely-than-not criterion to determine whether a valuation allowance should be recognized.

Notwithstanding the counterintuitive nature of an assumption that an entity would permit its minimum tax credit carryforward to expire unused, an entity may still need to assess whether it expects to always be an AMT taxpayer. If an entity expects to always be an AMT taxpayer, it may not realize the entire amount of tax benefits of its deferred tax assets under the regular tax system. For example, a temporary difference under the regular tax system may reduce future taxable income under the regular tax system but may not reduce future taxable income under the alternative minimum tax system and may result in little or no reduction in income taxes paid. As a result, we believe entities have a policy choice about whether to consider or ignore such effect of the AMT system in determining the valuation allowance for deferred tax assets under the regular tax system. If an entity elects to consider the AMT system in determining its valuation allowance for deferred tax assets under the regular tax system, the amount of a valuation allowance required would need to be assessed in the period the Senate bill is enacted. We believe an entity's policy as to whether it considers the effect of the AMT system should be consistent with its policy as to whether it considers the BEAT system when evaluating the realizability of deferred tax assets under the regular tax system.

Excise tax on repurchase of corporate stock

The Senate bill would impose a 1% excise tax on publicly traded U.S. corporations for the value of any of its stock that is repurchased by the corporation during the tax year, excluding certain excepted repurchases. The excise tax applies to repurchases that arise after December 31, 2022.

KPMG observation

As the excise tax is determined on a non-income-based measure, we would not expect the excise tax, as included within the Senate bill, to be accounted for as an income tax within the scope of ASC 740. Direct costs associated with acquiring equity-classified treasury stock are generally considered in the cost of acquiring the treasury stock; in other words, there is generally no affect to net income.

Direct costs associated with extinguishing a mandatorily redeemable stock liability or temporary equity-classified stock may affect net income and earnings per share.

Energy security and climate change investments

The Senate bill includes a number of incentives intended to bring down consumer energy costs and increase American energy security, while reducing greenhouse gas emissions. Those incentives include new, extended and expanded investment and production credits. Those incentives also include an elective payment that may be received in lieu of certain credits and a mechanism to allow for the transfer of certain other credits. Additionally, the incentives provide for a three-year carryback of certain credits.

KPMG observation

Entities will need to separately assess each of the incentives to determine whether they are within the scope of ASC 740 or if they should be accounted for as government grants.

We believe refundable tax credits that are not dependent on an entity's ongoing tax status or tax position (for example, an entity that receives a refund despite being in a taxable loss position) are not within the scope of ASC 740. As such, although the claims may be filed and administered in connection with the income tax return, the refunds are not considered as part of income taxes and therefore the benefit would not be presented as an adjustment to income tax expense (benefit). Instead, such credits would be recognized, measured, presented, and disclosed consistent with an entity's policies on accounting for government grants.

With respect to transferable credits, since the payment for the credits may come from a party other than a government, we believe an entity should account for the credits based on how the entity intends to monetize the credit. Accordingly, if an entity intends to use the credit to reduce its income taxes payable, it would characterize the credit as within the scope of ASC 740 and recognize, measure, present and disclose the credit as part of income taxes. If an entity expects to sell the credit to another taxpayer, it would characterize the credit as outside the scope of ASC 740 and recognize, measure, present and disclose the credit under other applicable literature.

Additionally, entities would need to assess whether they expect a change in the amount of future tax credits they will generate that are within the scope of ASC 740. A change in the amount of tax credits generated in the future may result in a change in judgment about an entity's ability to utilize deferred tax assets that exist as of the date of enactment and a related adjustment to the amount of valuation allowance required. For example, an entity that evaluates future taxable income exclusive of reversing items under the replacement approach may conclude it needs a valuation allowance on existing deferred tax assets if it anticipates generating enough future tax credits within the scope of ASC 740 to offset future taxable income.

Financial statement disclosures

KPMG observation

As the legislative process moves forward, entities may need to consider disclosure of the expected effects of enactment of the Senate bill in the notes to the financial statements, within management discussion and analysis (MD&A) or within risk factors. Within the notes, entities are required to disclose income tax expense (benefit) arising from adjustments of deferred tax assets (liabilities) for changes in tax laws that have been enacted. If the tax law is enacted subsequent to the end of a financial reporting period but prior to the issuance of the financial statements, entities may need to disclose the nature of the event and an estimate of its financial statement effect or a statement that such an estimate cannot be made.

Within MD&A, entities may consider disclosing expected future effective tax rates, once there is clarity around whether the Senate bill will be enacted. Additionally, to the extent future regulatory, administrative, or legislative actions could have a materially adverse effect, additional disclosure within risk factors may be necessary.

SEC and FASB considerations

KPMG observation

Shortly after the enactment of TCJA in 2017, the SEC staff released Staff Accounting Bulletin No. 118 which provided that in the period of enactment, entities should reflect the income tax effects of items in which the accounting is complete, include provisional amounts for specific income tax effects for which the accounting was incomplete but a reasonable estimate could be determined, or exclude impacts of the change in tax law to the extent a reasonable estimate could not be made. We are not aware of any active initiatives by the SEC staff to provide similar relief as a result of enactment of any legislation coming from the Senate bill. Accordingly, entities may need to prepare to understand and account for the implications of any changes in tax laws in the interim period of enactment.

Further, the FASB provided clarification on various topics through Staff Q&As and an issuance of an ASU subsequent to enactment of the TCJA covering various matters. At this point, it is not clear whether any additional guidance or further clarification on the application of accounting literature to changes in tax laws due to the enactment of the Senate bill will be issued; however, if any guidance is issued, it may not be relied upon until such issuance occurs.

Summary

As noted above, this discussion highlights selective common areas of accounting for income taxes considerations that may be impacted by the Senate bill, but it is not all inclusive. An entity's specific facts and circumstances should be assessed in determining the accounting for income taxes impact of the Senate bill.

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