CLIENT ALERT: BIDEN FY 2023 BUDGET PLAN EXTENDS FOR CORPORATE, HIGH-NET-WORTH INDIVIDUALS TAX HIKES

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On March 28, 2022, the White House released its Fiscal Year 2023 Budget (the "FY23 Budget"), and concurrently, the U.S. Treasury released the General Explanations of the Administration's Fiscal Year 2023 Revenue Proposals (commonly known as the "Green Book"). The Green Book provides an explanation of the revenue proposals in the President's FY23 Budget and serves as a guidepost to Congress for tax legislation, and includes a description of current law, proposed changes, the policy rational for such changes, as well as Treasury's revenue projections. As such, it's important to keep in mind that nothing contained within the FY23 Budget or Green Book should not be confused with current law; rather, they should serve as an envisagement of what direction the current administration would wish to steer tax policy (think of it as a presidential wish list). This client alert provides a summary of the proposed changes within the FY23 Budget and Green Book, with a focus on corporations and businesses generally.

Raise Corporate Income Tax Rate	
Current Law	Proposal
A flat 21% corporate tax rate for C corporations and certain other non-passthrough entities.	Increase the corporate tax rate to 28% effective for taxable years after December 31, 2022. With an increase in the corporate tax rate, there would be a corresponding increase in the global intangible low tax income (GILTI) rate.

Repeal Beat and Adopt the Undertaxed Profits Rule	
Current Law	Proposal

Base Erosion Anti-Abuse Tax (BEAT) liability of 10% (12.5% after 2025) applies to certain corporate taxpayers, in addition to their regular tax liability. Generally speaking, BEAT is limited to corporate taxpayers with substantial gross receipts (>$500M) that make deductible payments for foreign related parties above a specified threshold.	Repeal the BEAT and replace it with the 'Undertaxed Profits Rule' (UTPR). The UTPR is consistent with Pillar Two rules from the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting. Generally speaking, the UTPR consists of two components: (i) a top-up tax on a parent entity with respect to the low-taxed income of a member of its financial reporting group; and (ii) deny deductions or require an equivalent adjustment to tax liability to the extent that the low-taxed income of a member of a corporate group is not subject to the top-up tax. The UTPR would primarily apply to foreign-parented multinationals operating in low-tax jurisdictions. Further, the UTPR would only apply to financial reporting groups that have global annual revenues of greater than $850M in at least two of the prior four years. The UTPR would be effective for years after December 31, 2022. This would be in addition to the adoption of a corporate global minimum tax as agreed to by 130 notions at the OECD in 2021.

Onshoring Tax Incentives	
Current Law	Proposal
There are limited tax incentives for U.S. employers to bring offshore jobs and investments to the United States.	The proposal would create a general business credit equal to 10% of eligible expenses incurred in connection with reducing or eliminating a trade or business currently conducted outside the U.S. in order to start, expand or otherwise more the same trade or business within the U.S. "to the extent that this action results in an increase in U.S. jobs." Further, the proposal would disallow deductions for expenses incurred in connection with offshoring a U.S. trade or business. This proposal would be effective for expenses paid or incurred after the date or enactment.

Confirming "Control" with Corporate Affiliation Test	
Current Law	Proposal

For purposes of most corporate tax provisions, Code § 368(c) "control" requires ownership of stock possessing at least 80 percent of the total combined voting power of all classes of voting stock and at least 80 percent ownership of the total number of shares of each class of outstanding nonvoting stock of the corporation. To determining whether a corporation is a member of an "affiliated group" of corporations, the "affiliation" test is significantly different. Specifically, the test under Code § 1504(a)(2) requires ownership of stock possessing at least 80 percent of the total voting power of the stock of the corporation and that has a value of at least 80 percent of the total value of the stock of the corporation.	The proposal would conform the Code § 368(c) control test with the Code § 1504(a)(2) affiliation test, whereby "control" would be defined as the ownership of at least 80 percent of the total voting power and at least 80 percent of the total value of stock of a corporation. This would be effective for transactions occurring after December 31, 2022.

Expanded Access to Retroactive QEF Election in Relation to PFICs	
Current Law	Proposal
The passive foreign investment company (PFIC) rules prevent taxpayers from deferring the taxation of passive income and recharacterizing income from those investments from ordinary income into capital gain by holding the investments through a foreign investment company. Absent a qualified electing fund (QEF) or another permitted election, excess distributions received from a PFIC are subject to additional tax in an amount determined by reference to the rate of interest that applies to underpayments of tax. If an investor in a PFIC makes a QEF election, the taxpayer is not subject to the tax on excess distributions after the effective date of the election. Instead, the taxpayer generally is required to take into account the taxpayer's pro rata share of the ordinary income and long-term capital gain of the PFIC on an annual basis and pay tax on this income. Typically, a QEF election must be made on or before the due date for the taxpayers' return. Currently, a retroactive QEF election is only allowed in limited circumstances provided within the regulations, or with the consent of the IRS.	The proposal would modify the PFIC rules to permit taxpayers to make a retroactive QEF election in expanded circumstances prescribed by the IRS. Taxpayers would be eligible to make a retroactive QEF election without requesting consent in cases that do not prejudice the U.S. government. For instance, if a taxpayer wanted to make a retroactive QEF election in a year that is still open to assessment, then IRS consent would not be necessary; however, if the taxpayer wanted to make a retroactive QEF election in a year that was closed to assessment, then the taxpayer would still need to consent of the IRS. The reasoning behind the proposal is to encourage more taxpayers to make a QEF election thereby hopefully increasing compliance and reducing PFIC ownership burdens.

Definition of Foreign Business Entity Expanded to Include Taxable Units	
Current Law	Proposal

In general, section 6038 of the Internal Revenue Code (Code) requires a U.S. person who controls a foreign business entity (a foreign corporation or foreign partnership) to report certain information with respect to such entity. The statute provides for penalties for a failure to report.	The proposal would expand the definition of foreign business entity to treat any taxable unit in a foreign jurisdiction as a "foreign business entity" for reporting purposes.
Prevent Basis Shifting by Related Parties though Partnerships and Section 754 Election	
Current Law	Proposal
A partnership is permitted to make a Code § 754 election, which allows a partnership to adjust the basis of the property within the partnership, to adjust the basis of its assets when the partnership distributes assets or a partner transfers interest in the partnership.	The proposal would reduce the ability of related parties to use a partnership to shift partnership basis among themselves. In the case of a distribution of partnership property that results in a basis step-up of the partnership's non-distributed property, the proposal would apply a matching rule that would prohibit any partner in the distributing partnership that is related to the distributee-partner from benefitting from the partnership's basis step-up until the distributee-partner disposes of the distributed property in a fully taxable transaction.
Tax Carried (Profits) Interests as Ordinary Income	
Current Law	Proposal
An interest in future partnership profits (without any corresponding capital contribution) in exchange for services is typically referred to as a 'profits interest' or 'carried interest.' If and to the extent a partnership recognizes long-term capital gain, the partners (including partners who provide services) will reflect their shares of such gain on their tax returns as long-term capital gain. Further, gain recognized on the sale of a partnership interest is generally capital gain. Similarly, capital gain attributable to a profits interest is generally excluded self-employment tax.	The proposal would tax as ordinary income a partner's share of income on an "investment services partnership interest" (ISPI) in an investment partnership, regardless of the character of the income at the partnership level, if the partner's taxable income (from all sources) exceeds $400,000. Further, the proposal would require partners in such investment partnerships to pay self-employment taxes on ISPI income if the partner's taxable income (from all sources) exceeds $400,000. Proposal would be effective after 2022.
Repeal Code § 1031 Deferral of Gain from Like-Kind Exchanges	
Current Law	Proposal
Under Code § 1031, owners of appreciated real property used in a trade or business or held for investment can defer gain on the exchange of the property for real property of a "like-kind," resulting in gain being deferred until a later recognition event.	The proposal would allow the deferral of gain up to an aggregate amount of $500K for each taxpayer each year for real property exchanges that are like-kind. Any excess gain would need to be recognized. The proposal would be effective after 2022.
Real Estate Depreciation Recapture	

Current Law	Proposal
There is no recapture of depreciation on depreciated real estate.	The proposal would require any depreciation on real estate to be recaptured and taxed at ordinary income rates for taxpayers with adjusted gross income over $400K if married ($200K if single). The proposal would be effective for taxable years after December 31, 2022.

While some of the above proposal are eye-opening, we should all keep in mind that these proposals are tantamount to a presidential wish-list and not part of any proposed legislation at this time. Should you have any questions, please feel free to contact Daniel W. Hudson or another tax professional at Berger Singerman.