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US Federal Tax Update

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Rising Star Association

2022 WINNER

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Agenda

- Overview of Biden Tax Proposals (FY 2024 Budget)

Overview of Biden Administration FY 2024 Budget

Domestic Provisions

Increase Corporate Tax Rate

- The administration's proposal would increase the flat corporate income tax rate from 21% to 28%, effective for tax years beginning after December 31, 2022. For fiscal year corporations with a tax year that straddles January 1, 2023 (i.e., a tax year beginning in 2022 and ending in 2023), the proposal would apply a tax rate equal to (i) 21% plus (ii) 7% multiplied by the portion of the tax year that occurs in 2023.

- Proposed rate change can increase the importance of the timing of income and deductions, and can affect the value of tax attributes such as carryovers of net operating losses (NOLs), capital losses, and deferred interest deductions under Section 163(j)

- Estimated to raise more than $1.3 trillion over ten years.

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Corporate Distributions as Dividends

- Expand the scope of corporate distributions that are treated as dividends. The administration believes that corporations have devised a number of ways to avoid dividend characterization of certain distributions of property, such as through certain transactions that reduce a corporation's earnings and profits but do not result in a reduction in a corporation's dividend paying capacity.

- Designed to prevent elimination of E&P through distributions of stock with basis attributable to dividend equivalent redemptions.

Leveraged Distributions/Return of Basis

- Treat a leveraged distribution from a corporation to its shareholders that is treated as a recovery of basis as the receipt of a dividend directly from a related corporation to the extent the funding corporation funded the distribution with a principal purpose of not treating the distribution as a dividend from the funding corporation.

- The proposal would treat what is otherwise a return of basis distribution from one corporation as the receipt of a dividend directly from a related corporation, to the extent the related corporation funds the distributing corporation with a principal purpose of not treating the distribution as a dividend from the funding corporation.

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Repeal Gain Limitation on Dividends in Reorgs

- Generally, under IRC Section 356(a)(2), if the exchange has the effect of the distribution of a dividend, then all or part of the gain recognized by the shareholder is treated as a dividend to the extent of the shareholder’s ratable share of the corporation’s E&P, with the remainder of the gain treated as gain from the exchange of property (generally capital gain).

- The proposal would repeal the “boot within gain” limitation in the case of any reorganization if the exchange has the effect of the distribution of a dividend under section 356(a)(2). In addition, the proposal would align the available pool of earnings and profits to test for dividend treatment with the rules of section 316 governing ordinary distributions.

Limitation of Losses Recognized in Liquidations

- A shareholder of a liquidating corporation generally recognizes gain or loss on the receipt of assets from the liquidating corporation in complete liquidation under section 331, and the liquidating corporation recognizes gain or loss (subject to certain loss limitation rules) on its distribution of property to its shareholders under section 336.

- Under section 332, if a corporation owns stock in a subsidiary corporation that possesses 80% or more of the total vote and value of the subsidiary's outstanding stock, thea80% corporate shareholder does not recognize gain or loss on its receipt of assets from the subsidiary in complete liquidation and, under section 337, the liquidating subsidiary corporation generally does not recognize gain or loss on property distributed to the 80% corporate shareholder.
- Section 267(f)(2) generally provides that losses recognized on sales or exchanges of property between members of a controlled group of corporations generally are deferred until the property is transferred outside the controlled group.

Limitation of Losses Recognized in Liquidations

- Section 267(f)(2) generally provides that losses recognized on sales or exchanges of property between members of a controlled group of corporations generally are deferred until the property is transferred outside the controlled group.

- The proposal would modify section 267 to deny the recognition of losses with respect to the stock or securities of a liquidating corporation and the property it distributes in a complete liquidation to which sections 331 and 336 apply if the assets of the liquidating corporation remain in the controlled group after the liquidation.

Amend Definition of Control

- The proposal would amend the “control test” under section 368(c) to adopt the “affiliation test” under section 1504(a)(2). Therefore, “control” would be defined as the ownership of at least 80% of the total voting power and at least 80% of the total value of stock of a corporation. For this purpose, stock would not include certain preferred stock that meets the requirements of section 1504(a)(4) (certain non-voting, “plain vanilla” preferred stock).

- Currently, for purposes of defining “control” as that term is used in connection with tax-free transfers of assets to controlled corporations in exchange for stock (section 351 exchanges), tax-free distributions of controlled corporations (such as in spin-offs), and tax-free corporate reorganizations, “control” is defined in section 368(c) as the ownership of 80% of the voting stock and 80% of the number of shares of all other classes of stock of the corporation.

- Control for purposes of the “affiliation test” under section 1504(a)(2) is defined by reference to the direct or indirect ownership by a parent corporation of stock in another corporation that possesses at least 80% of the total voting power and at least 80% of the total value of the other corporation’s stock (excluding certain plain vanilla preferred stock).

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Noncorporate Loss Limitation

- The Section 461(l) excess business loss limitation limits the extent to which trade or business losses of a noncorporate taxpayer may be used to offset other income of the taxpayer. The excess business loss limitation is calculated by taking the aggregate deductions attributable to trades or businesses over the sum of aggregate gross income or gain attributable to trades or businesses, plus an annual threshold amount. Under current law, any excess business loss which is suspended is carried over to the taxpayer's next tax year as a net operating loss (NOL).
- The excess business loss limitation regime is set to sunset, such that losses will no longer be limited after December 31, 2028. The proposal would remove the provision's present sunset date and make the excess business loss limitation permanent.
- Under the proposal, 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.

International Changes

DRD Limitation from Non-Controlled Foreign Corporations

- Under current law, section 245A provides a deduction for the foreign-source portion of a dividend received by a U.S. shareholder from a specified 10% owned foreign corporation (a “section 245A DRD”), subject to the U.S. shareholder satisfying the holding period requirements of section 246(c).
- Other than CFCs, the term qualified foreign corporation is intended to include corporations that are incorporated in a U.S. territory and those corporations that are eligible to claim the benefits of a comprehensive income tax treaty with the United States.
- The Green Book proposal would provide that a U.S. shareholder that owns at least 20% of the stock (vote and value) of a qualified foreign corporation that is not a CFC may claim a 65% (reduced from 100%) section 245A DRD. If the 20% ownership threshold is not met with respect to the qualified foreign corporation that is not a CFC, the U.S. shareholder would only be entitled to a 50% section 245A DRD.

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Inversion Limitations

- The proposal would reduce the ownership percentage for complete inversion (where the foreign acquirer is treated as a domestic corporation for U.S. tax purposes) from at least 80% to greater than 50% and would eliminate the current law 60% test for surrogate foreign corporations. The proposal would also expand the scope of an inversion to include certain asset acquisitions consisting of substantially all of a trade or business.

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Disallowance of Certain Stock Losses

- In determining a U.S. shareholder’s loss on the disposition of stock of a CFC, the proposal would require a U.S. shareholder to reduce its basis in the shares of a CFC (but not below zero) by the amount of deductions relating to GILTI or Section 965 income inclusions that were attributable to the stock.
- Under current law, a U.S. shareholder is entitled to a dollar-for-dollar basis increase equal to the full amount of the subpart F or GILTI inclusion, notwithstanding the fact that the U.S. shareholder might have been entitled to a Section 250 or a Section 965 deduction as a result of that inclusion.

Repeal of FDII

- The Green Book would repeal the deduction for foreign-derived intangible income (FDII), effective for tax years beginning after December 31, 2023.

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