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What a Biden Presidency May Mean for US Tax Law

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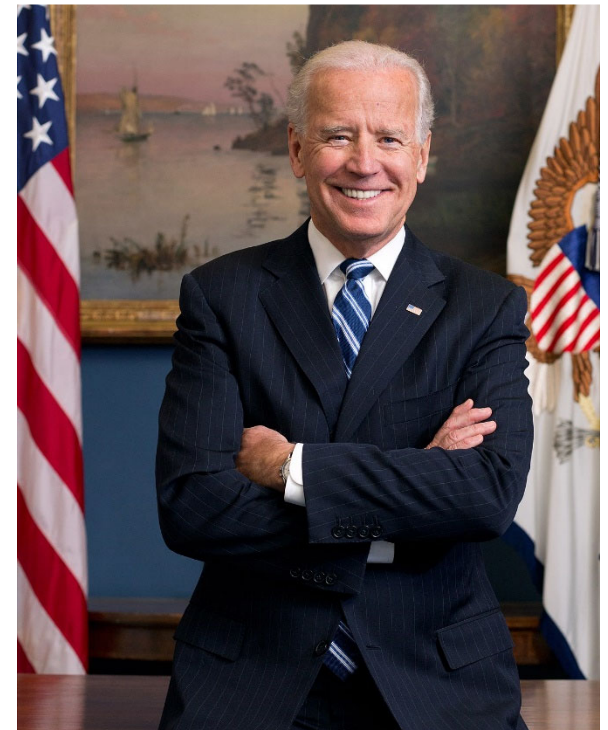
General Background

Joe Biden (Democrat) took office as President of the United States on January 20, 2021, replacing Donald Trump.

Biden has been highly critical of the so-called "Tax Cuts and Jobs Act" ("TCJA") enacted in December 2017 during the Donald Trump administration.

Biden's campaign platform included imposing more onerous tax rules on U.S. corporations with foreign subsidiaries and increasing the taxes of U.S. corporations and wealthier Americans, while also promising greater engagement with the international community.

Biden's ability to implement his tax proposals will depend in large part on his ability to navigate an evenly-divided Senate, in which the Democratic Vice President is able to cast a "tie breaker" vote.



Legislative Process and Impact of a Divided Government

Tax legislation needs to be passed by both the House of Representatives and the Senate, and then signed by the President.

— The lack of a powerful majority in the Senate will make it difficult to pass significant legislation. There are a lot "choke points" in the system.

International tax treaties become law in the U.S. only if approved by the Senate by a two-thirds supermajority vote.

The need for compromise is evident in the formal deal for power-sharing between Democrats and Republicans in the Senate.

Without Presidential support and with a Democratic-controlled Congress, certain Republican-backed legislation that might have been in the pipeline under the prior administration (*e.g.*, indexing capital gains to inflation, expanding the "Opportunity Zones" tax break) will not be enacted.

The TCJA Legislation and Impact of a Divided Government

The TCJA was passed in 2017 as a Republican initiative; Republicans controlled both the House and Senate.

The TCJA reduced corporate tax rates from 35% to 21% and provided many other tax benefits. But, under U.S. law, tax reductions may not increase the government deficit by more than certain amount after a ten-year period; so, many of the benefits are scheduled to expire ("sunset") in 2025 or otherwise change.

— Business taxpayers have been hoping the benefits will be extended by new legislation.

TCJA PROVISIONS THAT ARE IMPACTED INCLUDE

— rules relating to the expensing of tangible business investment;

— the income base against which net business interest expense may be deducted (from EBITDA to EBIT);

— tax rate on "GILTI" increased from 10.5% to 13.125%; and

— minimum tax required under the "BEAT" regime increased from 10% to 12.5%

Changes That Biden Could Implement Without Legislation

1. The Biden administration can control the agenda and priorities of the Treasury Department and the Internal Revenue Service ("IRS"), which interpret, implement and enforce the tax laws.

2. The Biden administration will appoint new senior executives at Treasury and the IRS.

3. The new leadership can impact how the existing laws are interpreted and implemented through administrative guidance (including Regulations) and may even work to change administrative guidance issued under the TCJA during the Trump presidency.

4. The new leadership can also refocus enforcement efforts, stressing certain laws and not others.

5. Multilateral projects (such as OECD-led efforts to address the tax challenges of the digital economy) are led by Treasury and, under Biden, the U.S. is likely to be more active in the international dialogue and negotiations, as Janet Yellen has already signaled. However, final implementation will require legislative support.

6. Treaty negotiations are run by the Treasury Department and the Biden-led Treasury may be more active in this area. But, treaties do not become law until the Senate ratifies them.

7. Biden can also directly impact businesses by issuing "executive orders, such as the recent executive orders to, among other matters, enforce or strengthen "Buy American" requirements in various activities and projects funded by the federal government (government agencies, infrastructure, etc.).

Biden’s More Ambitious Legislative Agenda

Although the ability to push forward major tax legislation may be difficult, the existence of a Democratic majority (with the Vice President) provides some possibility of major tax changes.

Let’s take a closer look at the proposals the Biden campaign talked about.

TAX RATE CHANGES

— *Increasing the Top Corporate Income Tax Rate from 21% to 28%*
  - Note: TCJA lowered the corporate rate from 35% to 21%.

— *Imposing a 15% “Alternative Minimum Tax” (“AMT”) on corporations*
  - Note: TCJA completely eliminated the then-20% corporate AMT.

— *Increasing the Top Individual Tax Rate from 37% to 39.6%*
  - Note: This is reversal of TCJA’s reduction of the top individual tax rate.

Further Legislative Proposals by Biden

SOCIAL SECURITY TAX INCREASE

— Under current law, a payroll tax of 12.4% (6.2% paid by employer and 6.2% paid by employee) is imposed to fund social security, but only on annual earned income up to approximately $148,000. Income from self-employment is subject to a simple 12.4% tax on earned income up to approximately $148,000.

— Biden has proposed imposing the tax additionally on all earned income in excess of $400,000.

PARTIAL REPEAL OF CAPITAL GAINS RATE

— Gains in respect of capital assets held for more than one year are taxed current at a preferential rate equal to 20%.

— The Biden administration would remove the preferential rate for taxpayers earning more that $1 million annually (*i.e.,* the capital gain rate would be 39.6%).

Biden’s International Tax Legislative Proposals: Background

International Tax Rules Before TCJA :

Income of foreign corporate subsidiaries of U.S. multinationals generally was not taxed by the U.S. until repatriated to the U.S. parent via actual distributions.

— “Subpart F” taxed *some* foreign subsidiary income currently, but not much.

This system caused a lot of cash to be “trapped” in foreign low-tax jurisdictions because of the U.S. tax cost of repatriation (so-called “APB 23 earnings”).

— This system was much debated and widely criticized.

Biden’s International Tax Legislative Proposals: Background

TCJA Changes to International Tax Rules:

TCJA IMPLEMENTED A NEW SYSTEM:

— A portion of the foreign subsidiaries’ earnings are not taxed currently by the U.S. The untaxed amount equals:

- the foreign subsidiaries’ tax bases in “qualified business investment assets” (generally, tangible assets used in a business) *multiplied by* 10%.

— Earnings above that amount are taxed currently by the U.S. (referred to as “Global Intangible Low Taxed Income” (“GILTI”) at a rate of 10.5%.

- Theory is that the earnings derived from foreign-located tangible assets should not be taxed by U.S. and that all other earnings must be from intangible assets (and should be taxed by the U.S.).
- A limited foreign tax credit may be available to offset GILTI, and is provided at the shareholder level based on worldwide GILTI income.

— Actual distributions by the foreign subsidiaries to the U.S. parent are not taxed by the U.S. (by virtue of a 100% dividends-received deduction).

Biden's International Tax Legislative Proposals

The Biden campaign criticized the current regime as subsidizing the offshoring of U.S. jobs and not collecting sufficient taxes from profitable U.S. corporate multinationals.

Proposals Biden has suggested:

Ensure that all foreign income of U.S. multinationals is taxed at 21% (presumably on a current basis).

- Eliminate the exemption for 10% returns on QBAI
- Country-by-country basis

Implement strong anti-inversion penalties

- Note that many think they are pretty strong already.

DIRECTLY ENCOURAGE U.S. JOBS AND INDUSTRY BY:

- Imposing an additional 10% penalty surcharge on profits earned from off-shoring U.S. jobs (raising the total tax rate on such profits to 30.8%).
- Denying deductions for expenses of moving jobs or production overseas "where those jobs could plausibly be offered to American workers".
- Provide a "Made in America" 10% tax credit.

OECD Implementation: Prerequisites for Success

Global challenges call for global solutions – the need for an international agreement on the two pillars in the OECD Inclusive Framework on BEPS

— Addressing the tax challenges arising from digitalisation is more relevant than ever since it is an important issue to our citizens and also pertinent to the economic recovery in the post-COVID era. This includes the introduction of an effective minimum taxation as well as an agreement on the reallocation of taxing rights. Otherwise, unilateral measures and fragmentation will continue to grow.

Ensure implementation – the alignment of national tax provisions with international solutions

— An agreement on both pillars will make changes to national provisions necessary. With regard to the US, GILTI and BEAT raise the issue of co-existence with the IIR regimes and the UTPR.

Respecting the perspectives of relevant stakeholders when creating an international level playing field

— In order to reach sustainable and reliable international consent, the perspectives of the domestic stakeholders (legislators, but also business, trade unions, academia, civil society) have to be taken on board at an early stage. Such early dialogue and interaction pave the way for broad acceptance and a smooth implementation.

Multilateral Efforts/OECD

There has been much discussion of Pillars 1 and 2:

— Historically, the United States has been more interested in addressing issues on its own.

— Recent proposed Treasury regulations on foreign tax credits could deny credits for foreign taxes paid under systems that do not require a traditional "jurisdictional nexus" (e.g., digital sales tax).

— On the other hand, Secretary Yellen has taken a more positive tone, and Itai Grinberg, (the new "Deputy Assistant Secretary for Multilateral Tax") who seems supportive of the project of "unified approach" and has written extensively on tax policy.

— Mnuchin's suggestion that Pillar 1 be a "safe harbor" is no longer being considered.

— Potential changes to GILTI may provide hope for convergence with Pillar 2.

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