Insights
March 2024

Skadden

State of Play on US Tax Proposals

This article was published in the [March 2024 issue of *Insights*].

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Nazmiye Anna Gökçebay
Partner / New York
212.735.2292
nazmiye.gokcebay@skadden.com

Chen (Tracy) Grais
Associate / New York
212.735.2319
tracy.grais@skadden.com

Patrick Q. Hasson
Associate / New York
212.735.2313
patrick.hasson@skadden.com

Key Points

- A House bill extending business-friendly tax provisions would delay mandatory capitalization of research expenditures, ease the cap on the deduction of business interest expense and temporarily restore "bonus" depreciation for some categories of property.
- The changes in the House bill apply to 2024 and 2025, as well as retroactively to 2023 and, in certain cases, 2022.
- However, the possibility of Senate amendments to the House bill is causing delay and uncertainty this tax season and will require taxpayers to monitor legislative administrative developments closely as they prepare their returns.
- Even if the House measure is adopted in its current form, given the interrelatedness of the bill's provisions and other parts of the U.S. tax code, taxpayers will need to conduct careful analyses before making permitted elections or opting to amend prior returns.
- The current Green Book proposals would significantly increase taxes payable by corporations and high-net-worth individuals. But they are unlikely to be considered by Congress this year.

The House Bill

A House bill adopted in January 2024, H.R. 7024 (the Bill), would extend some business-friendly tax provisions of the Tax Cuts and Jobs Act of 2017 (TCJA) that were being, or have already been, phased out. Titled the "Tax Relief for American Families and Workers Act of 2024," the Bill would temporarily restore deductibility of research and experimental (R&E) expenditures, raise the cap on the deduction of business interest expense and accelerate depreciation for some categories of purchased property.

The Bill would also enhance the child tax credit, expand availability of low-income housing tax credits and provide disaster relief, among other things. To offset the projected $79 billion cost of these benefits, the Bill would accelerate the deadline for new pandemic-era employee retention tax credit (ERTC) claims to January 31, 2024 (now past), and significantly increase penalties for ERTC-related fraud.

While the Bill passed the House in a lopsided, 357-70 bipartisan vote, a number of senators have voiced opposition to specific provisions, and the Senate has yet to consider it. If the Senate amends the Bill, the legislation would likely go to a conference committee for resolution of differences between the two chambers, which would cause substantial delay and uncertainty as to whether it will be enacted, and in what form. This, as well as the Bill's retroactive provisions, may complicate the current tax filing season.

The following summary of key business incentives and related considerations assumes the Bill will be enacted as drafted.

Deduction for R&E Expenditures Under the Bill

For taxable years beginning before 2022, R&E expenditures paid or incurred in the taxable year could be deducted in full or, at the taxpayer's election, amortized over a period of not less than 60 months. If a project was abandoned, unamortized expenditures could be recovered. Taxpayers could also elect annually to recover some or all of their R&E expenditures ratably over 10 years to avoid certain adjustments under the alternative minimum tax (AMT).

Under the TCJA, for taxable years beginning after 2021, current expensing of all R&E expenditures was eliminated. Instead, all "specified" R&E (SR&E) expenditures must be capitalized and generally may be amortized ratably over five years or, if attributable to foreign research, 15 years. SR&E expenditures consist of those paid or incurred in connection with the taxpayer's trade or business and specifically include software development costs.

Deductions for SR&E expenditures may not be accelerated on the abandonment or disposal of the property with respect to which they were incurred; instead, amortization continues over any remaining term. In addition, the TCJA did not make conforming amendments to the rules governing the election to recover R&E expenditures over 10 years. Accordingly, it is unclear whether this election is available for SR&E expenditures.

The TCJA's changes to the characterization and treatment of R&E expenditures affected taxpayers under several other provisions of the U.S. tax code. For example, R&E expenditures are subject to special allocation and apportionment rules for purposes of determining foreign-derived intangible income (FDII), global intangible low-taxed income (GILTI) and foreign tax credits.

The Bill temporarily revives the pre-TCJA rules, but only for domestic SR&E expenditures. As a result, the foregoing ripple effects are not entirely reversed.

Under the Bill, immediate expensing is again allowed for any domestic SR&E expenditures paid or incurred in taxable years beginning after 2021 and before 2026. In addition, the Bill provides that taxpayers may instead elect to capitalize such expenditures, amortize them over 10 years under the AMT rules or otherwise amortize them over a period of not less than 60 months.

The Bill does not alter the rules that apply to foreign SR&E expenditures, which remain subject to the capitalization and amortization rules imposed by the TCJA.

Because the Bill's provisions apply retroactively, the Bill includes transition rules. A taxpayer that filed returns for its first taxable year beginning after 2021 may make a late election to charge its domestic SR&E expenditures to capital or amortize them over a period of not less than 60 months.

This election must be made on an amended return for such year filed within one year of the Bill's enactment (or as otherwise provided by the secretary of the Treasury (Secretary)). This election should be considered by taxpayers that would benefit from an adjustment to the amortization required by the TCJA.

A taxpayer that adopted a method of accounting with respect to its domestic SR&E expenditures for its first taxable year beginning after 2021 may treat the immediate expensing of any unamortized portion of such expenditures as a change in method of accounting, made with the Secretary's consent, in the succeeding taxable year (or, at the taxpayer's election, over the succeeding two taxable years). This change in method of accounting applies only to the unamortized portion of such expenditures on a modified cut-off basis.

Taxpayers that benefited from correlative adjustments (for example, in the amount of their FDII inclusions) should consider these options when deciding whether to file an amended return for 2022.

Business Interest Expense Limitation Under the Bill

The TCJA limited the ability of taxpayers to deduct business interest expense that exceeds business interest income. Deductibility of any such excess interest expense is generally limited to 30% of the taxpayer's adjusted taxable income (ATI).

For taxable years beginning before 2022, ATI was defined as tax-adjusted earnings before interest, taxes, depreciation and amortization (EBITDA), and for taxable years thereafter, tax-adjusted earnings before interest and taxes (EBIT). Disallowed business interest expense may be carried forward indefinitely (subject to the business interest expense limitation and any other applicable limitations).

The change to the definition of ATI to tie it to EBIT rather than EBITDA collided with the considerable increase in interest rates since the TCJA was enacted. This may have limited the amount of business interest expense that could be deducted (and, thereby, increased the cost of capital) more significantly than was anticipated when the TCJA was enacted, particularly for taxpayers in capital-intensive industries that rely on debt financing (*e.g.*, heavy manufacturing).

The Bill offers relief by reinstating the original definition of ATI (*i.e.*, EBITDA) for 2024 and 2025. In addition, taxpayers may elect to use EBITDA to determine the business interest expense limitation for 2022 and 2023. The Bill does not include rules for making such an election, however, leaving it to the Secretary to provide guidance on how taxpayers can elect to adjust their limitations retroactively.

A taxpayer that might otherwise file an amended 2022 return to claim full expensing of domestic SR&E expenditures should consider the impact reduced amortization may have on its business interest expense limitation for that year.

Bonus Depreciation Under the Bill

Before enactment of the TCJA, the bonus depreciation rules allowed taxpayers to deduct 50% of the cost of new qualified property in the year in which the property was placed in service. Qualified property generally includes property with a recovery period of 20 years or less, such as computer equipment and office furniture, and depreciable — but not amortizable — computer software.

The TCJA modified the bonus depreciation rules to permit full expensing of new as well as certain used qualified property acquired and placed in service after September 27, 2017, and before 2023. Thereafter, bonus depreciation starts to phase out, decreasing by 20 percentage points per year to 80% for property placed in service in 2023, 60% in 2024, and so on.

The Bill restores 100% bonus depreciation for property placed in service in 2023 and 2024 and extends it for property placed in service through 2025. The Bill does not change the law for property placed in service thereafter. In 2026, bonus depreciation will generally be limited to 20%, and in 2027, bonus depreciation will be eliminated entirely. Each of these rules is extended by one year for property with longer production periods.

This extension of bonus depreciation will generally boost a taxpayer's ability to deduct business interest, given that the Bill's change to the definition of ATI permits taxpayers to calculate the business interest expense limitation using EBITDA rather than EBIT.

Highlights of the Green Book

On March 11, 2024, the Treasury Department issued General Explanations of the Administration's Fiscal Year 2025 Revenue Proposals (sometimes called the Green Book) to accompany President Joe Biden's proposed budget for FY 2025.

The Green Book would significantly increase tax burdens on corporations and high-net-worth individuals. The Green Book includes many of the proposals that were in the Green Book accompanying the FY 2024 budget, such as:

- Increasing the corporate income tax rate from 21% to 28%.
- Quadrupling the stock repurchase excise tax from 1% to 4%.
- Imposing additional requirements on tax-free treatment for spin-offs and split-offs (including the creation of an "excess monetization amount" that would cause the distributing corporation to recognize gain on certain monetization transactions that would otherwise be tax-free).
- Doubling the effective GILTI rate from 10.5% to 21% (by reducing the allowable deduction from 50% to 25% of the GILTI inclusion and applying the 28% corporate tax rate under the Green Book) and eliminating the exemption of a 10% deemed return on qualified business asset investment (QBAI) for purposes of calculating GILTI.
- Repealing the base erosion anti-abuse tax (BEAT) and adopting an undertaxed profits rule (UTPR) consistent with Pillar Two of the Organization for Economic Cooperation and Development (OECD) framework designed to ensure multinational companies are subject to a minimum 15% rate of taxation on their worldwide income.
- Imposing a minimum tax of 25% on total income (generally inclusive of unrealized capital gains) on individuals with a net worth greater than $100 million (the billionaires' tax).

Some notable proposals not contained in the last Green Book include:

- Increasing the corporate alternative minimum tax (or CAMT) from 15% to 21%.
- Disallowing corporate deductions for compensation over $1 million per year paid to any employee (not just top executives).

As indicated in the FY 2025 budget, the current Green Book proposals are expected to reduce the national deficit by $3 trillion over the next 10 years. Proposals in the Green Book will not be considered by Congress this year, but they are intended to serve as a starting point for discussions with Congress if President Biden is reelected in the upcoming presidential election.

One Manhattan West / New York, NY 10001 / 212.735.3000