Unpacking The Bill To Extend TCJA's Biz-Friendly Tax Breaks

By **Nazmiye Gökçebay, Tracy Grais and Patrick Hasson** (April 26, 2024)

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In January 2024, the U.S. House of Representatives adopted H.R. 7024, which, among other things, would extend certain expiring, or expired, business-friendly tax provisions of the Tax Cuts and Jobs Act, and enhance the child tax credit — including by retroactively increasing the maximum refundable portion of the credit for 2023.

To offset its projected $79 billion cost, the bill would accelerate the deadline for new pandemic-era employee retention tax credit, or ERTC, claims to Jan. 31 — now past — extending the statute of limitations with respect to ERTC claims and significantly increasing penalties for ERTC-related fraud.

Titled the "Tax Relief for American Families and Workers Act of 2024," the bill passed the House in a lopsided 357-70 bipartisan vote. A number of senators have voiced opposition to specific provisions, however, and the U.S. Senate has yet to formally consider it, even as small businesses push Congress to renew the soon-to-expire and expired provisions.

Recent reports indicate that Senate Republican opposition in particular is growing, in large part due to the enhanced child tax credit proposals. 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 about whether it will be enacted, and in what form.

Taxpayers that have not yet filed their returns — or that might consider filing amended returns — must closely monitor legislative and administrative developments as they prepare their returns.

Even if adopted as drafted, the bill's changes to provisions of the TCJA, some of which taxpayers may elect to apply retroactively, may affect taxpayers under other parts of the U.S. tax code. Accordingly, taxpayers will need to conduct careful analyses.

Key Business Incentives

If enacted in its current form, the bill would amend certain provisions of the TCJA to temporarily restore the deductibility of domestic research and experimental, or R&E, expenditures, raise the cap on the deduction of business interest expenses, and accelerate depreciation for some categories of purchased property.

The bill's changes apply to 2024 and 2025, as well as retroactively to 2023 and, in certain cases, 2022.

This article assumes the bill will be enacted as drafted and explains the proposed changes, identifying some of the considerations taxpayers should take into account in light of these potential amendments.

Deduction for R&E Expenditures

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, be amortized over a period of no less than 60 months. If a project was abandoned, unamortized expenditures could be deducted currently.

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. The TCJA disallowed R&E expenditures in an amount equal to any research credit claimed.

Under the TCJA, for taxable years beginning after 2021, current expensing of all R&E expenditures was eliminated. Instead, all specified R&E expenditures must be capitalized and may generally be amortized ratably over five years or, if attributable to foreign research, 15 years — in each case beginning with the midpoint of the taxable year in which such expenditures were paid or incurred.

Specified R&E expenditures, like pre-2022 R&E expenditures, are those paid or incurred in connection with the taxpayer's trade or business, although the TCJA made explicit that specified R&E expenditures include software development costs.

Unamortized specified R&E expenditures may not be accelerated on the abandonment of the related project; instead, amortization continues over any remaining term. Whether specified R&E expenditures may be recovered over 10 years under the alternative minimum tax rules is not clear as the TCJA did not make conforming amendments to those provisions.

Capitalized specified R&E expenditures — and, consequently, subsequent amortization — must be reduced by an amount equal to the excess of the taxpayer's allowable research credit over the deductible amount of specified R&E expenditures for the year.

To avoid this result, a taxpayer may instead elect to reduce its research credit by an amount equal to the research credit multiplied by the maximum corporate tax rate.

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, or FDII, and global intangible low-taxed income, or GILTI, among other things.

For a domestic multinational, the now-required amortization of specified R&E expenditures of any subsidiary that is a controlled foreign corporation may increase its net controlled-foreign-corporation-tested income resulting in increased GILTI inclusions.

At the same time, a domestic subsidiary may benefit from larger FDII deductions attributable to an increase in taxable income resulting from the allocation and apportionment of capitalized specified R&E expenditures to FDII.

Although the bill temporarily revives some of the pre-TCJA rules, it does not alter the rules that apply to foreign specified R&E expenditures, which remain subject to the capitalization and amortization rules imposed by the TCJA. As a result, the foregoing ripple effects would not be entirely reversed.

Under the bill, immediate expensing is again allowed for any domestic specified R&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 alternative minimum tax rules, or otherwise amortize them over a period of no less than 60 months, although, in the latter case, the amortization period begins in the month in which the taxpayer first realizes benefits attributable to such expenditures.

Like the TCJA, the bill requires a reduction in deductible domestic specified R&E expenditures to the extent that the taxpayer's research credit exceeds such expenditures, although taxpayers may reduce the research credit instead.

Because the bill's provisions apply retroactively, it 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 specified R&E expenditures to capital or amortize them over a period of no less than 60 months.

This election must be made on an amended return for that year, filed within one year of the bill's enactment — or as the U.S. secretary of the Treasury may otherwise provide.

This election should be considered by taxpayers that would benefit from an adjustment to the amortization required by the TCJA attributable to a change in the beginning of the prescribed amortization period from the midpoint of the taxable year in which the applicable expenditures were incurred to the month in which the taxpayer first realizes benefits from such expenditures.

A taxpayer that adopted a method of accounting with respect to its domestic specified R&E expenditures for its first taxable year beginning after 2021 may elect to treat the immediate expensing of any unamortized portion of such expenditures as a change in its 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 cutoff basis.

An adjustment with respect to a change in accounting method is generally taken into account in the taxable year of the change.

Therefore, the adjustment in respect of the immediate expensing of any unamortized specified R&E expenditures would generally be taken into account for the taxpayer's 2023 taxable year if the taxpayer makes the election on its 2023 tax return — or 2023 and 2024 for taxpayers that elect to take the adjustment into account over the two succeeding years.

Taxpayers may have benefited from correlative adjustments attributable to the amortization of specified R&E expenditures required by the TCJA.

For instance, the mandatory capitalization of previously deductible R&E expenditures would generally be expected to have increased a taxpayer's FDII — and the corresponding FDII deduction — and accelerated the use of net operating loss and credit carryforwards that might otherwise have expired.

Accordingly, the decision whether to immediately expense 2022 specified R&E expenditures by filing an amended 2022 return or to make the elections described above will require a

holistic assessment of the taxpayer's position for 2022 and going forward, including with respect to the remaining life of any carryforwards and other tax attributes, and the extent to which amortization of specified R&E expenditures may be beneficial.

Business Interest Expense Limitation

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

For taxable years beginning before 2022, "adjusted taxable income" was defined as tax-adjusted earnings before interest, taxes, depreciation and amortization, or EBITDA, and for taxable years thereafter, tax-adjusted earnings before interest and taxes, or EBIT, i.e., tax-adjusted earnings reduced by depreciation and amortization deductions.

Disallowed business interest expense may be carried forward indefinitely, subject to the business interest expense limitation in subsequent taxable years and any other applicable limitations.

The change in the definition of adjusted taxable income from EBITDA to EBIT 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, such as, for example, heavy manufacturing.

The bill offers relief by reinstating the original definition of adjusted taxable income — 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 Treasury 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 specified R&E expenditures should consider the impact that reduced amortization may have on its business interest expense limitation for that year if the taxpayer does not also elect to use EBITDA to determine their business interest expense limitation for 2022.

Bonus Depreciation

A taxpayer must generally capitalize the cost of tangible property used in a trade or business, or held for the production of income, and may recover the cost over time through annual depreciation deductions or upon disposition.

Before enactment of the TCJA, the bonus depreciation rules allowed taxpayers to accelerate some of this cost recovery by deducting 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 and certain used qualified property, acquired and placed in service after Sept. 27, 2017, and before

2023.

Thereafter, bonus depreciation starts to phase out, decreasing 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 adjusted taxable income permits taxpayers to calculate the business interest expense limitation using EBITDA rather than EBIT.

Conclusion

Although the bill in its current form would provide businesses with a welcome, albeit temporary, reprieve from certain unfavorable TCJA phaseouts, the interrelatedness of the bill's provisions with other sections of the U.S. tax code and the elective retroactivity of some of the changes will require taxpayers to model and carefully analyze alternative filing positions to maximize the benefits for all affected years, past and future.

Whether the bill will be enacted as drafted — or at all — remains uncertain. However, the opposition in the Senate underscores the importance of remaining abreast of legislative and administrative developments.

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