DESCRIPTION OF THE TAX PROVISIONS OF THE CHAIRMAN'S AMENDMENT IN THE NATURE OF A SUBSTITUTE TO THE BUDGET RECONCILIATION LEGISLATIVE RECOMMENDATIONS RELATED TO TAX

Scheduled for Markup
by the
HOUSE COMMITTEE ON WAYS AND MEANS
on May 13, 2025

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The House Committee on Ways and Means has scheduled a committee markup for May 13, 2025, of the Chairman's Amendment in the Nature of a Substitute to the Budget Reconciliation Legislative Recommendations Related to Tax. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the tax provisions of the bill.[2]

The Chairman's amendment in the nature of a substitute strikes the language of the bill and replaces it with the language as described below.

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[1] This document may be cited as follows: Joint Committee on Taxation*, Description of the Tax Provisions of the Chairman's Amendment in the Nature of a Substitute to the Budget Reconciliation Legislative Recommendations Related to Tax* (JCX-21-25), May 12, 2025. This document can also be found on the Joint Committee on Taxation website at www.jct.gov. All section references in the document, and all references in the text of the bill to a section or provision, are to the Internal Revenue Code of 1986, as amended (the "Code"), unless otherwise stated.

[2] The bill provides that section 15 does not apply to any tax rate change resulting from any provision of the bill.

SUBTITLE A—MAKE AMERICAN FAMILIES AND WORKERS THRIVE AGAIN

PART I—PERMANENTLY PREVENTING TAX HIKES ON AMERICAN FAMILIES AND WORKERS

A. Extension of Modification of Rates

Present Law

In general

To determine regular tax liability, individual, estate, and trust taxpayers generally must apply the tax rate schedules (or the tax tables) to their regular taxable income.[3] The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income bracket increases.

Tax rate schedules

Separate rate schedules apply based on an individual's filing status. Public Law 115-97 changed the rate schedules for taxable years beginning after December 31, 2017, and beginning before January 1, 2026. For 2025, the regular individual, estate, and trust income tax rate schedules are as follows:

Table 1.–Federal Individual, Estate, and Trust Income Tax Rates for 2025[*]

If taxable income is:	Then income tax equals:
Single Individuals	
Not over $11,925	10% of the taxable income
Over $11,925 but not over $48,475	$1,192.50 plus 12% of the excess over $11,925
Over $48,475 but not over $103,350	$5,578.50 plus 22% of the excess over $48,475
Over $103,350 but not over $197,300	$17,651 plus 24% of the excess over $103,350
Over $197,300 but not over $250,525	$40,199 plus 32% of the excess over $197,300
Over $250,525 but not over $626,350	$57,231 plus 35% of the excess over $250,525
Over $626,350	$188,769.75 plus 37% of the excess over $626,350

[3] Sec. 1.

If taxable income is:	Then income tax equals:
Heads of Households	
Not over $17,000	10% of the taxable income
Over $17,000 but not over $64,850	$1,700 plus 12% of the excess over $17,000
Over $64,850 but not over $103,350	$7,442 plus 22% of the excess over $64,850
Over $103,350 but not over $197,300	$15,912 plus 24% of the excess over $103,350
Over $197,300 but not over $250,500	$38,460 plus 32% of the excess over $197,300
Over $250,500 but not over $626,350	$55,484 plus 35% of the excess over $250,500
Over $626,350	$187,031.50 plus 37% of the excess over $626,350
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $23,850	10% of the taxable income
Over $23,850 but not over $96,950	$2,385 plus 12% of the excess over $23,850
Over $96,950 but not over $206,700	$11,157 plus 22% of the excess over $96,950
Over $206,700 but not over $394,600	$35,302 plus 24% of the excess over $206,700
Over $394,600 but not over $501,050	$80,398 plus 32% of the excess over $394,600
Over $501,050 but not over $751,600	$114,462 plus 35% of the excess over $501,050
Over $751,600	$202,154.50 plus 37% of the excess over $751,600
Married Individuals Filing Separate Returns	
Not over $11,925	10% of the taxable income
Over $11,925 but not over $48,475	$1,192.50 plus 12% of the excess over $11,925
Over $48,475 but not over $103,350	$5,578.50 plus 22% of the excess over $48,475
Over $103,350 but not over $197,300	$17,651 plus 24% of the excess over $103,350
Over $197,300 but not over $250,525	$40,199 plus 32% of the excess over $197,300
Over $250,525 but not over $375,800	$57,231 plus 35% of the excess over $250,525
Over $375,800	$101,077.25 plus 37% of the excess over $375,800
Estates and Trusts	
Not over $3,150	10% of the taxable income
Over $3,150 but not over $11,450	$315 plus 24% of the excess over $3,150
Over $11,450 but not over $15,650	$2,307 plus 35% of the excess over $11,450
Over $15,650	$3,777 plus 37% of the excess over $15,650

* Rev. Proc. 2024-40, 2024-45 I.R.B. 1100, November 4, 2024.

For taxable years beginning after December 31, 2025, the changes made to the rate schedules by Public Law 115-97 no longer apply. For 2026, the regular individual, estate, and trust income tax rate schedules are projected to be as follows:

Table 2.–Federal Individual, Estate, and Trust Income Tax Rates for 2026[*]

If taxable income is:	Then income tax equals:
Single Individuals	
Not over $12,150	10% of the taxable income
Over $12,150 but not over $49,300	$1,215 plus 15% of the excess over $12,150
Over $49,300 but not over $119,400	$6,787.50 plus 25% of the excess over $49,300
Over $119,400 but not over $249,100	$24,312.50 plus 28% of the excess over $119,400
Over $249,100 but not over $541,550	$60,628.50 plus 33% of the excess over $249,100
Over $541,550 but not over $543,800	$157,137 plus 35% of the excess over $541,550
Over $543,800	$157,924.50 plus 39.6% of the excess over $543,800
Heads of Households	
Not over $17,350	10% of the taxable income
Over $17,350 but not over $66,050	$1,735 plus 15% of the excess over $17,350
Over $66,050 but not over $170,550	$9,040 plus 25% of the excess over $66,050
Over $170,550 but not over $276,200	$35,165 plus 28% of the excess over $170,550
Over $276,200 but not over $541,550	$64,747 plus 33% of the excess over $276,200
Over $541,550 but not over $577,750	$152,312.50 plus 35% of the excess over $541,550
Over $577,750	$164,982.50 plus 39.6% of the excess over $577,750
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $24,300	10% of the taxable income
Over $24,300 but not over $98,600	$2,430 plus 15% of the excess over $24,300
Over $98,600 but not over $199,000	$13,575 plus 25% of the excess over $98,600
Over $199,000 but not over $303,250	$38,675 plus 28% of the excess over $199,000
Over $303,250 but not over $541,550	$67,865 plus 33% of the excess over $303,250
Over $541,550 but not over $611,750	$146,504 plus 35% of the excess over $541,550
Over $611,750	$171,074 plus 39.6% of the excess over $611,750

If taxable income is:	Then income tax equals:
Married Individuals Filing Separate Returns	
Not over $12,150	10% of the taxable income
Over $12,150 but not over $49,300	$1,215 plus 15% of the excess over $12,150
Over $49,300 but not over $99,500	$6,787.50 plus 25% of the excess over $49,300
Over $99,500 but not over $151,625	$19,337.50 plus 28% of the excess over $99,500
Over $151,625 but not over $270,775	$33,932.50 plus 33% of the excess over $151,625
Over $270,775 but not over $305,875	$73,252 plus 35% of the excess over $270,775
Over $305,875	$85,537 plus 39.6% of the excess over $305,875
Estates and Trusts	
Not over $3,300	15% of the taxable income
Over $3,300 but not over $7,800	$495 plus 25% of the excess over $3,300
Over $7,800 but not over $11,900	$1,620 plus 28% of the excess over $7,800
Over $11,900 but not over $16,200	$2,768 plus 33% of the excess over $11,900
Over $16,200	$4,187 plus 39.6% of the excess over $16,200

*Joint Committee on Taxation staff projections.

Indexing for inflation

The income bracket thresholds, the amounts where a higher rate bracket begins and a lower rate bracket ends, are indexed for inflation using a cost-of-living adjustment.[4] The cost-of-living adjustment for the regular income tax brackets for 2025 is the percentage by which the Chained Consumer Price Index for all Urban Consumers ("chained CPI") for 2024 exceeds the chained CPI for 2017.[5]

Description of Proposal

The proposal makes permanent the regular income tax rate schedules for individuals, estates, and trusts enacted by Public Law 115-97.

The proposal generally modifies the indexing for inflation for bracket thresholds by providing one additional year of inflation in the cost-of-living adjustment. Under the proposal, the cost-of-living adjustment for the regular income tax brackets for 2026 is generally the

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[4] Sec. 1(f).

[5] Sec. 1(j)(3). In general, provisions in the Code that are inflation adjusted using the Consumer Price Index calculate the inflation adjustment for a given calendar year by comparing the price index in the preceding calendar year to the price index in a "base year."

percentage by which the chained CPI for 2025 exceeds the chained CPI for 2016.[6] The result is that the bracket thresholds are larger than they would otherwise be absent this additional year of inflation.

However, the dollar amount at which the 37-percent rate bracket begins and the 35-percent rate bracket ends (the "37-percent rate bracket threshold") is not provided this additional year of inflation in the cost-of-living adjustment. Thus, the cost-of-living adjustment for the 37-percent rate bracket threshold for 2026 is the percentage by which chained CPI for 2025 exceeds the chained CPI for 2017.

Under the proposal, for 2026, the regular individual income tax rate schedules are projected to be as follows:

Table 3.–Federal Individual, Estate, and Trust Income Tax Rates for 2026 Under the Proposal*

If taxable income is:	Then income tax equals:
Single Individuals	
Not over $12,375	10% of the taxable income
Over $12,375 but not over $50,275	$1,237.50 plus 12% of the excess over $12,375
Over $50,275 but not over $107,200	$5,785.50 plus 22% of the excess over $50,275
Over $107,200 but not over $204,700	$18,309 plus 24% of the excess over $107,200
Over $204,700 but not over $259,925	$41,709 plus 32% of the excess over $204,700
Over $259,925 but not over $639,275	$59,381 plus 35% of the excess over $259,925
Over $639,275	$192,153.50 plus 37.0% of the excess over $639,275
Heads of Households	
Not over $17,650	10% of the taxable income
Over $17,650 but not over $67,300	$1,765 plus 12% of the excess over $17,650
Over $67,300 but not over $107,200	$7,723 plus 22% of the excess over $67,300
Over $107,200 but not over $204,700	$16,501 plus 24% of the excess over $107,200
Over $204,700 but not over $259,900	$39,901 plus 32% of the excess over $204,700
Over $259,900 but not over $639,250	$57,565 plus 35% of the excess over $259,900
Over $639,250	$190,337.50 plus 37.0% of the excess over $639,250

[6] Absent this modification, the cost-of-living adjustment for this purpose for 2026 is the percentage by which the chained CPI for 2025 exceeds the chained CPI for 2017.

If taxable income is:	Then income tax equals:
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $24,750	10% of the taxable income
Over $24,750 but not over $100,550	$2,475 plus 12% of the excess over $24,750
Over $100,550 but not over $214,400	$11,571 plus 22% of the excess over $100,550
Over $214,400 but not over $409,400	$36,618 plus 24% of the excess over $214,400
Over $409,400 but not over $519,850	$83,418 plus 32% of the excess over $409,400
Over $519,850 but not over $767,150	$118,762 plus 35% of the excess over $519,850
Over $767,150	$205,317 plus 37.0% of the excess over $767,150
Married Individuals Filing Separate Returns	
Not over $12,375	10% of the taxable income
Over $12,375 but not over $50,275	$1,237.50 plus 12% of the excess over $12,375
Over $50,275 but not over $107,200	$5,785.50 plus 22% of the excess over $50,275
Over $107,200 but not over $204,700	$18,309 plus 24% of the excess over $107,200
Over $204,700 but not over $259,925	$41,709 plus 32% of the excess over $204,700
Over $259,925 but not over $383,575	$59,381 plus 35% of the excess over $259,925
Over $383,575	$102,658.50 plus 37.0% of the excess over $383,575
Estates and Trusts	
Not over $3,300	10% of the taxable income
Over $3,300 but not over $11,850	$330 plus 24% of the excess over $3,300
Over $11,850 but not over $15,950	$2,382 plus 35% of the excess over $11,850
Over $15,950	$3,817 plus 37% of the excess over $15,950

* JCT staff calculations.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

B. Extension of Increased Standard Deduction and Temporary Enhancement

Present Law

An individual who does not elect to itemize deductions reduces adjusted gross income ("AGI") by the amount of the applicable standard deduction in arriving at taxable income. The standard deduction is the sum of the basic standard deduction and, if applicable, the additional standard deduction.[7] The basic standard deduction varies depending upon a taxpayer's filing status. For taxable years beginning in 2025, the amount of the basic standard deduction is $15,000 for an unmarried individual (other than a head of household or a surviving spouse) and a married individual filing a separate return,[8] $22,500 for a head of household, and $30,000 for married individuals filing a joint return and a surviving spouse.[9]

An additional standard deduction is allowed to an individual who has attained age 65 before the close of the taxable year or is blind at the close of the taxable year.[10] For 2025, the additional amount is $1,600 for a married taxpayer (for each spouse meeting the applicable criteria in the case of a joint return) and a surviving spouse. The additional amount for a single individual and head of household is $2,000. An individual who is both blind and has attained age 65 is entitled to two additional standard deductions, for a total additional amount (for 2025) of $3,200 or $4,000, as applicable.

In the case of a dependent for whom a deduction for a personal exemption[11] is allowable to another taxpayer, the standard deduction may not exceed the greater of (i) $1,350 (in 2025) or (ii) the sum of $450 (in 2025) plus the dependent's earned income.[12] The standard deduction for an estate or trust is zero.[13] The amounts of the basic and additional standard deduction are indexed annually for inflation.[14]

Public law 115-97 temporarily increases the basic standard deduction for tax years beginning after December 31, 2017, and before January 1, 2026. Under present law, relative to taxable years beginning in 2025, the standard deduction will decrease for taxable years beginning

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[7] Sec. 63(c)(1).

[8] In the case of a married individual filing a separate return where either spouse itemizes deductions, the standard deduction is zero. Sec. 63(c)(6).

[9] Rev. Proc. 2024-40, 2024-45 I.R.B. 1100.

[10] Sec. 63(f).

[11] For taxable years beginning in 2018 through 2025, the personal exemption amount is reduced to zero. Sec. 151(d)(5). This reduction is not taken into account in determining the limitation on the standard deduction for dependents. See sec. 151(d)(5).

[12] Sec. 63(c)(5).

[13] Sec. 63(f).

[14] Sec. 63(c)(4) and (c)(7)(B).

in 2026, with the amount of the basic standard deduction being $8,300 for an unmarried individual (other than a head of household or a surviving spouse) and a married individual filing a separate return,[15] $12,150 for a head of household, and $16,600 for married individuals filing a joint return and a surviving spouse.[16] The additional standard deduction was not modified by Public Law 115-97.

Description of Proposal

The proposal strikes the expiration date of the temporary increases to the standard deduction enacted by Public Law 115-97.

The proposal modifies the indexing for inflation of the standard deduction amount by providing one additional year of inflation in the cost-of-living adjustment starting in taxable years beginning after December 31, 2025. Under the proposal, the cost-of-living adjustment for the standard deduction amount for 2026 is the percentage by which the chained CPI for 2025 exceeds the chained CPI for 2016.[17] The result is that the standard deduction amount is larger than it would otherwise be absent this additional year of inflation.

In addition, the proposal temporarily increases the amount of the standard deduction by $2,000 in the case of married individuals filing a joint return and a surviving spouse, $1,500 in the case of a head of household, and $1,000 in any other case for taxable years beginning after December 31, 2024, and before January 1, 2029. These temporary amounts are not indexed for inflation.

As a result, the amount of the basic standard deduction for taxable years beginning in 2025 will increase to $16,000 for an unmarried individual (other than a head of household or a surviving spouse) and a married individual filing a separate return, $24,000 for a head of household, and $32,000 for married individuals filing a joint return and a surviving spouse. For taxable years in beginning in 2026 the standard deduction is projected to be $16,550 for an unmarried individual (other than a head of household or a surviving spouse) and a married individual filing a separate return, $24,850 for a head of household, and $33,100 for married individuals filing a joint return and a surviving spouse.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2024.

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[15] In the case of a married individual filing a separate return where either spouse itemizes deductions, the standard deduction is zero. Sec. 63(c)(6).

[16] Joint Committee on Taxation staff projections.

[17] Absent this modification, the cost-of-living adjustment for this purpose for 2026 is the percentage by which the chained CPI for 2025 exceeds the chained CPI for 2017.

C. Termination of Deduction for Personal Exemptions

Present Law

In general

In determining taxable income, an individual reduces adjusted gross income by any personal exemption deductions and either the applicable standard deduction or their itemized deductions. Personal exemptions generally are allowed for the taxpayer (both taxpayers in the case of a joint return) and any dependents of the taxpayer.[18] Public Law 115-97 temporarily reduced the amount of the personal exemption to $0 for taxable years 2018 through 2025.[19]

For 2026, the amount deductible for each personal exemption is projected to be $5,300.[20] The personal exemption amount is phased out in the case of an individual with AGI in excess of $407,850 for married taxpayers filing jointly, $373,850 for heads of household, $203,925 for married taxpayers filing separately, and $339,850 for all other filers.[21] The amounts of the personal exemption and phaseout thresholds are indexed annually for inflation. In addition, no deduction for a personal exemption is allowed to a dependent if a personal exemption deduction for the dependent is allowable to another taxpayer or if an individual's taxpayer identification number is not included on the return claiming the exemption.

Trusts and estates

In lieu of the deduction for personal exemptions, an estate is allowed a deduction of $600.[22] A trust is allowed a deduction of $100; $300 if required to distribute all its income currently; and an amount equal to the personal exemption of an individual, or for years in which the personal exemption is zero, an indexed value ($5,100 for 2025), in the case of a qualified disability trust.[23]

Description of Proposal

The proposal permanently reduces the amount of the personal exemption to $0.

[18] In addition, a married taxpayer filing a separate return may claim a personal exemption deduction for a spouse if the spouse has no gross income and is not a dependent of another taxpayer.

[19] Sec. 63(d)(5).

[20] Joint Committee on Taxation staff projection.

[21] Sec. 63(d)(3).

[22] Sec. 642(b)(1).

[23] Sec. 642(b)(2).

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

D. Extension of Increased Child Tax Credit and Temporary Enhancement

Present Law

Child tax credit

In general

Taxpayers are allowed a child tax credit of $2,000 for each qualifying child.[24] The aggregate amount of otherwise allowable child tax credit is phased out for taxpayers with income over a threshold amount of $400,000 for taxpayers filing jointly and $200,000 for all other taxpayers.[25] The otherwise allowable child tax credit amount is reduced by $50 for each $1,000 (or fraction thereof) of modified adjusted gross income ("modified AGI") over the applicable threshold amount. For purposes of this limitation, modified AGI means AGI increased by any amount excluded from gross income under section 911 (foreign earned income exclusion), 931 (exclusion of income for a bona fide resident of American Samoa), or 933 (exclusion of income for a bona fide resident of Puerto Rico).[26]

Generally, for purposes of the child tax credit, a qualifying child is a qualifying child as defined in section 152(c) who is under the age of 17.[27] Only a child who is a U.S. citizen, national, or resident may be a qualifying child; citizens of contiguous countries are ineligible under the child tax credit definition of qualifying child.[28]

The name and social security number ("SSN") of the qualifying child must appear on the return, and the SSN must be issued before the due date for filing the return.[29] The SSN also must be issued to a citizen or national of the United States or pursuant to a provision of the

[24] Sec. 24(a), (h)(2). For taxable years beginning after December 31, 2025, the amount of the credit is $1,000 for each qualifying child. See below for descriptions of other changes to the child tax credit for taxable years beginning after December 31, 2025.

[25] Sec. 24(b), (h)(3). For taxable years beginning after December 31, 2025, the modified AGI threshold amounts at which the credit begins to phase out are $75,000 for individuals who are not married, $110,000 for married individuals filing joint returns, and $55,000 for married individuals filing separate returns.

[26] Sec. 24(b)(1).

[27] Sec. 24(c)(1).

[28] Sec. 24(c)(2).

[29] Sec. 24(h)(7). For taxable years beginning after December 31, 2025, the child tax credit may be claimed if the taxpayer identification number ("TIN") of the qualifying child, rather than the SSN of the child, appears on the return. Sec. 24(e)(1).

Social Security Act relating to the lawful admission for employment in the United States.[30] The TIN of the taxpayer must be issued on or before the due date for filing the return.[31]

Partial refundability and calculation of additional child tax credit

The child tax credit is generally a nonrefundable tax credit taken against income tax liability. The credit is allowable against both the regular tax and the alternative minimum tax.[32]

In some circumstances, all or a portion of the otherwise allowable credit is treated as a refundable credit (the "additional child tax credit").[33] The credit is treated as refundable in an amount equal to 15 percent of earned income in excess of $2,500 (the "earned income formula").[34] Earned income generally has the same definition as for purposes of the earned income tax credit and is defined as the sum of wages, salaries, tips, and other taxable employee compensation plus net self-employment earnings.[35] For purposes of the additional child tax credit, only items taken into account in computing taxable income are treated as earned income.[36] However, combat pay that is excluded from gross income under section 112 is also taken into account.

A taxpayer with three or more qualifying children may determine the additional child tax credit using the "alternative formula," if this formula results in a larger additional child tax credit than determined under the earned income formula. Under the alternative formula, the additional child tax credit equals the amount by which the taxpayer's Social Security taxes exceed the taxpayer's earned income tax credit.[37]

The maximum amount of the additional child tax credit per qualifying child ($1,700 for 2025)[38] is indexed for inflation, although the amount may not exceed the $2,000 amount of the

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[30] See sec. 205(c)(2)(B)(i)(I) (or that portion of subclause (III) that relates to subclause (I)) of the Social Security Act.

[31] Sec. 24(e)(2).

[32] Sec. 26(a).

[33] Sec. 24(d).

[34] Sec. 24(d)(1)(B)(i), (h)(6). For taxable years beginning after December 31, 2025, the earned income threshold for the refundable child tax credit is $3,000.

[35] Sec. 32(c)(2).

[36] Sec. 24(d)(1)(B)(i). For example, some ministers' parsonage allowances are considered self-employment income, see section 1402(a)(8), and thus are considered earned income for purposes of computing the EITC, but they are excluded from gross income for income tax purposes and thus are not considered earned income for purposes of the additional child tax credit.

[37] Sec. 24(d)(1)(B)(ii).

[38] Rev. Proc. 2024-40, 2024-45 I.R.B. 1100.

nonrefundable child tax credit.[39] The inflation adjustment is the percentage by which the Chained Consumer Price Index for all Urban Consumers ("chained CPI") for the preceding calendar year exceeds the chained CPI for 2017.

Withholding

Chapter 24 of the Code provides rules for employers to deduct and withhold amounts from employee wages for the payment of income tax. Under rules determined by the Secretary, an employee may be permitted one or more withholding allowances that reduces the amount of income tax withholding. A taxpayer's withholding allowances may take into account the number of children in respect of whom it is reasonably expected that the taxpayer is eligible for a child tax credit.[40]

Credit for other dependents

An individual is allowed a $500 nonrefundable credit for each dependent of the taxpayer as defined in section 152, other than a qualifying child as defined for purposes of the child tax credit.[41]

Application of the child tax credit in the territories of the United States

The three mirror Code territories (Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands) have, under their mirror Codes, a child tax credit identical to that in the Internal Revenue Code. A resident of one of these territories claims the child tax credit on the income tax return filed with the territory's revenue authority.

Mirror Code territories

The Secretary is directed to make payments to each of Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands in an amount equal to the loss in revenue by reason of the application of the child tax credit to the territory's mirror Code for the taxable year.[42] This amount is determined by the Secretary based on information provided by the government of the territory.

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[39] Sec. 24(h)(5). The nonrefundable portion of the child tax credit is not adjusted for inflation. For taxable years beginning after December 31, 2025, there is no separately stated maximum amount of the additional child tax credit; however, the refundable credit may not exceed the total amount of the credit of $1,000 for taxable years beginning after December 31, 2025.

[40] Sec. 3402(f)(1)(C).

[41] An individual who is a qualifying child for purposes of the dependent rules under section 152, but not a qualifying child for purposes of the child tax credit (*e.g.*, a child who is age 17 or 18, a full-time student under age 24, or a child without a valid SSN) is eligible to be a qualifying dependent for purposes of the $500 nonrefundable credit for other dependents. For taxable years beginning after December 31, 2025, there is no tax credit for other dependents.

[42] Sec. 24(k)(1).

No child tax credit under the Internal Revenue Code is permitted for any resident of a mirror Code territory with respect to whom a child tax credit is allowed against income taxes of the territory.[43]

Puerto Rico

Bona fide residents of Puerto Rico may claim an additional child tax credit up to the maximum amount[44] from the U.S. Treasury under the alternative formula, but determined without regard to the three-child limitation, by filing a return with the Internal Revenue Service ("IRS").[45]

Residents of Puerto Rico claim the additional child tax credit under the alternative formula by filing a Form 1040-SS or Form 1040-PR with the IRS.

American Samoa

The Secretary is directed to make payments to American Samoa in an amount estimated by the Secretary as being equal to the aggregate benefits that would have been provided to residents of American Samoa if the U.S. child tax credit had been in effect in American Samoa (and had been applied as if American Samoa were the United States) in that taxable year.[46]

The provision prohibits the Secretary from making these payments unless American Samoa has a plan approved by the Secretary to promptly distribute the payments to its residents. For years with respect to which American Samoa has an approved plan, no child tax credit under the Internal Revenue Code is permitted for any person who is eligible for a payment under the plan. If American Samoa does not have a plan in place for a taxable year, a bona fide resident of American Samoa may claim a child tax credit by filing a return with the IRS under rules similar to those for Puerto Rico, described above.

Tax exemption for certain organizations

Section 501(a) exempts certain organizations from Federal income tax. Such organizations include: (1) tax-exempt organizations described in section 501(c) (including, among others, 501(c)(3) charitable organizations and section 501(c)(4) social welfare organizations); (2) religious and apostolic organizations described in section 501(d); and (3) trusts forming part of a pension, profit-sharing, or stock bonus plan of an employer described in section 401(a).

A religious and apostolic organization is described in section 501(d) if the organization has a common treasury or community treasury. The organization may engage in business for the

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[43] Sec. 24(k)(2).

[44] This amount is $1,700 for taxable years beginning in 2025. Rev. Proc. 2024-40, 2024-45 I.R.B. 1100.

[45] Sec. 24(k)(2)(B).

[46] Sec. 24(k)(3).

common benefit of its members, but only if the members include their entire pro rata shares of the taxable income of the organization for the year in their gross income (at the time of filing their returns), regardless of whether such shares are distributed. Any amount included in the gross income of a member is treated as a dividend.[47]

Description of Proposal

The proposal temporarily increases the maximum child tax credit to $2,500 for taxable years beginning after December 31, 2024, and before December 31, 2028.

For taxable years beginning after December 31, 2028, the maximum child tax credit will revert to a permanent amount of $2,000. This amount is indexed for inflation in taxable years beginning after 2028. The inflation adjustment is the percentage by which chained CPI for the preceding calendar year exceeds the chained CPI for 2024.

The proposal makes permanent the maximum amount of the additional child tax credit per qualifying child of $1,400 adjusted for inflation ($1,700 in 2025).[48] The proposal also makes permanent the earned income threshold of $2,500 for purposes of the earned income formula. The proposal treats any amount treated as a dividend received under section 501(d) as earned income which is taken into account in computing taxable income for the taxable year.

The proposal makes permanent the income phaseout threshold amounts of $400,000 for taxpayers filing jointly and $200,000 for all other taxpayers.

Under the proposal, the $500 nonrefundable credit for each dependent of the taxpayer other than a qualifying child is permanent. This credit is not adjusted for inflation.

Under the proposal, the SSN of the taxpayer, the taxpayer's spouse (if married filing jointly), and the qualifying child must appear on the return. The SSN for each individual must be issued before the due date of the return. Each SSN also must be issued to a citizen or national of the United States or pursuant to a provision of the Social Security Act relating to the lawful admission for employment in the United States.[49]

The proposal applies rules similar to the rules of section 32(d), meaning married individuals must file a joint return in order to receive the child tax credit. Marital status is determined under section 7703(a).[50] Under the proposal, an individual is not treated as married if the individual (1) is married and does not file a joint return for the taxable year, (2) resides with a qualifying child for more than one-half of the taxable year, and (3) either does not have

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[47] Sec. 501(d).

[48] The inflation adjustment is the percentage by which the chained CPI for the preceding calendar year exceeds the chained CPI for 2017.

[49] See sec. 205(c)(2)(B)(i)(I) (or that portion of subclause (III) that relates to subclause (I)) of the Social Security Act.

[50] Sec. 32(d)(2)(A).

the same principal place of abode as their spouse during the last six months of the taxable year or has a decree, instrument, or agreement (other than a decree of divorce) described in section 121(d)(3)(C) with respect to their spouse and is not a member of the same household of their spouse by the end of the taxable year.[51]

Effective Date

The proposal is effective for taxable years beginning after December 31, 2024.

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[51] Sec. 32(d)(2)(B).

E. Extension of Deduction for Qualified Business Income and Permanent Enhancement

Present Law

In general

For taxable years beginning after December 31, 2017, and before January 1, 2026, certain individuals, trusts, and estates may deduct 20 percent of qualified business income from a partnership, S corporation, or sole proprietorship, as well as 20 percent of aggregate qualified real estate investment trust ("REIT") dividends and qualified publicly traded partnership income.[52] Special rules apply to determine the deduction attributable to domestic production activities of specified agricultural or horticultural cooperatives.[53]

The qualified business income deduction is subject to several limitations. The deduction may not exceed 20 percent of taxable income (reduced by net capital gain).[54] Limitations based on W-2 wages and capital investment phase in over a range of income above threshold amount of taxable income.[55] A disallowance of the deduction for income of specified service trades or businesses[56] also phases in over a range of income above the threshold amount of taxable income. Both the W-2 and capital investment and specified service trade or business limits are subject to the threshold amounts and phase-in ranges below for 2025.[57]

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[52] Sec. 199A(b)(2) and (b)(1)(B). See also Treas. Reg. secs. 1.199A-1 through 1.199A-7.

[53] For taxable years beginning after December 31, 2017, and before January 1, 2026, a specified agricultural or horticultural cooperative generally may deduct nine percent of the lesser of the cooperative's qualified production activities income or taxable income (determined without regard to the cooperative's section 199A(g) deduction and reduced by certain payments or allocations to patrons) for the taxable year. The deduction is limited to 50 percent of W-2 wages that are paid by the cooperative during the calendar year that ends in such taxable year and are properly allocable to domestic production gross receipts. Sec. 199A(g). See also Treas. Reg. secs. 1.199A-8 through 1.199A-12.

[54] Sec. 199A(a)(2). For this purpose, taxable income is computed without regard to the deduction allowable under the provision. Sec. 199A(e)(1).

[55] For a taxpayer with taxable income above the threshold, the taxpayer is allowed a deductible amount for each qualified trade or business equal to the lesser of (1) 20 percent of the qualified business income with respect to such trade or business, or (2) the greater of (a) 50 percent of the W-2 wages paid with respect to the qualified trade or business, or (b) the sum of 25 percent of the W-2 wages paid with respect to the qualified trade or business plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property of the qualified trade or business. Sec. 199A(b)(2).

[56] A specified service trade or business means any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners, or which involves the performance of services that consist of investing and investment management, trading, or dealing in securities, partnership interests, or commodities. Sec. 199A(d)(2).

[57] Sec. 199A(b)(3) and (d)(3).

Filing Status	2025 Threshold Amount[58]	2025 Phase-in Range Amount
Married filing jointly	$394,600	$494,600
Married filing separately	$197,300	$247,300
Other returns	$197,300	$247,300

The taxpayer's deduction for qualified business income is not allowed in computing adjusted gross income; instead, the deduction is allowed in computing taxable income.[59] The deduction is available to individuals regardless of whether they itemize their deductions.[60]

Qualified business income

In general

Qualified business income is determined for each qualified trade or business of the taxpayer. For any taxable year, qualified business income is the net amount of qualified items of income, gain, deduction, and loss attributable to the qualified trade or business of the taxpayer.[61] A taxpayer includes qualified items of income, gain, deduction, and loss only to the extent those items are included or allowed to determine taxable income for the taxable year.[62] Items are treated as qualified items of income, gain, deduction, and loss only to the extent they are effectively connected with the conduct of a trade or business within the United States.[63]

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[58] Sec. 2.27 of Rev. Proc. 2024-40, 2024-45 I.R.B., November 4, 2024. The threshold amount is adjusted for inflation in taxable years beginning after 2018. Sec. 199A(e)(2).

[59] Sec. 62(a).

[60] Sec. 63(b) and (d).

[61] Qualified business income excludes qualified REIT dividends and qualified publicly traded partnership income. Sec. 199A(c)(1).

[62] Sec. 199A(c)(3)(A)(ii).

[63] For this purpose, section 864(c) is applied by substituting "qualified trade or business (within the meaning of section 199A)" for "nonresident alien individual or a foreign corporation" or for "a foreign corporation," each place they appear. Sec. 199A(c)(3)(A). In the case of an individual with qualified business income from sources within the Commonwealth of Puerto Rico, if all such income for the taxable year is taxable under section 1 (income tax rates for individuals), then the term "United States" is considered to include Puerto Rico for purposes of determining the individual's qualified business income. Sec. 199A(f)(1)(C).

Qualified items of income, gain, deduction, and loss exclude:

1. any item taken into account in determining net capital gain or net capital loss,
2. dividends, income equivalent to a dividend, or payments in lieu of dividends,
3. interest income other than that which is properly allocable to a trade or business,
4. the excess of gain over loss from certain commodities transactions,[64]
5. the excess of foreign currency gains over foreign currency losses from section 988 transactions other than transactions directly related to the business needs of the business activity,
6. net income from notional principal contracts other than clearly identified hedging transactions that are treated as ordinary (i.e., not treated as capital assets),
7. any amount received from an annuity that is not received in connection with the trade or business, and
8. any item of deduction or loss properly allocable to any of the preceding items.[65]

Qualified business income also does not include any amount paid by an S corporation that is treated as reasonable compensation of the taxpayer.[66] Similarly, qualified business income does not include any guaranteed payment for services rendered with respect to the trade or business,[67] and, to the extent provided in regulations, does not include any amount paid or incurred by a partnership to a partner, acting other than in his or her capacity as a partner, for services.[68]

If the net amount of qualified business income from all qualified trades or businesses during the taxable year is a loss, then such loss is carried forward and in the next taxable year is treated as a loss from a qualified trade or business.[69] Any deduction that would otherwise be

[64] The exclusion does not apply to commodities transactions entered into in the normal course of the trade or business or with respect to stock in trade or property held primarily for sale to customers in the ordinary course of the trade or business, property used in the trade or business, or supplies regularly used or consumed in the trade or business.

[65] Sec. 199A(c)(3)(B).

[66] Sec. 199A(c)(4).

[67] Described in sec. 707(c).

[68] Described in sec. 707(a).

[69] Sec. 199A(c)(2).

allowed in a subsequent taxable year with respect to the taxpayer's qualified trades or businesses is reduced by 20 percent of any carryover qualified business loss.

Qualified trade or business

A qualified trade or business means any trade or business other than a specified service trade or business and other than the trade or business of performing services as an employee.[70]

Partnerships and S corporations

In the case of a partnership or S corporation, the section 199A deduction is determined at the partner or shareholder level.[71] Each partner in a partnership takes into account the partner's allocable share of each qualified item of income, gain, deduction, and loss, and for purposes of the limitation described above, is treated as having W-2 wages and unadjusted basis of qualified property for the taxable year equal to the partner's allocable share of W-2 wages and unadjusted basis of qualified property of the partnership. The partner's allocable share of W-2 wages and unadjusted basis of qualified property are determined in the same manner as the partner's allocable share of wage expenses and depreciation, respectively. Similarly, each shareholder of an S corporation takes into account the shareholder's pro rata share of each qualified item of income, gain, deduction, and loss of the S corporation, and is treated as having W-2 wages and unadjusted basis of qualified property for the taxable year equal to the shareholder's pro rata share of W-2 wages and unadjusted basis of qualified property of the S corporation.

Description of Proposal

The proposal makes five modifications to the deduction for qualified business income.

The first modification makes permanent the deduction for qualified business income (including the deduction for REIT dividends and qualified publicly traded partnership income) and the deduction for income attributable to the domestic production activities of specified agricultural or horticultural cooperatives.

The second modification increases three percentages used to calculate the deduction for qualified business income from 20 percent to 23 percent. The proposal increases the percentage of the excess of taxable income over net capital gain used in determining the maximum allowable deduction for qualified business income from 20 percent to 23 percent. The proposal increases the percentage of the aggregate amount of the taxpayer's qualified REIT dividends and qualified publicly traded partnership income for the taxable year used to calculate the combined qualified business income amount from 20 percent to 23 percent. Finally, the proposal increases the deductible amount for each qualified trade or business from 20 percent to 23 percent of the taxpayer's qualified business income with respect to that trade or business, before applying any applicable modifications.

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70 Sec. 199A(d)(1).

71 Sec. 199A(f)(1).

The third modification replaces the existing phase-in of W-2 wages, capital investment, and specified service trades or businesses with a two-step process for taxpayers whose taxable income exceeds the threshold amount. Similar to current law, step one requires a taxpayer to limit the deductible amount for each qualified trade or business (*i.e.*, 23 percent of qualified business income) to the greater of W-2 wages or W-2 wages and capital investment for each trade or business. Unlike current law, however, there is no phase in of the W-2 wages and capital investment limitation over a fixed dollar phase-in range. Rather, the taxpayer compares the sum of the deductible amounts for each qualified trade or business in step one to a new phase-in rule in step two. Under step two, the taxpayer (1) takes 23 percent of qualified business income from all trades or businesses (including specified service trades or businesses) without regard to the W-2 wages and capital limitation and (2) reduces the amount in (1) by a limitation phase-in amount equal to 75 percent of the excess of taxable income over the threshold amount. The taxpayer then compares the aggregate deductible amounts under steps one and two, and includes the greater of the two amounts in combined qualified business income.[72]

The fourth modification allows a taxpayer to include qualified BDC interest dividends in the aggregated qualified REIT dividends and qualified publicly-traded partnership income used to calculate the combined qualified business amount. The proposal defines a qualified BDC interest dividend as any dividend received from a business development company[73] that has elected to be treated as a regulated investment company, [74] to the extent that the dividend is attributable to that company's net interest income derived from a qualifying trade or business. The proposal also excludes qualified BDC interest dividends from the calculation of qualified business income for a qualified trade or business.

The fifth modification indexes the threshold amounts for inflation for taxable years beginning after 2025.

Effective Date

The five modifications in this proposal apply to taxable years beginning after December 31, 2025.

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[72] For example, assume that a taxpayer's (1) taxable income is $483,900, (2) threshold amount is $383,900, (3) and qualified business income from one specified service trade or business is $700,000. Under step one, the taxpayer's aggregate deduction is $0 because the taxpayer does not receive any qualified business income from a qualified trade or business. Under step two, the taxpayer's aggregate deduction is $86,000 [($700,000 qualified business income * 23 percent) – (75 percent * ($483,900 taxable income – $383,900 threshold amount))]. The taxpayer compares the aggregate deductible amounts under step one ($0) to step two ($86,000) and applies the larger of the two amounts (in this case $86,000).

[73] As defined in section 2(a) of the Investment Company Act of 1940.

[74] Sec. 851(a).

F. Extension of Increased Estate and Gift Tax Exemption Amounts and Permanent Enhancement

Present Law

Gift, estate, and generation-skipping transfer taxes

A gift tax generally is imposed on any transfer of property by gift by a U.S. citizen or resident,[75] and an estate tax generally is imposed on the taxable estate of any person who is a U.S. citizen or resident at the time of death.[76]

The estate and gift taxes are unified with a top tax rate of 40 percent and, under a temporary provision enacted as part of Public Law 115-97, a $10 million inflation-indexed lifetime exemption for decedents dying and gifts made after December 31, 2017, and before January 1, 2026.[77] Accordingly, the first $10 million (plus inflation) of the aggregate of taxable gifts and the gross estate is not subject to gift or estate tax. The inflation adjustment is determined using a base year of 2010. For 2025, the exemption amount is $13.99 million.

For decedents dying and gifts made after 2025, the estate and gift tax exemption is an inflation-indexed $5 million (again with a base year of 2010).[78] For 2026, the projected exemption amount is $7.14 million.

Exemption amounts used during life to offset gift tax reduce the amount of exemption that remains at death to offset the decedent's estate tax. Surviving spouses generally are permitted to use the unused portion of a predeceased spouse's estate and gift tax exemption (sometimes referred to as exemption portability).[79]

A separate transfer tax is imposed on generation-skipping transfers in addition to any estate or gift tax imposed on such transfers.[80] This tax generally is imposed on transfers, whether made directly or by trust or similar arrangement, to a beneficiary more than one generation below that of the transferor. The generation-skipping transfer tax is computed using a flat rate equal to the top tax rate applied to estates[81] and an exemption equal to the estate and gift

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[75] Sec. 2501.

[76] Sec. 2001.

[77] The exemption is granted by means of a credit equivalent to a $10 million exemption. See sec. 2010(c)(1).

[78] If the exemption amount in effect at a decedent's death is less than the exemption amount in effect during one or more years of the decedent's life, generally there is no "clawback" of the higher exemption amount used during life to offset gift tax. See Treas. Reg. sec. 20.2010-1(c).

[79] Sec. 2010(c)(2)(B).

[80] Sec. 2601.

[81] Sec. 2641.

tax exemption in effect for the taxable year, reduced by amounts of exemption allocated by the transferor to generation-skipping transfers in prior taxable years.[82] There is no spousal exemption portability for the generation-skipping transfer tax exemption.

Description of Proposal

The proposal permanently increases the unified estate and gift tax exemption to an inflation-indexed $15 million for taxable years beginning after December 31, 2025. Accordingly, the generation-skipping transfer tax exemption is also permanently increased to an inflation-indexed $15 million. The $15 million exemption amount is indexed for inflation with a base year of 2025. Accordingly, the exemption amount is $15 million for decedents dying and gifts made in calendar year 2026 and increases with inflation thereafter.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

[82] Sec. 2631 and Treas. Reg. sec. 26.2632-1.

G. Extension of Increased Alternative Minimum Tax Exemption and Phase-out Thresholds

Present Law

Individual alternative minimum tax

In general

An alternative minimum tax ("AMT") is imposed on an individual, an estate, or a trust in an amount by which the tentative minimum tax exceeds the regular income tax for the taxable year. For taxable years beginning in 2025, the tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed $239,100 ($119,550 in the case of a married individual filing a separate return), and (2) 28 percent of the remaining taxable excess. The breakpoints are indexed for inflation. The taxable excess is so much of the alternative minimum taxable income ("AMTI") as exceeds the exemption amount. The maximum tax rates on net capital gain and dividends used in computing the regular tax are used in computing the tentative minimum tax. AMTI is taxable income adjusted to take account of specified tax preferences and adjustments.

The exemption amounts for taxable years beginning in 2025 are: (1) $137,000 in the case of married individuals filing a joint return and surviving spouses; (2) $88,100 in the case of unmarried individuals (other than surviving spouses); (3) $68,500 in the case of married individuals filing separate returns; and (4) $30,700 in the case of an estate or a trust. For taxable years beginning in 2025, the exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) $1,252,700 in the case of married individuals filing a joint return and surviving spouses, (2) $626,350 in the case of married individuals filing separate returns and unmarried individuals (other than surviving spouses), and (3) $102,500 in the case of an estate or a trust. The amounts are indexed for inflation.

AMTI is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

Exemption amounts and exemption phase-out thresholds after 2025

The AMT exemption amounts and phase-out thresholds for individuals, which were increased starting in 2018 by Public Law 115-97, decrease for taxable years beginning after December 31, 2025. In 2026 exemption amounts for individuals are projected to be (1) $109,800 in the case of married individuals filing a joint return and surviving spouses; (2) $70,600 in the case of unmarried individuals (other than surviving spouses); and (3) $54,900 in the case of married individuals filing separate returns. For 2026 the exemption amount phase-out thresholds for individuals are projected to be (1) $209,200 in the case of married individuals filing a joint return and surviving spouses, (2) $156,900 in the case of unmarried individuals (other than surviving spouses), and (3) $104,600 in the case of married individuals filing a separate return.

Preference items in computing AMTI

The minimum tax preference items are:

1. The excess of the deduction for percentage depletion over the adjusted basis of each mineral property (other than oil and gas properties) at the end of the taxable year.

2. The amount by which excess intangible drilling costs (that is, expenses in excess the amount that would have been allowable if amortized over a 10-year period) exceed 65 percent of the net income from oil, gas, and geothermal properties. This preference applies to independent producers only to the extent it reduces the producer's AMTI (determined without regard to this preference and the net operating loss deduction) by more than 40 percent.

3. Tax-exempt interest income on private activity bonds (other than qualified 501(c)(3) bonds, certain housing bonds, and bonds issued in 2009 and 2010) issued after August 7, 1986.

4. Accelerated depreciation or amortization on certain property placed in service before January 1, 1987.

5. Seven percent of the amount excluded from income under section 1202 (relating to gains on the sale of certain small business stock).

In addition, losses from any tax shelter farm activity or passive activities are not taken into account in computing AMTI.

Adjustments in computing AMTI

The adjustments that individuals must make to compute AMTI are:

1. Depreciation on property placed in service after 1986 and before January 1, 1999, is computed by using the generally longer class lives prescribed by the alternative depreciation system of section 168(g) and either (a) the straight-line method in the case of property subject to the straight-line method under the regular tax or (b) the 150-percent declining balance method in the case of other property. Depreciation on property placed in service after December 31, 1998, is computed by using the regular tax recovery periods and the AMT methods described in the previous sentence. Depreciation on property acquired after September 10, 2001, which is allowed an additional allowance under section 168(k) for the regular tax is computed without regard to any AMT adjustments.

2. Mining exploration and development costs are capitalized and amortized over a 10-year period.

3. Taxable income from a long-term contract (other than a home construction contract) is computed using the percentage of completion method of accounting.

4. The amortization deduction allowed for pollution control facilities placed in service before January 1, 1999 (generally determined using 60-month amortization for a portion of the cost of the facility under the regular tax), is calculated under the alternative depreciation system (generally, using longer class lives and the straight-line method). The amortization deduction allowed for pollution control facilities placed in service after December 31, 1998, is calculated using the regular tax recovery periods and the straight-line method.

5. Miscellaneous itemized deductions (which are suspended through 2025) are not allowed.

6. Itemized deductions for State, local, and foreign real property taxes; State and local personal property taxes; State, local, and foreign income, war profits, and excess profits taxes; and State and local sales taxes are not allowed.

7. Deductions for interest on home equity loans are not allowed.

8. The standard deduction and the deduction for personal exemptions (which deduction is suspended through 2025) are not allowed.

9. The amount allowable as a deduction for circulation expenditures is capitalized and amortized over a three-year period.

10. The amount allowable as a deduction for research and experimentation expenditures from passive activities is capitalized and amortized over a 10-year period.

11. The regular tax rules relating to incentive stock options do not apply.

<u>Other rules</u>

The taxpayer's net operating loss deduction generally cannot reduce the taxpayer's AMTI by more than 90 percent of the AMTI (determined without the net operating loss deduction).

The alternative minimum tax foreign tax credit reduces the tentative minimum tax.

The various nonrefundable business credits allowed under the regular tax generally are not allowed against the AMT. Certain exceptions apply.

If an individual is subject to AMT in any year, the amount of tax exceeding the taxpayer's regular tax liability is allowed as a credit (the "AMT credit") in any subsequent taxable year to the extent the taxpayer's regular tax liability exceeds his or her tentative minimum tax liability in such subsequent year. The AMT credit is allowed only to the extent that the taxpayer's AMT liability is the result of adjustments that are timing in nature. The individual AMT adjustments relating to itemized deductions and personal exemptions are not timing in nature, and no minimum tax credit is allowed with respect to these items.

An individual may elect to write off certain expenditures paid or incurred with respect of circulation expenses, research and experimental expenses, intangible drilling and development expenditures, development expenditures, and mining exploration expenditures over a specified period (three years in the case of circulation expenses, 60 months in the case of intangible drilling and development expenditures, and 10 years in case of other expenditures). The election applies for purposes of both the regular tax and the alternative minimum tax.

Description of Proposal

The proposal repeals the expiration of the Public Law 115-97 increase in the AMT exemption amounts and phase-out thresholds.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

H. Extension of Limitation on Deduction for Qualified Residence Interest

Present Law

Deductibility of home mortgage interest

As a general matter, personal interest is not deductible.[83] Qualified residence interest is not treated as personal interest and is allowed as an itemized deduction, subject to limitations.[84] For taxable years beginning after December 31, 2017, and before January 1, 2026, qualified residence interest means interest paid or accrued during the taxable year on acquisition indebtedness with respect to a qualified residence. For taxable years beginning after December 31, 2025, qualified residence interest means interest paid or accrued during the taxable year on acquisition indebtedness or home equity indebtedness with respect to a qualified residence. A qualified residence is the taxpayer's principal residence and one other residence of the taxpayer selected to be a qualified residence. A qualified residence may be a house, apartment, condominium, mobile home, boat, or similar property.

Acquisition indebtedness

Acquisition indebtedness is indebtedness which is incurred in acquiring, constructing, or substantially improving a qualified residence of the taxpayer and which secures the residence. In the case of a taxable year beginning after December 31, 2017, and before January 1, 2026, a taxpayer may treat no more than $750,000 of indebtedness as acquisition indebtedness ($375,000 in the case of a married individual filing separately). In the case of indebtedness incurred on or before December 15, 2017, this limitation is $1,000,000 ($500,000 in the case of a married individual filing separately).[85] For taxable years beginning after December 31, 2025, a taxpayer may treat up to $1,000,000 ($500,000 in the case of a married individual filing separately) of indebtedness as acquisition indebtedness, regardless of when the indebtedness was incurred.

Acquisition indebtedness also includes indebtedness from the refinancing of other acquisition indebtedness, but only to the extent of the balance of the refinanced indebtedness. For example, if the taxpayer incurs $200,000 of acquisition indebtedness to acquire a principal residence and pays down the debt to $150,000, a refinancing cannot increase the taxpayer's acquisition indebtedness with respect to the residence above $150,000

[83] Sec. 163(h)(1).

[84] Sec. 163(h)(2)(D) and (h)(3).

[85] Special rules apply in the case of indebtedness from refinancing existing acquisition indebtedness. Specifically, the $1,000,000 ($500,000 in the case of a married taxpayer filing separately) limitation continues to apply to any indebtedness incurred on or after December 15, 2017, to refinance qualified residence indebtedness incurred before that date to the extent the amount of the indebtedness resulting from the refinancing does not exceed the amount of the refinanced indebtedness.

Interest on acquisition indebtedness is deductible in computing alternative minimum taxable income.[86] However, in the case of a second residence, the acquisition indebtedness may only be incurred with respect to a house, an apartment, a condominium, or a mobile home that is not used on a transient basis.

Home equity indebtedness

Home equity indebtedness is indebtedness (other than acquisition indebtedness) secured by a qualified residence. For taxable years beginning after December 31, 2025, a taxpayer may treat up to $100,000 ($50,000 in the case of a married individual filing separately) of indebtedness as home equity indebtedness. However, the amount of home equity indebtedness with respect to a qualified residence may not exceed the fair market value of the residence reduced by the acquisition indebtedness with respect to it.

Interest on home equity indebtedness is not deductible in computing alternative minimum taxable income.

For taxable years beginning after December 31, 2025, interest on qualifying home equity indebtedness is deductible (up to the specified limit) regardless of how the proceeds of the indebtedness are used. For example, the proceeds may be applied towards health costs and education expenses for the taxpayer's family members or any other personal expenses such as vacations, furniture, or automobiles. A taxpayer and a mortgage company may contract for the home equity indebtedness loan proceeds to be transferred to the taxpayer in a lump sum payment (*e.g.*, a traditional mortgage) or a series of payments (*e.g.*, a reverse mortgage); or, the lender may extend the borrower a line of credit up to a fixed limit over the term of the loan (*e.g.*, a home equity line of credit).

Thus, for taxable years beginning after December 31, 2025, the aggregate limitation on a taxpayer's acquisition indebtedness and home equity indebtedness with respect to a principal residence and a second residence that may give rise to deductible interest is $1,100,000 ($550,000 for a married individual filing separately).

Description of Proposal

Under the proposal, the $750,000 ($375,000 in the case of a married individual filing separately) limitation on acquisition indebtedness is made permanent, and the exclusion of interest on home equity indebtedness from the definition of qualified residence interest is made permanent.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

[86] Sec. 56(b)(1)(B)(i) and (e).

I. Extension of Limitation on Casualty Loss Deduction

Present Law

An individual taxpayer may claim an itemized deduction for a personal casualty loss.[87] If the loss is attributable to a disaster declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (the "Stafford Act"),[88] then the loss is deductible only to the extent of the sum of the individual's personal casualty gains plus the amount by which aggregate net disaster-related losses exceed 10 percent of the individual taxpayer's adjusted gross income.[89] In any taxable year beginning after December 31, 2017, and before January 1, 2026, all other personal casualty losses are deductible only to the extent that the losses do not exceed the individual's personal casualty gains.

For individual taxpayers, personal casualty losses are losses of property not connected with a trade or business or a transaction entered into for profit, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft.[90] Personal casualty gains are recognized gains from any involuntary conversion of property not connected with a trade or business or a transaction entered into for profit, if such gains arise from fire, storm, shipwreck, or other casualty, or from theft.[91] Personal casualty losses are deductible to the extent they exceed $100 per casualty.[92]

Description of Proposal

Under the proposal, the temporary limitation on personal casualty losses in section 165(h)(5) is made permanent.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

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[87] Sec. 165(h).

[88] Sec. 165(h)(5).

[89] Sec. 165(h)(2). Personal casualty gains are reduced for this purpose by any gain used to offset any personal casualty loss which is not attributable to a disaster.

[90] Sec. 165(c)(3)(B).

[91] Sec. 165(c)(3)(A).

[92] Sec. 165(h)(1).

J. Termination of Miscellaneous Itemized Deductions

Present Law

An individual's taxable income is determined by adding together income from different sources such as personal services and investment and by subtracting permitted amounts.

All individuals are permitted to deduct from gross income (which is defined as all income from whatever source derived) amounts (colloquially referred to as "above-the-line" deductions) that are allowable in determining adjusted gross income.[93] These amounts include, for example, ordinary and necessary expenses of a trade or business and certain reimbursed expenses paid in connection with the performance of services as an employee.[94]

In determining taxable income, individuals are also allowed to deduct other amounts that are sometimes referred to as "below-the line" deductions. An individual who does not elect to itemize deductions is allowed a standard deduction and deductions for certain other amounts listed in section 63(b) (sometimes referred to as "non-itemizer deductions," for example, the deduction for qualified business income).[95] Instead of taking a standard deduction, an individual may elect to subtract itemized deductions in computing taxable income.[96] Itemized deductions are all deductions allowable under chapter 1 of subtitle A of the Code other than above-the-line deductions, the standard deduction, and non-itemizer deductions.[97]

All itemized deductions other than those listed in section 67(b) are "miscellaneous itemized deductions." Deductions listed in section 67(b) (meaning deductions that are not miscellaneous itemized deductions) include the deduction for interest, the deduction for state, local, and foreign taxes, the charitable contribution deduction, and the deduction for medical expenses that exceed 7.5 percent of adjusted gross income. Miscellaneous itemized deductions include, among many other expenses, investment expenses, legal fees, and unreimbursed employee business expenses.[98]

Before 2018, miscellaneous itemized deductions were allowed, but only to the extent they exceeded two percent of a taxpayer's adjusted gross income.[99] Following the 2017 enactment of

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93 Secs. 61, 62.

94 Secs. 62(a)(1), (a)(2)(A), 162(a).

95 Sec. 63(b).

96 Sec. 63(a), (e).

97 Sec. 63(d).

98 For a detailed description of all miscellaneous itemized deductions see IRS Publication 529, *Miscellaneous Deductions* (2020).

99 Sec. 67(a).

Public Law 115-97 miscellaneous itemized deductions are not allowed for taxable years beginning after December 31, 2017 and before January 1, 2026.

Description of Proposal

The proposal makes permanent the Public Law 115-97 temporary repeal of miscellaneous itemized deductions.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

K. Limitation on Tax Benefit of Itemized Deductions

Present Law

For any taxable year beginning after 2017 and before 2026, there is no overall limitation on the benefit of itemized deductions.

Before 2018, the total amount of itemized deductions, other than the deductions for medical expenses, investment interest, and casualty, theft or gambling losses, was limited for individual taxpayers whose adjusted gross income exceeded statutorily prescribed "applicable amounts."[100] The otherwise allowable amount of an individual taxpayer's itemized deductions for a taxable year was reduced by the lesser of three percent of the amount by which the taxpayer's adjusted gross income exceeded the applicable amount or 80 percent of the amount of the taxpayer's itemized deductions otherwise allowable for that year. This itemized deduction limitation was colloquially referred to as the "Pease limitation."

For 2017, the applicable amounts were $261,500 for an unmarried individual other than a head of household or a surviving spouse, $287,650 for a head of household, $313,800 for married individuals filing a joint return or for a surviving spouse, and $156,900 for married individuals filing a separate return. These amounts were indexed for inflation.

The Pease limitation becomes effective again for taxable years beginning after 2025.

Description of Proposal

In place of the Pease limitation, the proposal provides a limitation on the tax benefit of itemized deductions.

Under the proposal, the amount of an individual's itemized deductions otherwise allowable for a taxable year is reduced by 2/37 of the lesser of the amount of itemized deductions otherwise allowable for the year or so much of the taxable income of the taxpayer for the year (determined without regard to the proposal and increased by the amount of otherwise allowable itemized deductions) as exceeds that dollar amount at which the 37 percent rate bracket under section 1 begins in respect of the taxpayer.

The proposal's limitation on the tax benefit of itemized deduction applies after the application of any other limitation on the allowance of any itemized deduction (such as the adjusted-gross-income-based limitation on the charitable contribution deduction).

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

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[100] Sec. 68.

L. Termination of Qualified Bicycle Commuting Reimbursement Exclusion

Present Law

For taxable years beginning before December 31, 2017, qualified bicycle commuting reimbursements of up to $20 per qualifying bicycle commuting month in a calendar year are excludible from an employee's gross income.[101] A qualifying bicycle commuting month is any month during which the employee regularly uses the bicycle for a substantial portion of the travel between the employee's residence and place of employment and during which the employee does not receive any qualified transportation fringe benefit for transportation in a commuter highway vehicle (in connection with travel between the employee's residence and place of employment), a transit pass, or qualified parking.[102]

A qualified bicycle commuting reimbursement for a calendar year is an employer reimbursement during the 15-month period beginning with the first day of the calendar year for reasonable expenses incurred by the employee during such calendar year for the purchase of a bicycle and bicycle improvements, repair, and storage, if the bicycle is regularly used for travel between the employee's residence and place of employment.[103]

Qualified bicycle commuting reimbursements that are excludible from gross income for income tax purposes are also excluded from wages for employment tax purposes.

For taxable years beginning after December 31, 2017, and before January 1, 2026, the exclusion from gross income and wages for qualified bicycle commuting reimbursements was temporarily repealed.[104]

Description of Proposal

The proposal terminates the exclusion for qualified bicycle commuting reimbursement for taxable years beginning after December 31, 2025.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

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[101] Secs. 132(a)(5), 132(f)(1)(D), and 132(f)(5)(F)(ii).

[102] Sec. 132(f)(5)(F)(iii).

[103] Sec. 132(f)(5)(F)(i).

[104] Pub. L. No. 115-97, sec. 11047, December 22, 2017.

M. Extension of Limitation on Exclusion and Deduction for Moving Expenses

Present Law

Deduction for Moving Expenses

Individuals are permitted an above-the-line deduction for moving expenses paid or incurred during the taxable year in connection with the commencement of work by the taxpayer as an employee or as a self-employed individual at a new principal place of work.[105] Moving expenses means only the reasonable expenses of moving household goods and personal effects from the former residence to the new residence and of traveling (including lodging) from the former residence to the new place of residence.[106] Moving expenses are deductible only if the move meets certain conditions related to distance from the taxpayer's former residence and the taxpayer's status as a full-time employee or as a self-employed individual performing services on a full-time basis in the new location.[107]

Special rules apply under section 217(g) in the case of a member of the Armed Forces of the United States. In the case of a member of the Armed Forces on active duty who moves pursuant to a military order and incident to a permanent change of station, the limitations related to distance from the taxpayer's previous residence and status as a full-time employee (or self-employed individual performing services on a full-time basis) in the new location do not apply.[108] Additionally, any moving and storage expenses that are furnished in kind (or for which reimbursement or an allowance is provided) to the member of the Armed Forces, their spouse, or dependents are excluded from gross income.[109] Rules also apply to exclude amounts furnished to the spouse and dependents of a member of the Armed Forces in the event that such individuals move to a location other than to where the member of the Armed Forces is moving.[110]

Section 217(k) eliminates the deduction for moving expenses for taxable years 2018 through 2025. However, during that period, the subsection retains the deduction for moving expenses and the rules providing for exclusions of amounts attributable to in-kind moving and storage expenses (and reimbursements or allowances for these expenses) for members of the Armed Forces (or their spouses or dependents) on active duty who move pursuant to a military order and incident to a permanent change of station.

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105 Secs. 62(a)(15) and 217(a).

106 Sec. 217(b)(1).

107 Sec. 217(c).

108 Sec. 217(g)(1).

109 Sec. 217(g)(2).

110 Sec. 217(g)(3).

Exclusion for Qualified Moving Expense Reimbursement

Qualified moving expense reimbursements are excluded from an employee's gross income,[111] and are defined as any amount received (directly or indirectly) by an individual from an employer as a payment for (or reimbursement of) expenses which would be deductible as moving expenses under section 217 if directly paid or incurred by the individual.[112] However, any amount actually deducted by the individual is not eligible for this exclusion. Qualified moving expense reimbursements that are excludible from gross income for income tax purposes are also excluded from wages for employment tax purposes.

For taxable years beginning after December 31, 2017, and before January 1, 2026, section 132(g)(2) repeals the exclusion from gross income and wages for qualified moving expense reimbursements except in the case of a member of the Armed Forces of the United States on active duty who moves pursuant to a military order and incident to a permanent change of station.

Description of Proposal

The proposal would permanently repeal the deduction for moving expenses, except in the case of a member of the Armed Forces (or their spouse or child) to whom section 217(g) applies.

The proposal would permanently repeal the qualified moving expense reimbursement exclusion except in the case of a member of the Armed Forces of the United States on active duty who moves pursuant to a military order and incident to a permanent change of station.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

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[111] Sec. 132(a)(6) and 132(g).

[112] Sec. 132(g)(1).

N. Extension of Limitation on Wagering Losses

Present Law

Losses sustained during the taxable year on wagering transactions are allowed as a deduction only to the extent of the gains during the taxable year from such transactions.[113] For taxable years beginning after December 31, 2017, and before January 1, 2026, the term "losses from wagering transactions" as used in section 165(d) includes any deduction otherwise allowable under chapter 1 of the Code incurred in carrying on any wagering transaction. Thus, for such taxable years the limitation on losses from wagering transactions applies not only to the actual costs of wagers but also to other expenses incurred in connection with gambling activity (for instance, the otherwise deductible costs of travel to and from a casino).

Description of Proposal

Under the proposal, the clarification of the term "losses from wagering transactions" as used in section 165(d) is made permanent. Therefore, in the case of any taxable year beginning after December 31, 2017, such term includes any deduction otherwise allowable under chapter 1 of the Code incurred in carrying on any wagering transaction.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

[113] Sec. 165(d).

O. Extension of Increased Limitation on Contributions to ABLE Accounts and Permanent Enhancement

Present Law

Qualified ABLE programs

The Code provides for tax-favored savings programs intended to benefit disabled individuals, known as qualified ABLE programs.[114] A qualified ABLE program is a program established and maintained by a State or agency or instrumentality thereof. A qualified ABLE program must meet the following conditions: (1) Under the provisions of the program, contributions may be made to an account (an "ABLE account") established for the purpose of meeting the qualified disability expenses of the designated beneficiary of the account; (2) the program must limit a designated beneficiary to one ABLE account; and (3) the program must meet certain other requirements discussed below.

Designated beneficiaries and eligible individuals

A designated beneficiary of an ABLE account is the owner of the ABLE account. A designated beneficiary generally must be an eligible individual (discussed below) at the time the ABLE account is established. An ABLE account may be transferred to a successor designated beneficiary who is a member of the same family as the original designated beneficiary. For this purpose, a member of the family includes the original designated beneficiary's brother, sister, stepbrother, or stepsister. In the case of such a transfer, the successor designated beneficiary must be an eligible individual at the time of transfer.

An eligible individual is an individual either (1) for whom a disability certification has been filed with the Secretary for the taxable year, or (2) who is entitled to Social Security Disability Insurance (SSDI) benefits or Supplemental Security Income (SSI) benefits[115] based on blindness or disability, and such blindness or disability occurred before the individual attained age 26 (or, for taxable years beginning after December 31, 2025, age 46). A disability certification means a certification to the satisfaction of the Secretary, made by the eligible individual or the parent or guardian of the eligible individual, that the individual either (1) has a medically determinable physical or mental impairment, which results in marked and severe functional limitations and which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months, or (2) is blind (within the meaning of section 1614(a)(2) of the Social Security Act). Such blindness or disability must have occurred before the date the individual attained age 26 (or, for taxable years beginning after

[114] Sec. 529A.

[115] These are benefits under Title II and Title XVI, respectively, of the Social Security Act.

December 31, 2025, age 46). The certification must include a copy of the diagnosis of the individual's impairment and be signed by a licensed physician.[116]

Tax treatment and additional requirements

A qualified ABLE program is generally exempt from income tax but is subject to the taxes imposed on the unrelated business income of tax-exempt organizations.[117]

Contributions to an ABLE account must be made in cash and are not deductible for Federal income tax purposes. Except in the case of a rollover contribution from another ABLE account, an ABLE account must not receive aggregate contributions during a taxable year in excess of the $10,000 amount under section 2503(b) of the Code (the annual gift tax exclusion), which is indexed for inflation using a cost-of-living adjustment with a base year of 1997. For 2025, the annual gift tax exclusion is $19,000.[118]

Until January 1, 2026, if the designated beneficiary is an employee for whom no contribution during the taxable year is made to a tax-advantaged defined contribution plan, a section 403(b) plan, or a governmental section 457 plan, the beneficiary may contribute to his or her ABLE account the lesser of the beneficiary's compensation included in gross income or an amount equal to the poverty line for a one-person household for the preceding calendar year. The beneficiary may make such a contribution regardless of whether it increases the total amount contributed (by the beneficiary or others) for the taxable year above the amount determined under section 2503(b).

In addition to the foregoing contribution limitations, a qualified ABLE program must provide adequate safeguards to ensure that ABLE account contributions do not exceed the limit imposed on accounts under the qualified tuition program of the State maintaining the qualified ABLE program.[119]

A qualified ABLE program may permit a designated beneficiary to direct (directly or indirectly) the investment of any contributions (or earnings thereon) no more than two times in any calendar year and must provide separate accounting for each designated beneficiary. A qualified ABLE program may not allow any interest in the program (or any portion thereof) to be used as security for a loan.

[116] No inference may be drawn from a disability certification under section 529A for purposes of eligibility for SSDI, SSI, or Medicaid benefits.

[117] See sec. 511.

[118] If contributions to an ABLE account exceed the annual limit, an excise tax in the amount of six percent of the excess contribution to such account is imposed on the designated beneficiary. Sec. 4973. Such tax does not apply in the event that the trustee of the account makes a corrective distribution of the excess amount by the due date (including extensions) of the designated beneficiary's tax return for the taxable year of the excess contribution.

[119] See sec. 529(b)(6).

A distribution from an ABLE account is generally includible in the distributee's income to the extent it consists of earnings on the account.[120] However, distributions from an ABLE account in a taxable year are excludable from income to the extent they do not exceed the qualified disability expenses (discussed below) of the designated beneficiary for the taxable year. If distributions from an ABLE account exceed such qualified disability expenses, a pro rata portion of the distributions is excludable from income. The portion of any distribution that is includible in income is subject to an additional 10-percent tax unless the distribution is made after the death of the beneficiary.

Amounts in an ABLE account may be rolled over without income tax liability to another ABLE account for the same beneficiary[121] or another ABLE account for the designated beneficiary's brother, sister, stepbrother, or stepsister who is also an eligible individual. Once an ABLE account has been established by a designated beneficiary, no account subsequently established by such beneficiary shall be treated as an ABLE account, except in the case of a rollover (in which case the contributor ABLE account must be closed within 60 days of the rollover).

A contribution to an ABLE account is treated as a completed gift of a present interest to the designated beneficiary. Such contributions qualify for the per-donee annual gift tax exclusion ($19,000 for 2025) and, to the extent of such exclusion, are also exempt from the generation-skipping transfer ("GST") tax. A distribution from an ABLE account to the designated beneficiary is not subject to gift tax or GST tax.

Rollover from qualified tuition programs

Amounts rolled over within 60 days of distribution from a qualified tuition program (also known as a 529 account) to an ABLE account before January 1, 2026, generally are not included in the gross income of the 529 account beneficiary, provided that the ABLE account beneficiary is either the 529 account beneficiary or a member of the 529 account beneficiary's family.[122] Such rolled-over amounts count towards the overall limitation on amounts that may be contributed to an ABLE account within a taxable year.[123] However, to the extent that a 529 rollover amount, when added to all other amounts contributed to the ABLE account in the taxable year, exceeds the inflation-indexed $10,000 amount under section 2503(b), the 529

[120] The rules of section 72 apply in determining the portion of a distribution that consists of earnings.

[121] For instance, if a designated beneficiary were to relocate to a different State.

[122] Sec. 529(c)(3)(C)(i). For these purposes, a member of the family means, with respect to any 529 account beneficiary, the beneficiary's: (1) spouse, (2) child or descendant of a child, (3) brother, sister, stepbrother, or stepsister, (4) father, mother, or ancestor of either, (5) stepfather or stepmother, (6) niece or nephew, (7) aunt or uncle, or (8) in-law. Also included are (9) the spouse of any individual described in (2)–(8), and (10) any first cousin of the beneficiary. Sec. 529(e)(2).

[123] Sec. 529A(b)(2)(B).

rollover is includible in the gross income of the 529 beneficiary in the manner provided by section 72.[124]

Qualified disability expenses

As described above, distributed earnings from an ABLE account are excluded from income only to the extent total distributions do not exceed the qualified disability expenses of the designated beneficiary. For this purpose, qualified disability expenses are any expenses related to the designated beneficiary's blindness or disability which are made for the benefit of the designated beneficiary. Such expenses include expenses for the following: education, housing, transportation, employment training and support, assistive technology and personal support services, health, prevention and wellness, financial management and administrative services, legal fees, expenses for oversight and monitoring, funeral and burial expenses, and other expenses, which are approved by the Secretary under regulations and consistent with the purposes of section 529A.

Transfer to State

Upon death of the designated beneficiary, subject to any outstanding payments due for qualified disability expenses incurred by the designated beneficiary, a State may file a claim for payment of amounts remaining in the designated beneficiary's account. Such claim may not exceed the total medical assistance paid for the designated beneficiary after the establishment of the ABLE account under the State's Medicaid plan established under title XIX of the Social Security Act, net of any premiums paid from the ABLE account or by or on behalf of the beneficiary to such State's Medicaid Buy-In program.[125]

Treatment of ABLE accounts under Federal programs

Any amounts in an ABLE account, any contributions to such account, and any distributions for qualified disability expenses shall be disregarded for purposes of determining the designated beneficiary's eligibility to receive, or the amount of, any assistance or benefit authorized by any Federal means-tested program.[126] However, in the case of the SSI program, a distribution from an ABLE account for housing expenses is not disregarded, nor are amounts in an ABLE account in excess of $100,000. If an individual's ABLE account balance exceeds $100,000, such individual's SSI benefits shall not be terminated but instead shall be suspended until such time as the individual's resources fall below $100,000. However, such suspension shall not be taken into account for purposes of Medicaid eligibility.

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[124] Sec. 529(c)(3)(A).

[125] Sec. 529A(f).

[126] Pub. L. No. 113-295, div. B, sec. 103, December 19, 2014.

Description of Proposal

The proposal makes permanent the ability of a designated beneficiary who is an employee (and for whom no contribution during the taxable year is made to a tax-advantaged defined contribution plan, a section 403(b) plan, or a governmental section 457 plan) to contribute to his or her ABLE account the lesser of his or her compensation included in gross income or an amount equal to the poverty line for a one-person household for the preceding calendar year. The beneficiary may make such a contribution regardless of whether it increases the total amount contributed (by the beneficiary or others) for the taxable year above the amount determined under section 2503(b).

Under the proposal, the maximum annual contribution limit for an ABLE account (not including the employment-related contributions made by the designated beneficiary) is equal to the annual gift tax exclusion specified in section 2503(b) with a modified inflation adjustment. Whereas section 2503(b) adjusts the $10,000 base amount for inflation with a base year of 1997,[127] under the proposal the $10,000 base amount is adjusted for inflation with a base year of 1996. The extra year of inflation increases the annual contribution limit above what it would be under present law.

Effective Date

The proposal is generally effective for contributions made after December 31, 2025. The modified inflation adjustment is effective for taxable years beginning after December 31, 2025.

[127] Sec. 2503(b)(2)(B).

P. Extension of Savers Credit Allowed for ABLE Contributions

Present Law

Qualified ABLE programs

For present law regarding qualified ABLE programs, see the present law description for the provision "Increased Limitation on Contributions to ABLE Accounts Modified and Made Permanent," above.

Saver's Credit

Eligible individuals may claim a nonrefundable tax credit (the "saver's credit") for qualified retirement savings contributions to certain retirement accounts.[128] The maximum annual contribution eligible for the credit is $2,000 per individual. The credit rate depends on the adjusted gross income ("AGI") of the taxpayer. For this purpose, AGI is determined without regard to certain exclusions for foreign-source earned income and certain U.S. possession-source income. As the taxpayer's AGI increases, the saver's credit rate available to the taxpayer is reduced, until, at certain AGI levels, the credit is unavailable. For taxable years beginning in 2025, the following taxpayers may be eligible for at least some amount of credit: married taxpayers filing joint returns with AGI of $79,000 or less, taxpayers filing head of household returns with AGI of $59,250 or less, and all other taxpayers filing returns with AGI of $39,500 or less. The credit rates based on AGI for taxable years beginning in 2025 are provided in the table below. The AGI levels used for the determination of the available credit rate are indexed for inflation.

Table 4.–Credit Rates for Saver's Credit (2025)

Joint Filers	Heads of Households	All Other Filers	Credit Rate
$0–$47,500	$0–$35,625	$0–$23,750	50 percent
$47,501–$51,000	$35,626–$38,250	$23,751–$25,500	20 percent
$51,001–$79,000	$38,251–$59,250	$25,501–$39,500	10 percent
Over $79,000	Over $59,250	Over $39,500	0 percent

The saver's credit is in addition to any deduction or exclusion that would otherwise apply with respect to the qualified retirement savings contributions. The credit offsets alternative minimum tax liability as well as regular tax liability. The credit is available to individuals who

[128] Sec. 25B.

are 18 years old or older, other than individuals who are full-time students or claimed as a dependent on another taxpayer's return.

Eligible contributions for purposes of the credit include: (1) contributions to traditional and Roth individual retirement accounts ("IRAs"), (2) elective deferrals to a section 401(k) plan, a section 403(b) plan, a governmental section 457(b) plan, a savings incentive match plan for employees ("SIMPLE IRA"), or a simplified employee pension ("SEP") plan, (3) voluntary after-tax employee contributions to a qualified retirement plan or annuity or a section 403(b) plan, and (4) contributions to a section 501(c)(18) plan.[129] Under changes enacted by Public Law 115–97, eligible contributions for purposes of the credit also include contributions made by the individual to the ABLE account of which the individual is the designated beneficiary.[130] A credit for such ABLE contributions is available for contributions made in calendar years 2018 through 2025.

Under changes enacted by Public Law 117-328, for taxable years beginning after December 31, 2026, eligible contributions for purposes of the credit for any individual are limited to such individual's ABLE contributions, if any, made before January 1, 2026.[131] In effect, the credit is unavailable to any taxpayer in a taxable year beginning after December 31, 2026. Instead, taxpayers may be eligible for the "saver's match" credit enacted by Public Law 117-328, starting in taxable years beginning after December 31, 2026.[132]

The amount of contributions eligible for the saver's credit is reduced by distributions received by the taxpayer (or by the taxpayer's spouse if the taxpayer files a joint return) from any retirement plan or IRA to which eligible contributions may be made during the taxable year for which the credit is claimed, during the two taxable years prior to the year the credit is claimed, and during the period after the end of the taxable year for which the credit is claimed and prior to the due date for filing the taxpayer's return for the year.[133] Distributions that are rolled over to another retirement plan or IRA do not affect the credit.

Description of Proposal

The proposal makes permanent the temporary provision including ABLE account contributions made by the account's designated beneficiary as eligible contributions for purposes of the saver's credit. Therefore, for taxable years beginning after December 31, 2026, eligible contributions for purposes of the credit include (and are limited to) ABLE account contributions made during the taxable year by the account's beneficiary.

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[129] Sec. 25B(d)(1).

[130] Sec. 25B(d)(1)(D).

[131] Pub. L. No. 117-328, sec. 103(e) and (f), Dec. 29, 2022.

[132] Sec. 6433.

[133] Sec. 25B(d)(2).

Effective Date

The proposal is effective for taxable years ending after December 31, 2025.

Q. Extension of Rollovers from Qualified Tuition Programs to ABLE Accounts Permitted

Present Law

Qualified ABLE programs

For present law regarding qualified ABLE programs, see the present law description for the provision "Increased Limitation on Contributions to ABLE Accounts Modified and Made Permanent," above.

Description of Proposal

The proposal makes permanent the temporary provision that allows nontaxable rollovers from qualified tuition programs (529 accounts) to ABLE accounts, provided that (i) the rollover is completed within 60 days, (ii) the ABLE account beneficiary is either the 529 account beneficiary or a member of the 529 account beneficiary's family,[134] and (iii) the rollover amount does not, when added to all other contributions to the ABLE account in the taxable year, exceed the inflation-indexed $10,000 amount under section 2503(b) (with an additional year of inflation adjustment as provided by section 110015 of the bill).

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

[134] Sec. 529(c)(3)(C)(i). For these purposes, a member of the family means, with respect to any 529 account beneficiary, the beneficiary's: (1) spouse, (2) child or descendant of a child, (3) brother, sister, stepbrother, or stepsister, (4) father, mother, or ancestor of either, (5) stepfather or stepmother, (6) niece or nephew, (7) aunt or uncle, or (8) in-law. Also included are (9) the spouse of any individual described in (2)–(8), and (10) any first cousin of the beneficiary. Sec. 529(e)(2).

R. Extension of Treatment of Certain Individuals Performing Services in the Sinai Peninsula and Enhancement to Include Additional Areas

Present Law

Members of the Armed Forces serving in a combat zone are afforded a number of tax benefits. These include:

1. An exclusion from gross income of certain military pay received for any month during which the member served in a combat zone or was hospitalized as a result of serving in a combat zone;[135]

2. An exemption from taxes on death while serving in a combat zone or dying as a result of wounds, disease, or injury incurred while so serving;[136]

3. Special estate tax rules where death occurs in a combat zone;[137]

4. Special benefits to surviving spouses in the event of a service member's death or missing status;[138]

5. An extension of time limits governing the filing of returns and other rules regarding timely compliance with Federal income tax rules;[139] and

6. An exclusion from telephone excise taxes.[140]

Section 11026 of Public Law 115-97 provides that a qualified hazardous duty area is temporarily treated in the same manner as a combat zone for purposes of determining eligibility for the tax benefits available to members of the Armed Forces listed above.

The Sinai Peninsula of Egypt is identified as a "qualified hazardous duty area" for this purpose. This qualified hazardous duty area designation applies only during periods in which a member of the Armed Forces is entitled to special pay under 37 U.S.C. sec. 310 for duty subject to hostile fire or imminent danger for services performed in the Sinai Peninsula of Egypt. The identification of the Sinai Peninsula of Egypt as a qualified hazardous duty area for this purpose begins June 9, 2015, and includes the portion of the first taxable year ending after that date, as well as all subsequent taxable years beginning before January 1, 2026.

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[135] Sec. 112; see also sec. 3401(a)(1), exempting such income from wage withholding.

[136] Sec. 692.

[137] Sec. 2201.

[138] Secs. 2(a)(3) and 6013(f)(1).

[139] Sec. 7508.

[140] Sec. 4253(d).

Description of Proposal

The proposal amends Public Law 115-97 to permanently treat a qualified hazardous duty area in the same manner as a combat zone for purposes of determining eligibility for the certain tax benefits available to members of the Armed Forces.

The proposal also modifies the definition of qualified hazardous duty area to include (1) the Sinai Peninsula of Egypt if as of December 22, 2017, any member of the Armed Forces of the United States is entitled do special pay under 37 U.S.C. section 310 for duty subject to hostile fire or imminent danger for services performed in such location and (2) Kenya, Mali, Burkina Faso, and Chad if as of date of enactment, any member of the Armed Forces of the United States is entitled to special pay under 37 U.S.C. section 310 for duty subject to hostile fire or imminent danger for services performed in such location.

Effective Date

The proposal is effective on January 1, 2026.

S. Extension of Exclusion from Gross Income of Student Loans Discharged on Account of Death or Disability

Present Law

Gross income generally includes the amount of a taxpayer's indebtedness that is discharged.

An amount that otherwise would be includible in gross income as a result of the discharge of a taxpayer's indebtedness may be excluded from gross income under one of several exceptions. Under one exception, an individual's gross income does not include any amount from the forgiveness (in whole or in part) of the individual's student loan (under the definition described below) if the forgiveness is made under a provision of the loan according to which all or a part of the individual's indebtedness will be discharged if the individual works for a certain period of time in certain professions for any of a broad class of employers.[141]

A loan is a student loan in respect of which the exclusion is allowed if it satisfies the following requirements.[142] A loan must be made to an individual to assist the individual in attending an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of students in attendance at the place where its educational activities are regularly carried on. A loan may qualify if the proceeds are used for tuition and required fees or for room and board expenses. The loan must be made by (1) the United States (or an instrumentality or agency thereof), (2) a State, territory, or possession of the United States, or the District of Columbia, or any political subdivision thereof, (3) a tax-exempt public benefit corporation that controls a State, county, or municipal hospital and whose employees have been deemed to be public employees under State law, or (4) an educational organization that originally received the funds from which the loan was made from the United States, a State, territory, or possession of the United States, or the District of Columbia, or any political subdivision thereof, or a tax-exempt public benefit corporation. The exclusion from gross income for the discharge of a loan made by an educational organization described in the last prong applies only if the discharge is not on account of services performed for the organization.[143]

An individual's gross income also does not include an amount from the forgiveness of a loan made by an educational organization (or, in the case of a refinancing loan, an organization exempt from tax under section 501(a)) out of private, nongovernmental funds if the proceeds of such loans are used to pay costs of attendance at an educational institution or to refinance any outstanding student loans (not just loans made by educational organizations) and the student is not employed by the lender organization. In the case of such loans made or refinanced by educational organizations (or refinancing loans made by certain tax-exempt organizations), cancellation of the student loan must be contingent on the student working in an occupation or

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[141] Sec. 108(f)(1).

[142] Sec. 108(f)(2).

[143] Sec. 108(f)(3).

area with unmet needs and such work must be performed for, or under the direction of, a tax-exempt charitable organization or a governmental entity.

An amount paid by a person other than the taxpayer in repayment of the taxpayer's indebtedness generally is included in the taxpayer's gross income. An individual's gross income does not, however, include any loan repayment amount received under the National Health Service Corps Loan Repayment Program (the "NHSC Loan Repayment Program"), a qualifying State loan repayment program, or a qualifying State loan repayment or loan forgiveness program that is intended to provide for the increased availability of health care services in underserved or health professional shortage areas (as determined by the State).[144]

A temporary provision enacted in Public Law 115-97 excluded from an individual's gross income an otherwise includible amount from the discharge of a qualifying loan on account of a student's death or total and permanent disability.[145] An amount from the discharge of a loan qualified for this exclusion if the loan was a (1) a student loan (under the requirements for student loans described previously) or (2) a private education loan.[146] This temporary exclusion applied to a discharge after December 31, 2017 and before January 1, 2026.

A more recently enacted temporary provision (included in the American Rescue Plan Act) expands this earlier temporary exclusion from gross income for amounts from the discharge of student loan or private education loan indebtedness.[147] This more recent expansion applies to discharges of loans (in whole or in part) after December 31, 2020 and before January 1, 2026.

Under the expanded exclusion, an amount from the discharge of indebtedness is excluded from gross income irrespective of whether the discharge is on account of a student's death or total and permanent disability.

The temporary expanded exclusion not only is allowed irrespective of whether a discharge is on account of a student's death or disability; it also is available for discharges of a broader category of loans than was the earlier temporary rule for discharges on account of death or disability. This broader category includes any loan provided expressly for postsecondary educational expenses, regardless of whether provided through the educational institution or directly to the borrower, if the loan was made, insured, or guaranteed by one of the categories of

[144] Sec. 108(f)(4). The NHSC Loan Repayment Program offers loan repayment to certain health care professionals who provide medical services for a certain number of years at an approved service site in an area identified as having a shortage of health care professionals.

[145] Pub. L. No. 115-97, sec. 11031(a), December 22, 2017; prior law sec. 108(f)(5). The provision makes specific reference to those provisions of the Higher Education Act of 1965 that discharge William D. Ford Federal Direct Loan Program loans, Federal Family Education Loan Program loans, and Federal Perkins Loan Program loans in the case of death and total and permanent disability. See sec. 108(f)(5)(A)(i) and (ii). The provision also includes a general exclusion for a discharge on account of the death or total and permanent disability of the student. See sec. 108(f)(5)(A)(iii).

[146] Sec. 108(f)(5)(B). For this purpose, a private education loan is defined in section 140(a) of the Consumer Credit Protection Act (15 U.S.C. sec. 1650(a)).

[147] Pub. L. No. 117-2, sec. 9675(a), March 11, 2021; present law sec. 108(f)(5).

lenders in respect of which the permanent exclusion is allowed (described previously and including, for example, the United States or a State) or by an eligible educational institution as defined in section 25A, a category of educational institution that includes nearly all public, nonprofit, and for-profit postsecondary institutions.

Description of Proposal

The proposal restores the Public Law 115-97 exclusion from an individual's gross income for an otherwise includible amount from the discharge of a qualifying loan on account of a student's death or total and permanent disability.

As under Public Law 115-97, an amount from the discharge of a loan qualifies for the proposal's exclusion if the loan was a (1) a student loan (under the section 108(f)(2) requirements for student loans described previously) or (2) a private education loan.[148]

The proposal's exclusion from gross income is allowed in respect of a discharge during a taxable year only if the taxpayer includes on the tax return for the year the taxpayer's social security number and, if the taxpayer is married, the social security number of the taxpayer's spouse. For this purpose, the term "social security number" has the same meaning as under section 24(h)(7).[149]

The proposal treats the omission of a correct, required social security number as a mathematical or clerical error for purposes of section 6213.

Effective Date

The proposal is effective for discharges after December 31, 2025.

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[148] For this purpose, a private education loan is defined in section 140(a) of the Consumer Credit Protection Act (15 U.S.C. sec. 1650(a)).

[149] Section 24(h)(7) defines "social security number" as a social security number issued to an individual by the Social Security Administration, but only if the number is issued before the due date for the individual's tax return and is issued to a citizen of the United States or pursuant to subclause (I) (or that portion of subclause (III) that relates to subclause (I)) of section 205(c)(2)(B)(i) of the Social Security Act. For purposes of the social security number requirement for an individual and an individual's spouse, rules similar to the marital rules of section 32(d) apply.

PART II—ADDITIONAL TAX RELIEF FOR AMERICAN FAMILIES AND WORKERS

A. No Tax on Tips

Present Law

Under present law, tips are generally includible in an individual's gross income[150] and are subject to Federal income and Federal employment taxes.

Federal income taxation

All tips received by an individual are subject to federal income taxation including (1) cash tips received directly from customers,[151] (2) electronically paid tips from credit and debit card charge customers, and (3) tips received under a tip-splitting or tip-pooling arrangement. The value of noncash tips received, such as tickets, passes or other goods or commodities that a customer gives the individual are generally also subject to income taxation. However, service charges that an employer adds on to a customer's bill and pays to an employee are treated as wages to the individual, not tips.

The following factors generally determine whether a payment qualifies as a tip; normally, each of the following must apply: (1) the payment is made free from compulsion; (2) the customer has the right to determine the amount of the payment; (3) the payment isn't subject to negotiation or dictated by employer policy; and (4) the customer generally has the right to determine who receives the payment.[152]

Federal employment taxes

Federal employment taxes are imposed on covered wages paid to employees with respect to employment and include taxes imposed under the Federal Insurance Contributions Act ("FICA"), the Federal Unemployment Tax Act ("FUTA"), and the Federal income tax.[153] In addition, Tier 1 of the Railroad Retirement Tax Act ("RRTA") imposes a tax on compensation paid to railroad employees and representatives.[154]

FICA taxes are comprised of two components: the Old-Age, Survivors, and Disability Insurance ("OASDI") and Hospital Insurance ("Medicare"). With respect to OASDI taxes, the

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[150] Treas. Reg. sec. 1.61-2(a).

[151] Certain individuals may receive "indirect" tips that are treated as income to those individuals. An indirect tip occurs when an employee, who normally does not receive tips directly from customers, receives a tip. For example, bussers, service bartenders, cooks and salon shampooers.

[152] Rev. Rul. 2012-18, 2012-26 I.R.B. 1032; IRS, *Publication 531, Reporting Tip Income*, Rev. December 2024.

[153] Secs. 3101, 3111, 3301, and 3401.

[154] Sec. 3221.

applicable rate is 12.4 percent with half of such rate (6.2 percent) imposed on the employee and the remainder (6.2 percent) imposed on the employer.[155] The tax is assessed on covered wages up to the OASDI wage base ($176,100 in 2025). Generally, the OASDI wage base rises based on increases in the national average wage index.[156] With respect to Medicare taxes, the applicable rate is 2.9 percent with half of such rate (1.45 percent) imposed on the employee and the remainder (1.45 percent) imposed on the employer.[157] The employee portion of the Medicare tax (not the employer portion) is increased by an additional tax of 0.9 percent on wages received in excess of a threshold amount. The threshold amount is $250,000 in the case of a joint return, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case.

The FICA tax is assessed on covered wages, which is defined for such tax purposes as all remuneration for "employment," including the cash value of all remuneration (including benefits and tips) paid in any medium other than cash, with certain exceptions. The name given to the remuneration for employment is immaterial. Such wages include salaries, vacation allowances, bonuses, deferred compensation, commissions, fringe benefits, and tips. With respect to tips, wages for FICA purposes includes cash and charge tips of $20 or more received by an employee in a calendar month. Employees are generally required to report to their employers the amount of tips received as further described below.

The term "employment" is generally defined for FICA tax purposes as any service, of whatever nature, performed by an employee for the person employing him or her, with certain specific exceptions.

The employee portion of OASDI and Medicare taxes must be withheld and remitted to the Federal government by the employer during the quarter, as required by the applicable deposit rules. The employer is liable for the employee portion of the OASDI and Medicare taxes, in addition to its own share, whether or not the employer withholds that amount from the employee's wages. OASDI and Medicare taxes are generally allocated by statute among separate trust funds: the OASDI Trust Funds, Medicare's Hospital Insurance Trust Fund, and the Medicare Supplementary Trust Fund.

Employee reporting of tips to employers

Employees normally include tips in income when they are received. However, employees who are required to report cash tips to their employer in a written statement are treated as receiving the tips when they provide this statement. For this purpose, cash tips include tips paid by cash, check, debit card and credit card.

If an employee receives cash tips of $20 or more in any calendar month, the employee must report those tips to the employer in one or more written statements by the tenth of the

[155] Secs. 3101(a) and 3111(a).

[156] Sec. 230 of the Social Security Act (42 U.S.C. sec. 430).

[157] Sec. 3101(b)(1) and 3111(b).

month following the month the tips were received.[158] The employer reports that tip income to the employee on the employee's W-2.[159] Thus, the employee includes those cash tips in income for the tax year in which he or she provides the required written statement to the employer. The employer is required to keep the employee tip reports and is required to withhold taxes, including both income taxes and the employee's and employer's share of FICA and Medicare tax on the total wages paid to the tipped employees as well as the reported tip income.[160]

Although noncash tips are not required to be reported to the employer, the employee is required to report them on his or her tax return. Any tips that the employee did not report to the employer, the employee must report separately[161] to include as additional wages with his or her tax return. The employee must also pay the employee share of Social Security and Medicare tax on those tips.

Independent contractor and sole proprietor reporting

Under present law, there is no required reporting of "tips" to independent contractors or sole proprietors.

However, under present law, there is tax reporting of certain payments made to vendors and independent contractors (both to those entities as well as to the IRS) on either a Form 1099-NEC or a Form 1099-K.[162]

A business that pays at least $600 in a calendar year to an individual who is not an employee (for example an independent contractor or freelancer) for services performed by that individual in the course of that business's trade or business during that year is generally required to furnish to such individual (and the IRS) a Form 1099-NEC on or before January 31 of the year following the calendar year for which the return is required.[163] The Form 1099-NEC provides the name, address and phone number of the person required to make the return and summarizes

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[158] Sec. 6053(a). The statement must include the employee's signature; the employee's name and address; the month or period the report covers; and the total of tips received during the month or period.

[159] Sec. 6051(a); Treas. Reg. sec. 30.6051-1(vi). The employer reports to the employee "only such tips as are reported by the employee to the employer in a written statement furnished to the employer pursuant to section 6053(a)." These tips are reported by the employer in Box 7 of the Form W-2 (Social Security tips), and the Form W-2 is reported to both the employee and the Internal Revenue Service.

[160] A special rule applies to large food or beverage establishments (10 or more employees) that must also report "allocated tips" to employees if the tips the employees reported to their employer were less than 8% of the employer's food and drink sales. Allocated tips are reported by the employer in box 8 of the Form W-2. Those allocated tips must also be reported by the employee on his or her tax return.

[161] On Form 4137, *Social Security and Medicare Tax on Unreported Tip Income*.

[162] Under secs. 6041(a) or 6050W(a).

[163] Sec. 6041(a) and (d). Sec. 6041(e) provides that this section does not apply to tips with respect to which section 6053(a) applies, *e.g.*, reporting of tips by employees to employers as described above.

(provides the aggregate amount) of all nonemployee compensation the business has paid to such an individual during that calendar year.

Payment settlement entities[164] including third-party settlement networks (such as VISA, Mastercard, PayPal or Square) are required to report certain payments made in a calendar year in settlement of payment card transactions[165] and third-party network transactions[166] on a Form 1099-K. The report must set forth (1) the name, address and TIN of each participating payee to whom one or more payments in settlement of reportable payment transactions are made and (2) the gross amount of the reportable payment transactions[167] with respect to each participating payee. Third party settlement organizations which include payment apps and online marketplaces are required to report payments on Form 1099-K when the total amount of payments received for goods or services through the platform exceeds: $5,000 in 2024, $2,500 in 2025, and $600 in 2026 and later.[168]

<u>FICA Business Tip Credit</u>

The Code[169] allows certain food and beverage establishments to elect to claim a business tax credit in an amount equal to the employer share of FICA taxes paid on tips in excess of those treated as wages for purposes of meeting the minimum wage requirements of the Fair Labor Standards Act (the "FLSA") as in effect on January 1, 2007 ("FICA tip credit").[170]

The credit applies only with respect to employer FICA tax paid on tips received from customers in connection with the providing, delivering, or serving of food or beverages for consumption if the tipping of employees delivering or serving food or beverages by customers is customary. No deduction is allowed to the employer for any amount taken into account in

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[164] Defined as either a "merchant acquiring entity" in the case of a payment card transaction or a "third party settlement organization" in the case of a third-party network transaction." Sec. 6050W(b)(1). A "merchant acquiring entity" means the bank or other organization which has the contractual obligation to make payment to participating payees in settlement of payment card transactions. Sec. 6050W(b)(2). A "third party settlement organization" means the central organization which has the contractual obligation to make payment to participating payees of third party network transactions. See sec. 6050W(b)(3).

[165] A payment card transaction means any transaction in which a payment card is accepted as payment. Sec. 6050W(c)(2).

[166] A third party-network transaction means any transaction that involves the establishment of accounts with a central organization by a substantial number of persons who are unrelated to the organization, provide goods or services and have agreed to settle transaction pursuant to such agreement or arrangement. Sec. 6050W(d)(3)(A).

[167] Reportable payment transactions mean any payment card transaction and any third party network transaction.

[168] However, money received from friends or family as a gift or repayment for a personal expense are not reported on a Form 1099-K because such payments are not taxable income.

[169] Sec. 45B.

[170] As of January 1, 2007, the Federal minimum wage under the FLSA was $5.15 per hour. In the case of tipped employees, the FLSA provides that the minimum wage may be reduced to $2.13 per hour (that is, the employer is only required to pay cash equal to $2.13 per hour) if the combination of tips and cash income equals the Federal minimum wage.

determining the tip credit. The credit is available whether or not the employee reports the tips on which the employer FICA tax is paid.

Description of Proposal

Federal tax deduction for qualified tips

The proposal provides a federal income tax deduction (the "tip deduction") equal to the qualified tips that an individual receives during any taxable that are included on Form W-2's, 1099-K's or 1099-NECs, or reported by the taxpayer on Form 4317 (or successor).[171]

"Qualified tips" are defined as any cash tip received by an individual in an occupation which traditionally and customarily received tips on or before December 31, 2024, as provided by the Secretary. The list of such occupations is to be published by the Secretary of the Treasury (or the Secretary's delegate) within 90 days of enactment. Qualified tips do not include any amount received by an individual unless: (1) such amount is paid voluntarily without any consequence in the event of nonpayment, is not the subject of negotiation, and is determined by the payor; (2) the trade or business in the course of which the individual receives such amount is not a specified service trade or business;[172] (3) such individual is not a highly compensated employee[173] of any employer for the calendar year in which the taxable year begins, and does not receive earned income in excess of the dollar amount in effect[174] for such calendar year; and (4) such other requirements as may be established by the Secretary in regulations or other guidance are satisfied.

In the case of qualified tips received by an individual during any taxable year in the course of any trade or business of such individual, such qualified tips are taken into account only to the extent that the gross receipts of the taxpayer from such trade or business for such taxable year (including such qualified tips) exceeds the sum of: (1) the cost of goods sold that are allocable to such receipts, plus (2) other expenses, losses, or deductions (other than the deduction allowed under this proposal), which are properly allocable to such receipts.

Non-itemizers may take the tip deduction in addition to the standard deduction

For individuals who do not elect to itemize their deductions, the tip deduction is allowed in addition to the standard deduction.

[171] Pursuant to secs. 6041(d)(3), 6041A(e)(3), 6050W(f)(2), or 6051(a)(18).

[172] As defined in sec. 199A(d)(2).

[173] As defined in sec. 414(q)(1).

[174] As defined in sec. 414(q)(1)(B)(i). For 2025, that amount is $160,000.

Social security number requirement

No tip deduction is allowed under this section with respect to qualified tips unless the taxpayer includes the social security number[175] of the individual who received such tips on his or her tax return for the taxable year. If the individual is married, such tax return must also include the social security number of such spouse.[176] An omission of a correct social security number is treated as a mathematical or clerical error.[177]

Exclusion from qualified business income

Any amount[178] for which a tip deduction is allowable under this proposal is excluded from being considered qualified business income.[179]

Reporting requirements

Tip deductions to employees are only allowed for qualified tips reported by the employer on Form W-2.[180] With respect to returns related to wages reported to the Secretary and the employee[181], the total amount of tips reported by the employee to the employer is provided.[182]

Independent contractors and sole proprietors are only eligible for the tip deduction in the following situations: (1) with respect to returns for payments made in the course of a trade or business reported to the Secretary[183] and the payee,[184] in the case of compensation to non-employees, there is a separate accounting of the portion of payments that have been properly designated as tips and whether such tips are received in an occupation which traditionally and customarily tips is noted;[185] (2) with respect to returns for payments made for services and direct

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[175] As defined in sec. 24(h)(7).

[176] With respect to the treatment of married individuals for purposes of this proposal, rules similar to section 32(d) apply.

[177] For purposes of section 6213(g)(2) as amended by the preceding provisions of this legislation.,.

[178] Under sec. 6050W(a).

[179] For purposes of the deduction under section 199A.

[180] Under sec. 6051(a), as amended by the preceding provisions of this Act and is further amended to provide this requirement.

[181] Under section 6051(a).

[182] Under section 6053(a).

[183] Under section 6041(a).

[184] Under section 6041(d).

[185] As described in section 224(c)(1).

sales reported to the Secretary[186] and the payee,[187] there is a separate accounting of the portion of payments that have been properly designated as tips and whether such tips are received in an occupation which traditionally and customarily tips is noted;[188] and (3) with respect to returns and payments relating to third party settlement organizations reported to the Secretary[189] and the payee,[190] there is a separate accounting of the portion of the reportable payment transactions that have been properly designated by payors as tips and whether such tips are received in an occupation which traditionally and customarily tips is noted.[191]

Withholding tables and procedures to be updated

Withholding tables and procedures, with respect to Federal individual income taxes, is to be updated to account for the tip deduction.

Regulations

The Secretary has the authority to prescribe such regulations or other guidance as may be necessary to prevent reclassification of income as qualified tips, including regulations or other guidance to prevent abuse of the tip deduction.

Sunset of tip deduction

No tip deduction is allowed under this section for any taxable year beginning after December 31, 2028.

Extension of tip credit to beauty service business

The proposal extends the FICA tip credit to certain beauty services.

The proposal extends the FICA tip credit to tips received from customers or clients by an employee in connection with providing beauty services for which tipping is customary. "Beauty services" are defined to include barbering, hair care, nail care, esthetics, and body and spa treatments. The minimum wage limitation is revised with respect to beauty services to reference the minimum wage rate applicable under the FLSA for that month (rather than the rate applicable as of January 1, 2007).

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[186] Under sec. 6041A(a).

[187] Under sec. 6041A(e).

[188] As described in sec. 224(c)(1).

[189] Under sec. 6050W(a).

[190] Under sec. 6050W(f)(2).

[191] As described in sec. 224(c)(1).

Effective Date

The proposal applies to taxable years beginning after December 31, 2024.

B. No Tax on Overtime

Present Law

Under present law, overtime is generally includible in an individual's gross income[192] and is subject to Federal income and Federal employment taxes.

Federal Labor Standards Act of 1938

The Federal Labor Standards Act of 1938 ("FLSA" or the "Act")[193] provides for the payment of overtime pay.[194]

Overtime under FLSA

Under present law, employers generally must pay covered, non-exempt employees at least one-and-a half times their "regular rate" of pay for hours worked over 40 hours a week at a given job ("overtime compensation").[195]

Regular rate of pay

The amount of overtime pay is based on the employee's regular rate of pay and the number of hours worked in a workweek. Because earnings may be determined on a piece-rate, salary, commission, or some other basis and the FLSA does not provide for how work hours are scheduled,[196] the determination of the regular rate of pay is based upon the actual facts of the individual's job and work schedule (as well as certain other rules) and is calculated by dividing the total pay for employment (except for certain statutory exclusions such as the premium portion of overtime compensation) in any workweek by the total number of hours actually worked.

The regular rate of pay includes all remuneration for employment, except certain payments excluded by the Act.[197]

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[192] Treas. Reg. sec. 1.61-2(a). Overtime is reported in Box 1 of the Form W-2.

[193] Pub. L. No. 75-718, June 25, 1938.

[194] 29 U.S.C. sec. 207(a).

[195] Congressional Research Service, *The Fair Labor Standards Act (FLSA): An Overview*, updated March 8, 2023, available at https://crsreports.congress.gov. 29 U.S.C. sec. 207(o) provides that an employee of a public agency which is a State, a political subdivision of a state or an interstate governmental agency may receive, in lieu of overtime compensation, compensatory time off.

[196] Wage and Hour Division, Department of Labor, "Fact Sheet #23: Overtime Pay Requirements of the FLSA," revised October 2019. An employee's workweek is a fixed and regularly recurring period of 168 hours, seven consecutive 24-hour periods. Different workweeks may be established for different employees or groups of employees.

[197] 29 U.S.C. sec. 207(e). For example, expenses incurred on the employer's behalf such as traveling expenses, discretionary bonuses, gifts and payments in the nature of gifts on special occasions, premium payments

Covered employees

The FLSA covers employees and enterprises engaged in interstate commerce. The FLSA covers most, but not all, private and public sector employees.[198]

Exemptions

There are a number of exemptions from the overtime requirements, including a broad exemption for executive, administrative, professional, computer and outside sales employees that narrows the individuals who are eligible to receive overtime compensation.[199]

Tip credit under FLSA and impact on overtime

Under the FLSA, an employer must pay a tipped worker a minimum cash wage of $2.13 if the employee receives at least $5.12 an hour in tips (for a total wage of $7.25).[200] Employers may claim up to $5.12 in tips as a tip credit. The additional amount may not exceed the value of the tips actually received by an employee and the employer must provide notice to the employee of the tip credit provision before applying the tip credit.[201] All tips received by such employee must be retained by the employee except the provision does not prohibit the pooling of tips among employees who customarily and regularly receive tips. However, if a tipped employee receives less than $5.12 an hour in tips, the employer must make up the difference with a higher cash wage.

An employer can use the tip credit towards meeting the overtime requirements as well.

Recordkeeping

Every covered employer must keep certain records for each non-exempt employee. FLSA does not require a particular form for such records but does require that the records include certain identifying information about the employee and data about the hours worked and

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for overtime work, extra compensation provided by a premium rate for work by the employee on Saturdays, Sundays, and holidays, contributions irrevocably made by an employer for providing old-age, retirement, life, accident or health insurance or similar benefits to employees, payments made to a bona fide profit sharing or thrift or savings plan, and payments for occasional periods when no work is performed due to vacation, holidays or illness.

[198] 29 U.S.C. sec. 203(e).

[199] 29 U.S.C. sec. 213(a)(1).

[200] 29 U.S.C. sec. 203(m)(2).

[201] The notice must include the amount of the cash wage the employer is paying the tipped employee, the additional amount claimed by the employer as a tip credit, provide that the tip credit claimed by the employer cannot exceed the amount of tips actually received by the tipped employee, that all tips received by the tipped employee are to be retained by the employee except for a valid tip pooling arrangement limited to employees who customarily and regularly receive tips, and that the tipped employee must have been provided this notice.

the wages earned.[202] Among other information included in such records is the employee's full name and social security number, the time and day of week when the employee's workweek begins, hours worked each day, total hours worked each workweek, the basis on which the employee's wages are paid, the regular hourly pay rate, and total premium pay for overtime hours for the workweek.[203]

Each employer is required to retain payroll records, collective bargaining agreements, and sales and purchase records for at least three years.[204] Records on which wage computations are based are retained for two years, including time cards and piece work tickets, wage rate tables, work and time schedules and records of additions to or deductions from wages.[205]

Employers are also required to keep detailed records of tips.[206]

These records must be open for inspection by the Wage and Hour Division of the Department of Labor, who may ask the employer to make extensions, computations or transcriptions.[207]

Income taxation

All overtime received by an individual is subject to federal income taxation and is currently reported in Box 1 of the W-2. An employer reports overtime compensation as part of all other taxable wages, tips, and other compensation paid to the employee during the year. Currently, there is no separate reporting of overtime compensation for tax reporting purposes on either the Form W-2 or on the Form 1040.

Employment taxes

For a general description of employment taxes, see Subtitle A, Part 2, section 110101 of this document, "No tax on tips."

Tax reporting

Under present law, there are no special rules for reporting overtime compensation for purposes of income taxation or employment tax reporting.

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[202] 29 C.F.R. Part 516.

[203] 29 C.F.R. Part 516.2.

[204] 29 C.F.R. Part 516.5.

[205] 29 C.F.R. Part 516.6.

[206] 29 C.F.R. Part 515.28.

[207] Wage and Hour Division, Department of Labor, "Fact Sheet #21: Recordkeeping Requirements under the Fair Labor Standards Act," revised July 2008.

Description of Proposal

Federal tax deduction for qualified overtime compensation

The proposal provides a federal income tax deduction (the "overtime deduction") equal to the qualified overtime compensation that an individual receives during the taxable year. Amounts excluded from the overtime deduction include (1) any qualified tips[208] and (2) any amount received by an individual during a taxable year if such individual is a highly compensated employee[209] of any employer for the calendar year in which the taxable year begins, or receives earned income in excess of the dollar amount in effect[210] for such calendar year.

"Qualified overtime compensation" means overtime compensation paid to an individual required under section seven of the FLSA that is in excess of the regular rate (as used in that section) at which such individual is employed. Such term does not include any qualified tips as defined in section 110101 of this bill, "No tax on tips."[211] As a result, there is no double tax benefit provided to qualified tips for which a deduction is permitted under that section and then used to determine qualified overtime compensation for purposes of calculating the overtime deduction under this section of the bill.

Non-itemizers may take the overtime deduction in addition to the standard deduction

For individuals who do not elect to itemize their deductions, the overtime deduction is allowed in addition to the standard deduction.

Social security number requirement

No overtime deduction is allowed under this section with respect to qualified overtime compensation unless the taxpayer includes the social security number[212] of the individual who received such qualified overtime compensation on his or her tax return for the taxable year. If the individual is married, such tax return must also include the social security number of such spouse.[213] An omission of a correct social security number (relating to the qualified overtime deduction) to be included on a return is treated as a mathematical or clerical error.[214]

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208 As defined in sec. 224(c).

209 As defined in sec. 414(q)(1).

210 As defined in sec. 414(q)(1)(B)(i). For 2025, that amount is $160,000.

211 Subtitle A, Part 2, section 110101.

212 As defined in sec. 24(h)(7).

213 With respect to the treatment of married individuals for purposes of this proposal, rules similar to section 32(d) apply.

214 For purposes of sec. 6213(g)(2).

Reporting requirements

Overtime deductions to employees are only allowed for qualified overtime compensation if the total amount of qualified overtime compensation is reported separately on the Form W-2.[215]

Withholding tables and procedures to be updated

Withholding tables and procedures, with respect to Federal individual income taxes, must be updated to account for the overtime deduction.

Regulations

The Secretary has the authority to prescribe such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this proposal.

Sunset of overtime deduction

No overtime deduction is allowed under this section for any taxable year beginning after December 31, 2028.

Effective Date

The proposal applies to taxable years beginning after December 31, 2024.

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[215] Under sec. 6051(a) as amended by the preceding provisions of this Act and further amended to provide this requirement.

C. Enhanced Deduction for Seniors

Present Law

An individual who does not elect to itemize deductions reduces adjusted gross income ("AGI") by the amount of the applicable standard deduction in arriving at taxable income. The standard deduction is the sum of the basic standard deduction and, if applicable, the additional standard deduction.[216] The basic standard deduction varies depending upon a taxpayer's filing status. For taxable years beginning in 2025, the amount of the basic standard deduction is $15,000 for an unmarried individual (other than a head of household or a surviving spouse) and a married individual filing a separate return,[217] $22,500 for a head of household, and $30,000 for married individuals filing a joint return and a surviving spouse.[218]

An additional standard deduction is allowed to an individual who has attained age 65 before the close of the taxable year or is blind at the close of the taxable year.[219] For 2025, the additional amount is $1,600 for a married taxpayer (for each spouse meeting the applicable criteria in the case of a joint return) and a surviving spouse. The additional amount for a single individual and head of household is $2,000. An individual who is both blind and has attained age 65 is entitled to two additional standard deductions, for a total additional amount (for 2025) of $3,200 or $4,000, as applicable.

In the case of a dependent for whom a deduction for a personal exemption[220] is allowable to another taxpayer, the standard deduction may not exceed the greater of (i) $1,350 (in 2025) or (ii) the sum of $450 (in 2025) plus the dependent's earned income.[221] The standard deduction for an estate or trust is zero.[222] The amounts of the basic and additional standard deduction are indexed annually for inflation.[223]

Public law 115-97 temporarily increases the basic standard deduction for tax years beginning after December 31, 2017, and before January 1, 2026. Under present law, relative to taxable years beginning in 2025, the standard deduction will decrease for taxable years beginning in 2026, with the amount of the basic standard deduction being $8,300 for an unmarried

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[216] Sec. 63(c)(1).

[217] In the case of a married individual filing a separate return where either spouse itemizes deductions, the standard deduction is zero. Sec. 63(c)(6).

[218] Rev. Proc. 2024-40, 2024-45 I.R.B. 1100, November 4, 2024.

[219] Sec. 63(f).

[220] For taxable years beginning in 2018 through 2025, the personal exemption amount is reduced to zero. Sec. 151(d)(5). This reduction is not taken into account in determining the limitation on the standard deduction for dependents. See sec. 151(d)(5).

[221] Sec. 63(c)(5).

[222] Sec. 63(f).

[223] Sec. 63(c)(4) and (c)(7)(B).

individual (other than a head of household or a surviving spouse) and a married individual filing a separate return,[224] $12,150 for a head of household, and $16,600 for married individuals filing a joint return and a surviving spouse.[225] The additional standard deduction was not modified by Public Law 115-97.

Description of Proposal

The proposal adds a deduction for a bonus additional amount for all individuals who have attained age 65 (for each spouse meeting the applicable criteria in the case of a joint return) for taxable years beginning after December 31, 2024, and before January 1, 2029. This additional amount is $4,000 per individual, the "senior bonus amount." The senior bonus amount phases out for taxpayers with income over a threshold amount of $150,000 for taxpayers filing jointly and $75,000 for all other taxpayers. The senior bonus amount is reduced by four percent of modified AGI in excess of the applicable threshold amount. For purposes of this limitation, modified AGI means AGI increased by any amount excluded from gross income under section 911 (foreign earned income exclusion), 931 (exclusion of income for a bona fide resident of American Samoa), or 933 (exclusion of income for a bona fide resident of Puerto Rico).

The deduction for the senior bonus amount is allowed to taxpayers who claim the standard deduction and to taxpayers who elect to itemize deductions. The senior bonus amount is not indexed for inflation.

Under the proposal, the social security number ("SSN") of the taxpayer and the taxpayer's spouse (if married filing jointly) must appear on the return.[226] The SSN for each individual must be issued before the due date of the return. Each SSN also must be issued to a citizen or national of the United States or pursuant to a provision of the Social Security Act relating to the lawful admission for employment in the United States.[227]

The proposal treats the omission of a correct, required SSN as a mathematical or clerical error for purposes of section 6213.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2024.

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[224] In the case of a married individual filing a separate return where either spouse itemizes deductions, the standard deduction is zero. Sec. 63(c)(6).

[225] Joint Committee on Taxation staff projections.

[226] With respect to the treatment of married individuals for purposes of this proposal, rules similar to section 32(d) apply.

[227] See sec. 205(c)(2)(B)(i)(I) (or that portion of subclause (III) that relates to subclause (I)) of the Social Security Act.

D. No Tax on Car Loan Interest

Present Law

A deduction is allowed for interest paid or accrued on indebtedness.[228] For a taxpayer other than a corporation, however, no deduction is allowed for personal interest.[229] For this purpose, personal interest means any interest for which a deduction is allowable under chapter 1 of subtitle A of the Code other than several kinds of specified interest including, for example, qualified residence interest (interest paid or accrued on indebtedness incurred in purchasing or improving the taxpayer's principal residence).[230]

Description of Proposal

For taxable years beginning in 2025, 2026, 2027, and 2028, the proposal excludes from the definition of personal interest qualified passenger vehicle loan interest. As a consequence, unless another rule disallows a deduction, for taxable years 2025 through 2028 a deduction is allowed for qualified passenger vehicle loan interest.

Qualified passenger vehicle loan interest

For purposes of this rule, qualified passenger vehicle loan interest means any interest that is paid or accrued during the taxable year on indebtedness incurred by the taxpayer after December 31, 2024 for the purchase of, and that is secured by a first lien on, an applicable passenger vehicle for personal use (referred to below as "auto acquisition indebtedness"). Qualified passenger vehicle loan interest does not include –

1. A loan to finance fleet sales,

2. A personal cash loan secured by a vehicle previously purchased by the taxpayer,

3. A loan incurred for the purchase of a commercial vehicle that is not used for personal purposes,

4. Any lease financing,

5. A loan to finance the purchase of vehicle with a salvage title, or

6. A loan to finance the purchase of a vehicle intended to be used for scrap or parts.

The proposal limits the amount of interest that a taxpayer may take into account in a taxable year as qualified passenger vehicle loan interest to $10,000.

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[228] Sec. 163(a).

[229] Sec. 163(h)(1).

[230] Sec. 163(h)(2).

The proposal reduces the amount that is otherwise allowable as a deduction for qualified passenger vehicle loan interest (after taking into account the $10,000 limitation) by 20 percent of the amount by which a taxpayer's modified adjusted gross income ("modified AGI") exceeds $100,000 (or, in the case of married individuals filing a joint return, $200,000). Accordingly, for a taxpayer with an otherwise allowable deduction of $10,000, the deduction is fully eliminated when modified AGI is at least $150,000 ($250,000 in the case of a joint return). For purposes of this income-based phaseout, modified AGI is adjusted gross income increased by the amount excluded from gross income under section 911, 931, or 933.

For purposes of the exclusion from personal interest for qualified passenger vehicle loan interest, an applicable passenger vehicle is any vehicle that is manufactured primarily for use on public streets, roads, and highways; that has at least two wheels; and that is a car, minivan, van, sport utility vehicle, pickup truck, or motorcycle. An all-terrain vehicle designed for use on land is also an applicable passenger vehicle. For this purpose an all-terrain vehicle is defined as any motorized vehicle that has three or four wheels, a seat designed to be straddled by the operator, and handlebars for steering control, An applicable passenger vehicle also includes any trailer, camper, or vehicle (designed for use on land) that is designed to provide temporary living quarters for recreational, camping, or seasonal use and that is a motor vehicle or is designed to be towed by, or affixed to, a motor vehicle.

A vehicle is an applicable passenger vehicle only if the vehicle's final assembly occurs in the United States.

For purposes of the U.S. final assembly requirement, final assembly is the process by which a manufacturer produces a vehicle at, or through the use of, a plant, factory, or other place from which the vehicle is delivered to a dealer or importer with all component parts necessary for the mechanical operation of the vehicle included with the vehicle, whether or not the component parts are permanently installed in or on the vehicle.

Interest on indebtedness may be considered qualified passenger vehicle loan interest if the indebtedness is incurred to refinance acquisition indebtedness, but only to the extent that the amount of this refinancing indebtedness does not exceed the amount of the acquisition indebtedness and only if the refinancing indebtedness is secured by a first lien on the applicable passenger vehicle with respect to which the acquisition indebtedness was incurred.

Indebtedness that is owed to a person related to the taxpayer within the meaning of section 267(b) or 707(b)(1) is not qualified passenger vehicle loan interest.

The deduction for qualified passenger vehicle loan interest is allowed in determining a taxpayer's adjusted gross income, with the consequence that the deduction is allowable to a taxpayer who does not elect to itemize deductions.

The deduction for qualified passenger vehicle loan interest is allowed for purposes of the alternative minimum tax.

Reporting

The proposal provides a new reporting requirement (in new section 6050AA) for interest received on a specified passenger vehicle loan. Any person who is engaged in a trade or business and who receives in the course of that trade or business from any individual at least $600 in a calendar year on a specified passenger vehicle loan must, by a deadline to be prescribed by the Secretary, make a return for each individual from whom the interest was received.

The prescribed return must contain the following information:

1. the name and address of the individual from whom the interest was received,

2. the amount of the interest received for the calendar year,

3. the amount of outstanding principal on the specified passenger vehicle loan at the beginning of the calendar year.

4. the date of the origination of the loan,

5. the year, make, and model of the applicable passenger vehicle that secures the loan (or another description of the vehicle as the Secretary may prescribe), and

6. any other information that the Secretary may prescribe.

A person that is required to make a return under this rule must furnish to each individual whose name is required to be set forth on that return a written statement that includes (1) the name, address, and phone number of the information contact of the person required to make the return, and (2) the information described in items 2 through 6 above. This written statement must be furnished by January 31 of the year following the calendar year for which the corresponding return was required to be made.

A specified passenger vehicle loan is the indebtedness with respect to which qualified passenger vehicle loan interest (described previously) is paid or accrued.

Effective Date

The proposal is effective for indebtedness incurred after December 31, 2024.

E. Enhancement of Employer-Provided Child Care Credit

Present Law

In general

Taxpayers may claim a general business credit for certain expenses associated with providing child care for their employees. The amount of the credit is equal to 25 percent of qualified child care expenditures and 10 percent of qualified child care resource and referral expenditures for the taxable year.[231] The maximum total credit that may be claimed by a taxpayer cannot exceed $150,000 per taxable year.[232]

Qualified child care expenditures include costs paid or incurred: (1) to acquire, construct, rehabilitate, or expand property that is to be used as part of the taxpayer's qualified child care facility ("qualified construction expenditures");[233] (2) for the operation of the taxpayer's qualified child care facility, including the costs of training and certain compensation for employees of the child care facility, and scholarship programs; or (3) under a contract with a qualified child care facility to provide child care services to employees of the taxpayer.[234] Qualified child care expenditures do not include expenses in excess of the fair market value of providing child care.[235]

A qualified child care facility is a facility with the principal use of providing child care assistance that meets all applicable State and local laws and regulations, including any licensing laws.[236] A facility is not treated as a qualified child care facility with respect to a taxpayer unless: (1) its enrollment is open to the employees of the taxpayer; (2) at least 30 percent of the children enrolled in the center are dependents of the taxpayer's employees, if the facility is the principal trade or business of the taxpayer; and (3) use of the facility (or eligibility to use such facility) does not discriminate in favor of highly compensated employees of the taxpayer (within the meaning of section 414(q)).[237]

Qualified child care resource and referral expenditures are amounts paid or incurred under a contract to provide child care resource and referral services to an employee of the

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[231] Sec. 45F(a).

[232] Sec. 45F(b).

[233] The property must be subject to depreciation or amortization and must not be part of the principal residence (within the meaning of section 121) of the taxpayer or any employee of the taxpayer.

[234] Sec. 45F(c)(1)(A).

[235] Sec. 45F(c)(1)(B).

[236] Sec. 45F(c)(2)(A). If the facility is the principal residence (within the meaning of section 121) of the operator of the facility, it does not satisfy the "principal use of providing child care assistance" requirement.

[237] Sec. 45F(c)(2)(B).

taxpayer.[238] These services must be provided (or be eligible for use) in a way that does not discriminate in favor of highly compensated employees of the taxpayer (within the meaning of section 414(q)).[239]

Denial of double benefit and recapture

No deduction or credit is allowed with respect to the amount of credit claimed for qualified child care expenditures and qualified child care resource and referral expenditures.[240] Additionally, if the credit is taken with respect to qualified construction expenditures, the taxpayer's basis in the property acquired, constructed, rehabilitated, or expanded is reduced by the amount of the credit attributable to such expenditures.[241]

A credit claimed with respect to qualified construction expenditures is subject to recapture for the first ten years after the qualified child care facility is placed in service. Under the recapture provision, a percentage of the credit claimed with respect to qualified construction expenditures is treated as an increase in tax liability in the year of recapture.[242] The recapture percentage is reduced over the 10-year recapture period:[243]

If the recapture event occurs in:	The applicable recapture percentage is:
Years 1-3	100
Year 4	85
Year 5	70
Year 6	55
Year 7	40
Year 8	25
Years 9 and 10	10
Years 11 and thereafter	0

A recapture event occurs if the taxpayer either (1) ceases operation of the qualified child care facility or (2) transfers its interest in the qualified child care facility without securing an agreement to assume recapture liability for the transferee.[244] The recapture tax is not treated as a tax for purposes of determining the amount of other income tax credits or for determining the

[238] Sec. 45F(c)(3)(A).

[239] Sec. 45F(c)(3)(B).

[240] Sec. 45F(f)(2).

[241] Sec. 45F(f)(1)(A).

[242] Sec. 45F(d)(1).

[243] Sec. 45F(d)(2).

[244] Sec. 45F(d)(3). Cessation of operations due to a casualty loss is not a recapture event to the extent that the loss is restored by reconstruction or replacement of the facility within a reasonable period established by the Secretary. Sec. 45F(d)(4)(C).

amount of the alternative minimum tax.[245] Only a credit that previously reduced tax liability may result in an increase in tax liability under the recapture rule; if the credit resulted in a carryforward or carryback, the recapture instead causes an adjustment of the carryforward or carryback.[246]

Any increase in tax liability or adjustment of carryforward or carrybacks is treated as an increase in basis immediately before the event giving rise to the recapture.[247] Thus, the taxpayer is not subject to both a reduction of basis and recapture, and may use the increase in basis to offset any gain on disposition of the facility (if applicable).

Special rules

All persons treated as a single employer under sections 52(a) and (b) are treated as single taxpayer for purposes of the credit.[248] There are guidelines that govern the allocation of the credit between a trust or estate and the beneficiaries of such trust or estate, and for the allocation of the credit among partners in a partnership.[249]

Description of Proposal

The proposal increases the employer-provided child care credit to 40 percent of qualified child care expenditures (50 percent for eligible small businesses) in addition to 10 percent of qualified referral expenses allowed under present law. The total credit limit is increased to $500,000 ($600,000 for small businesses), adjusted for inflation.

The proposal provides for a small business gross receipts test of less than or equal to $25 million (inflation adjusted)[250] based on the 5-year period (rather than 3-year period) preceding the taxable year. In 2025, the small business gross receipts threshold is $31 million.

The definition of qualified child care expenditures is expanded to include amounts paid or incurred under a contract with a third-party that contracts with one or more qualified child care facilities to provide child care services. In addition, the definition of qualified child care facilities is expanded to allow for qualified child care facilities that are jointly owned or operated by the taxpayer and other entities or persons.

The Secretary is directed to issue regulations as necessary.

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[245] Sec. 45F(d)(4)(B).

[246] Sec. 45F(d)(4)(A). The carryforward and carryback rules for the general business credit are provided in section 39.

[247] Sec. 45F(f)(1)(B).

[248] Sec. 45F(e)(1).

[249] Sec. 45F(e)(2), (3).

[250] Sec. 448(c).

Effective Date

The proposal is effective for amounts paid or incurred after December 31, 2025.

F. Extension and Enhancement of Paid Family and Medical Leave Credit

Present Law

In general

The Family and Medical Leave Act of 1993, as amended (the "FMLA"), generally requires employers to provide employees with up to 26 weeks of leave under certain circumstances.[251] In general, FMLA does not require that the employer continue to pay employees during such leave, although employers may choose to pay for all or a portion of such leave. State and local governments may provide, or State and local laws may require employers to provide, employees with up to a certain amount of paid leave for types of leave that may or may not fall under the FMLA.

Employer credit for paid family and medical leave

For wages paid in taxable years beginning after December 31, 2017, and before January 1, 2026, "eligible employers" may claim a general business credit, under section 45S, equal to 12.5 percent of the amount of eligible wages (based on the normal hourly wage rate) paid to "qualifying employees" during any period in which such employees are on "family and medical leave" if the rate of payment under the program is 50 percent of the wages normally paid to an employee for actual services performed for the employer.[252] The credit is increased by 0.25 percentage points (but not above 25 percent) for each percentage point by which the rate of payment exceeds 50 percent. The maximum amount of family and medical leave that may be taken into account with respect to any qualifying employee for any taxable year is 12 weeks.

An "eligible employer" is one which has in place a written policy that allows all qualifying full-time employees not less than two weeks of annual paid family and medical leave, and which allows all less-than-full-time qualifying employees a commensurate amount of leave (on a *pro rata* basis) compared to the leave provided to full-time employees. The policy must also provide that the rate of payment under the program is not less than 50 percent of the wages normally paid to any such employee for services performed for the employer.[253]

In addition, in order to be an eligible employer, the employer is prohibited from certain practices or acts which are also prohibited under the FMLA, regardless of whether the employer is subject to the FMLA. Specifically, the employer must provide paid family and medical leave in compliance with a written policy that ensures that the employer will not interfere with, restrain, or deny the exercise of or the attempt to exercise, any right provided under the policy

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[251] Pub. L. No. 103-3, February 5, 1993.

[252] Sec. 45S. Wages for this purpose are Federal Unemployment Tax Act wages defined in section 3306(b), without regard to the dollar limitation, but do not include amounts taken into account for purposes of determining any other credit under subpart D of the Code. Sec. 45S(g).

[253] Sec. 45S(c).

and will not discharge or in any other manner discriminate against any individual for opposing any practice prohibited by the policy.

A “qualifying employee” means any individual who is an employee under tax rules and principles and is defined in section 3(e) of the Fair Labor Standards Act of 1938,[254] as amended, who has been employed by the employer for one year or more, and who for the preceding year, had compensation not in excess of 60 percent of the compensation threshold in such year for highly compensated employees.[255] For 2025, this 60 percent amount is $96,000.

“Family and medical leave” for purposes of new section 45S is generally defined as leave described under sections 102(a)(1)(A)-(E) or 102(a)(3) of the FMLA.[256] If an employer provides paid leave as vacation leave, personal leave, or other medical or sick leave[257] (unless the medical or sick leave is specifically for one or more of the “family and medical leave” purposes defined above), such paid leave would not be considered to be family and medical leave. In addition, leave paid for by a State or local government or required by State or local law (including such leave required to be paid by the employer) is not taken into account in determining the amount of paid family and medical leave provided by the employer that is eligible for the credit.

A taxpayer may elect not to have the rules under section 45S apply for a taxable year. All persons treated as a single employer under sections 52(a) and (b) are treated as a single taxpayer.[258] Under IRS guidance, this aggregation rule applies only for purposes of the taxpayer’s election not to have section 45S apply.[259]

The Secretary will make determinations as to whether an employer or an employee satisfies the applicable requirements for an eligible employer or qualifying employee, based on information provided by the employer that the Secretary determines to be necessary or appropriate.

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[254] Pub. L. No. 75-718, June 25, 1938.

[255] Sec. 414(q)(1)(B) ($160,000 for 2025).

[256] FMLA section 102(a)(1) provides leave for FMLA purposes due to (A) the birth of a son or daughter of the employee and in order to care for such son or daughter; (B) the placement of a son or daughter with the employee for adoption or foster care; (C) caring for the spouse, or a son, daughter, or parent, of the employee, if such spouse, son, daughter, or parent has a serious health condition; (D) a serious health condition that makes the employee unable to perform the functions of the employee’s position; (E) any qualifying exigency (as the Secretary of Labor shall, by regulation, determine) arising out of the fact that the spouse, or a son, daughter, or parent of the employee is on covered active duty (or has been notified of an impending call or order to covered active duty) in the Armed Forces. In addition, FMLA section 102(a)(3) provides leave for FMLA purposes due to the need of an employee who is a spouse, son, daughter, parent, or next-of-kin of an eligible service member to care for such service member.

[257] These terms mean these types of leave within the meaning of FMLA section 102(d)(2).

[258] Sec. 45S(c)(3). Secs. 52(a) and (b) describe controlled groups of corporations and organizations such as partnerships and proprietorships under common control.

[259] Notice 2018-71, 2018-41 I.R.B. 548, October 9, 2018, Q&A 33.

Description of Proposal

The proposal extends the paid family and medical leave credit permanently. It also modifies the credit to allow it to be claimed for an applicable percentage of premiums paid or incurred by an eligible employer during a taxable year for insurance policies that provide paid family and medical leave for qualifying employees. Similar to the applicable percentage that applies in the case of wages paid to employees who are on leave, the applicable percentage in the case of an insurance policy is equal to 12.5 percent if the rate of payment under the policy is 50 percent of wages normally paid to an employee, and is increased by 0.25 percentage points (but not above 25 percent) for each percentage point by which the rate of payment exceeds 50 percent of wages normally paid. The rate of payment is determined without regard to whether any qualifying employees were actually on family and medical leave during the taxable year. Under the proposal, the employer elects whether to claim the credit based on wages paid or on premiums paid. (Thus, the credit cannot be claimed for both premiums paid on an insurance policy and wages paid under such insurance policy).

The proposal also includes an aggregation rule that provides that employers within the same controlled group are treated as a single employer under section 45S.[260] Thus, in order for an employer to qualify for the credit, each member of the controlled group must have a written policy providing paid family and medical leave that meets the requirements of section 45S. An exception exists for a person who establishes to the satisfaction of the Secretary that such person has a substantial and legitimate business reason for failing to provide such a written policy. For this purpose, "substantial and legitimate business reason" does not include the operation of a separate line of business, the rate of wages or category of jobs for employees (or any similar basis), or the application of State of local laws relating to family and medical leave, but it may include the grouping of employees of a common law employer. However, the proposal also modifies the rule relating to paid leave mandated by a State or local government to provide that such leave is taken into account in determining the amount of paid family and medical leave provided by the employer, except for purposes of determining the amount of the credit. Thus, an employer that is otherwise eligible to receive the section 45S credit would not fail to be eligible merely because another member of the employer's controlled group provides paid leave under a State or locally mandated policy.

Employers are permitted under the proposal to treat employees who have been employed for at least six months as qualifying employees (assuming the employee otherwise meets the definition of a qualifying employee). For purposes of the compensation limit that applies to qualifying employees, the proposal provides that compensation is determined on an annualized basis, except that it is determined pro rata for part-time employees. An employee must be customarily employed for at least 20 hours per week in order to be considered qualifying.

Under the proposal, certain offices of the Small Business Administration must conduct outreach regarding the paid family and medical leave credit to relevant parties, including through targeted communications, education, training, technical assistance, and the development of a

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[260] The proposal provides that all persons treated a single employer under section 414(b) and (c) of the Code are treated as a single employer. This rule modifies the present law aggregation rule in section 45S(c)(4), which treats members within the same controlled group as a single taxpayer.

written paid family leave policy. The proposal also directs the Secretary to perform targeted outreach to employers and other relevant entities regarding the availability and requirements of the credit, including providing relevant information as part of IRS communications that are regularly issued to payroll service entities, tax professionals, and small businesses.

Effective Date

The provision applies to taxable years beginning after December 31, 2025.

G. Enhancement of Adoption Credit

Present Law

In general

A taxpayer is allowed a nonrefundable income tax credit for the amount of qualified adoption expenses that the taxpayer pays or incurs (the "adoption tax credit").[261] The adoption credit is allowed only to individual taxpayers, not to partnerships, corporations, or other entities.

For an expense paid or incurred before the taxable year in which an adoption becomes final, the credit is allowed for the taxable year after the year in which the expense is paid or incurred.[262] For an expense paid or incurred in the year in which an adoption becomes final or in a later year, the credit is allowed for the year in which the expense is paid or incurred.[263]

In 2025 the total amount of qualified adoption expenses that a taxpayer is permitted to take into account for all taxable years with respect to the taxpayer's adoption of a child is $17,280.[264] A taxpayer's 2025 maximum total $17,280 of qualified adoption expenses is reduced ratably over a $40,000 income range as the taxpayer's adjusted gross income increases above $259,190; the adoption tax credit is, as a consequence, eliminated for a taxpayer with adjusted gross income of $299,190 or more.[265]

The maximum amount of qualified adoption expenses that may be taken into account in determining a taxpayer's credit and the amount of adjusted gross income at which this maximum expense amount begins to be reduced are adjusted annually for inflation.[266]

Qualified adoption expenses

Qualified adoption expenses are reasonable and necessary adoption fees, court costs, attorney fees, and other expenses that –

- are directly related to and have as their principal purpose a taxpayer's legal adoption of an eligible child;

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[261] Sec. 23.

[262] Sec. 23(a)(2)(A).

[263] Sec. 23(a)(2)(B).

[264] Sec. 23(b)(1), (h).

[265] Sec. 23(b)(2)(A). For purposes of the income-based reduction of the adoption tax credit, adjusted gross income is determined without regard to the foreign earned income exclusion (section 911), the exclusion for certain income from American Samoa, Guam, or the Northern Mariana Islands (section 931), and the exclusion for certain income from Puerto Rico sources (section 933). Sec. 23(b)(2)(B).

[266] Sec. 23(h).

- are not incurred in violation of State or Federal law or in carrying out any surrogate parenting arrangement;
- are not expenses in connection with an individual's adoption of a child who is the child of the individual's spouse, and
- are not reimbursed under an employer program or otherwise.[267]

An eligible child is any individual who is younger than age 18 or who is physically or mentally incapable of caring for himself or herself.[268]

Special needs adoption

If a taxpayer adopts a child with special needs, the taxpayer is treated as having paid during the year in which the adoption becomes final an amount of qualified adoption expenses equal to the excess of (1) $17,280 (in 2025) over (2) the amount of total qualified adoption expenses the taxpayer actually paid or incurred in respect of the adoption in that year and all prior years.[269]

For example, if a taxpayer's adoption of a child with special needs becomes final in 2025 and the taxpayer actually spent a total of $9,000 in qualified adoption expenses related to the adoption in 2024 (and no other amounts in any other year), the taxpayer is treated as having paid $8,280 in qualified adoption expenses in 2025 in addition to the $9,000 of actual expenses taken into account for 2024. Assuming the taxpayer's adjusted gross income in 2025 does not exceed $259,190, and assuming the other adoption tax credit requirements are satisfied, the taxpayer is allowed a nonrefundable credit of $17,280 in 2025 ($9,000 of actual expenses plus $8,280 of deemed expenses).

A child with special needs is any child if (1) a State has determined that the child cannot or should not be returned to the home of the child's parents, (2) the State has determined that, because of a specific factor or condition related to the child (for example, the child's age, ethnic background, membership in a minority or sibling group, or a medical condition or physical, mental, or emotional handicap), it is reasonable to conclude that the child cannot be placed with adoptive parents without providing adoption assistance, and (3) the child is a citizen or resident of the United States.[270]

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[267] Sec. 23(d)(1). An employee is allowed to exclude from gross income amounts that the employee's employer pays or incurs for qualified adoption expenses in connection with the employee's adoption of a child if the amounts are furnished under an adoption assistance program. Sec. 137. The maximum amount of qualified adoption expenses taken into account for purposes of this exclusion, the income-based reduction in the amount of expenses taken into account, the definition of qualified adoption expenses, and the rules for special needs adoptions (described next), are the same as the corresponding rules for the adoption tax credit. Sec. 137(a)(2), (b), (d), (e), (f).

[268] Sec. 23(d)(2).

[269] Sec. 23(a)(3).

[270] Sec. 23(d)(3).

Carryforward of unused credit

If the amount of adoption tax credit that is allowable to a taxpayer for any year exceeds the excess of (1) the taxpayer's income tax liability (less the amount of the taxpayer's allowable foreign tax credit, and including any amount of alternative minimum tax) for that year over (2) the sum of other nonrefundable income tax credits (other than the section 25D residential clean energy credit) (items (1) and (2) referred to below as the "tax liability limitation"), the excess allowable adoption tax credit is carried to the succeeding taxable year and is added to the adoption tax credit otherwise allowable in that year.[271] No credit may be carried forward under this rule for more than five years after the year in which the credit arose.[272]

Description of Proposal

The proposal treats up to $5,000 of the adoption tax credit as refundable. This $5,000 maximum refundable amount is indexed for inflation starting in 2026.

The proposal limits the maximum amount of the present law five-year carryforward of the portion of an adoption tax credit that a taxpayer is not permitted to use because it is exceeds the taxpayer's tax liability limitation. Under the proposal the maximum amount of an unused adoption tax credit that may be carried forward is limited to the maximum amount of the adoption tax credit that is nonrefundable ($12,280 in 2025 (which equals the $17,280 maximum credit minus the $5,000 refundable portion)).

Effective Date

The proposal is effective for taxable years beginning after December 31, 2024.

[271] Sec. 23(c)(1).

[272] Sec. 23(c)(2). For purposes of this five-year carryforward limitation, credits are treated as used on a first-in, first-out basis. *Ibid.*

H. Recognizing Indian Tribal Governments for Purposes of Determining Whether a Child Has Special Needs for Purposes of the Adoption Credit

Present Law

In general

For a description of the adoption credit, see *supra* the description of present law for section 110106, Adoption expenses credit made partially refundable.

Special needs adoption

If a taxpayer adopts a child with special needs, the taxpayer is treated as having paid during the year in which the adoption becomes final an amount of qualified adoption expenses equal to the excess of (1) $17,250 (in 2025) over (2) the amount of total qualified adoption expenses the taxpayer actually paid or incurred in respect of the adoption in that year and all prior years.[273]

A child with special needs is any child if (1) a State has determined that the child cannot or should not be returned to the home of the child's parents, (2) the State has determined that, because of a specific factor or condition related to the child (for example, the child's age, ethnic background, membership in a minority or sibling group, or a medical condition or physical, mental, or emotional handicap), it is reasonable to conclude that the child cannot be placed with adoptive parents without providing adoption assistance, and (3) the child is a citizen or resident of the United States.[274]

Indian tribal government

An Indian tribal government is treated as a State only if (a) a particular Code section specifically so provides, or (b) the Code section is listed in section 7871, which treats Indian tribal governments as States for certain purposes. Neither section 23 nor section 7871 provides that an Indian tribal government is to be treated as a State for purposes of the adoption credit. Thus, a determination by an Indian tribal government that a child is a child with special needs would not be sufficient to entitle the adoptive parents to a credit for an adoption of a child with special needs.

Description of Proposal

The proposal provides an Indian tribal government the same authority as a State for purposes of determining a child is a child with special needs for the adoption credit.

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[273] Sec. 23(a)(3).

[274] Sec. 23(d)(3).

Effective Date

The proposal applies to taxable years beginning after December 31, 2024.

I. Tax Credit for Contributions of Individuals to Scholarship Granting Organizations

Present Law

Charitable contribution deduction

In computing taxable income, an individual taxpayer who itemizes deductions or a corporate taxpayer generally is allowed to deduct the amount of cash and the fair market value of property contributed to an organization described in section 501(c)(3) or to a Federal, State, or local governmental entity, including to most educational organizations.[275]

The amount of the deduction allowable for a taxable year with respect to a charitable contribution of property may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer.[276] For individual taxpayers, the income-based limitation on the charitable contribution deduction is higher for gifts made to public charities than for gifts made to private foundations. Contributions of cash to a public charity generally are deductible up to 60 percent[277] of the donor's adjusted gross income ("AGI")[278] (30 percent for capital gain property, and 50 percent for non-capital gain property other than cash), whereas contributions to most private foundations generally are deductible up to 30 percent of the donor's AGI (20 percent for capital gain property).[279] For corporate taxpayers, the deductible amount of charitable contributions generally is limited to 10 percent of taxable income.[280] For all taxpayers, gifts of capital gain property to a public charity generally are deductible at the property's fair market value,[281] whereas gifts of capital gain property (other than publicly traded stock) to most private foundations are deductible at the taxpayer's basis (cost) in the property.[282]

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[275] Within certain limitations, donors also are entitled to deduct such contributions for estate and gift tax purposes. See secs. 2055 and 2522.

[276] Sec. 170(b) and (e).

[277] For contributions made in taxable years beginning after December 31, 2025, the 60-percent limit is reduced to 50 percent. Sec. 170(b)(1)(G)(i).

[278] The charitable percentage limits are applied to the donor's "contribution base," which is the donor's AGI computed without regard to any net operating loss carryback to the taxable year under section 172. Sec. 170(b)(1)(H).

[279] Sec. 170(b)(1).

[280] Sec. 170(b)(2).

[281] Sec. 170(e)(1). However, contributions of tangible personal property not for an exempt purpose of the donee organization are deductible at the taxpayer's basis in the property. Sec. 170(e)(1)(B)(i). A special rule determines the aggregate deduction for contributions of certain intellectual property. Sec. 170(e)(1)(B)(iii) and 170(m).

[282] Sec. 170(e)(1)(B)(ii) and 170(e)(5).

Qualified scholarships and qualified tuition reduction

Present law provides an exclusion from gross income for income tax purposes and from wages for employment tax purposes for amounts received as a qualified scholarship by an individual who is a candidate for a degree at an educational organization described in section 170(b)(1)(A)(ii) (a "qualifying educational organization").[283] In general, a qualified scholarship is any amount received by such an individual as a scholarship or fellowship grant if the amount is used for qualified tuition and related expenses. Qualified tuition and related expenses include tuition and fees required for enrollment or attendance, or for fees, books, supplies, and equipment required for courses of instruction, at the qualifying educational organization. This definition does not include regular living expenses, such as room and board. A qualifying educational organization is an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. These institutions include K-12 schools.

Present law also provides an exclusion from gross income for income tax purposes and from wages for employment tax purposes for qualified tuition reductions for certain education (below the graduate level) that is provided to employees (and their spouses and dependents) of qualifying educational organizations.[284] The education must be provided at the employing organization or another qualifying educational organization. This exclusion does not apply to any amount received by a student that represents payment for teaching, research, or other services by the student required as a condition for receiving the tuition reduction.

Gift tax exclusion for educational expenses

Under present law, gift tax is imposed on transfers of property by gift, subject to several exceptions. One exception is the gift tax annual exclusion of section 2503(b). Under this exclusion, a donor can transfer up to $18,000 of property to each of an unlimited number of donees without incurring gift tax on such transfers.[285]

In addition to the gift tax annual exclusion, the Code provides that certain tuition payments are not considered transfers of property by gift for gift tax purposes.[286] This exclusion covers amounts paid on behalf of an individual as tuition to a qualifying educational organization. An unlimited exclusion applies only to direct transfers to the educational institution, not to reimbursements to donees for amounts paid by them for otherwise qualifying services, or to trusts to provide for the education of designated beneficiaries.[287] Further, an

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[283] Secs. 117(a) and 3121(a)(20).

[284] Secs. 117(d) and 3121(a)(20).

[285] The Code provides an amount of $10,000 for the maximum gift tax annual exclusion, adjusted in $1,000 increments for inflation occurring after 1997. The inflation-adjusted amount for 2024 is $18,000.

[286] Sec. 2503(e).

[287] Treas. Reg. sec. 25.2503-6(c), ex. 2.

unlimited exclusion is not permitted for books, supplies, dormitory fees, board, or other similar expenses that do not constitute direct tuition costs.[288] This exclusion applies without regard to the relationship of the donor and donee.

Description of Proposal

Tax credit for contributions of individuals to scholarship granting organizations

Individual income tax credit

The proposal creates a nonrefundable income tax credit that is equal to the aggregate amount of qualified contributions made by the taxpayer during the taxable year. The credit allowed to a taxpayer for a taxable year may not exceed the greater of 10 percent of the taxpayer's aggregate gross income or $5,000. An individual is allowed the credit only to the extent that the Secretary of the Treasury (the "Secretary"), subject to an aggregate volume cap that is described below, allocates the credit to the individual.

For purposes of the credit, a "qualified contribution" is a charitable contribution (within the meaning of section 170(c)) to a scholarship granting organization in the form of cash or marketable securities. The amount allowed as a credit to a taxpayer for a taxable year is reduced by the amount allowed as a credit on any State tax return of the taxpayer for qualified contributions made by the taxpayer during the taxable year. The proposal provides that any qualified contribution for which a credit is allowed is not taken into account as a charitable contribution for purposes of section 170.

A "scholarship granting organization" is any organization (a) that is described in section 501(c)(3), is exempt from tax under section 501(a), and is not a private foundation; (b) substantially all of the activities of which are providing scholarships for qualified elementary or secondary education expenses of eligible students; (c) that prevents the co-mingling of qualified contributions with other amounts by maintaining one or more separate accounts exclusively for qualified contributions; and (d) that either meets the requirements to be a scholarship granting organization (discussed below) or was eligible on the date of enactment to receive contributions for which the donor is entitled to a State tax credit if the contributions are used by the organization to provide scholarships. An "eligible student" is an individual who is a member of a household with annual income of no greater than 300 percent of the area median gross income (within the meaning of that term in section 42) and is eligible to enroll in a public elementary or secondary school.

An organization meets the requirements of a scholarship granting organization (referred to above) only if (a) the organization provides scholarships to two or more students at two or more schools, (b) the organization does not provide scholarships for expenses other than qualified elementary or secondary education expenses, (c) the organization provides scholarships to eligible students with a priority for students awarded a scholarship the previous year and their siblings, (d) the organization does not earmark or set aside contributions for scholarships for any particular student, (e) the organization takes appropriate steps to verify the income and family

[288] Treas. Reg. sec. 25.2503-6(b)(2).

size of eligible students to whom it awards scholarships, and limits scholarships to individuals in households with annual household income that meets the limits set forth in the definition of an eligible student (the "income verification requirement"), (f) the organization obtains from an independent certified public accountant[289] annual financial and compliance audits and certifies to the Secretary that the audit has been completed, and (g) no officer or board member of the organization has been convicted of a felony.

The term "qualified elementary or secondary education expense" means the following expenses in connection with enrollment or attendance at, or for students enrolled at or attending, an elementary or secondary public, private, or religious school: tuition; curriculum and curricular materials; books or other instructional materials; online educational materials; tuition for certain tutoring or educational classes outside of the home;[290] fees for a nationally standardized norm-referenced achievement test, an Advanced Placement examination, or any examinations related to college or university admission; fees for dual enrollment in an institution of higher education; and educational therapies for students with disabilities provided by a licensed or accredited practitioner or provider. Such expenses include expenses in connection with a homeschool (whether treated as a homeschool or a private school for purposes of applicable State law). However, such expenses do not include amounts paid to an elementary or secondary school unless the school demonstrates that it maintains an admissions policy which provides that the school does not take into account whether the student seeking enrollment has a current individualized education plan or whether the student requires equitable services for a learning disability, and if a student does have such an individualized education plan, the school abides by the plan's terms and provides services outlined in the plan.

A scholarship granting organization can satisfy the income verification requirement, discussed above, by reviewing all of the following documents (as applicable): (1) Federal and State income tax returns or tax return transcripts with applicable schedules for the taxable year prior to application, (2) income reporting statements for tax purposes or wage and income transcripts from the Internal Revenue Service, (3) notarized income verification letter from employers, (4) unemployment or workers compensation statements, and (5) budget letters regarding public assistance payments and Supplemental Nutrition Assistance Program ("SNAP") payments including a list of household members.

The credit is a nonrefundable personal tax credit taken against income tax liability. The credit is allowable against both the regular tax and the alternative minimum tax under section 26(a). If the credit allowable for any taxable year exceeds the limitation imposed by section 26(a) for such taxable year reduced by the sum of nonrefundable personal tax credits (other than the individual credit under the proposal and the credits allowable under section 23 and section 25D), the excess is carried to the succeeding taxable year and added to the credit allowable for

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[289] For purposes of this requirement, the term "independent certified public accountant" means a certified public accountant who is not a person described in section 465(b)(3)(A) (*i.e.*, having an interest, or being a related person to a person having an interest) with respect to such organization or any employee of such organization.

[290] Such tuition is a qualified expense only if the tutor or instructor is not related to the student and is licensed as a teacher in any State, has taught at an eligible educational institution, or is a subject matter expert in the relevant subject.

such taxable year. However, no credit may be carried forward to any taxable year following the fifth taxable year after the taxable year in which the credit arose. For this purpose, credits are treated as used on a first-in, first-out basis.

The proposal provides rules against self-dealing, such that a scholarship granting organization may not award a scholarship to a disqualified person. For this purpose, a disqualified person is determined pursuant to rules similar to rules in section 4946, and includes, for example, substantial contributors, founders, and family members of substantial contributors and founders.

Failure of scholarship granting organizations to make distributions

If the Secretary determines that a scholarship granting organization has not satisfied one or more of the distributional requirements, described below, any contribution made to the organization during the first taxable year beginning after the date of the determination is not treated as a qualified contribution for purposes of the tax credit for individuals created under the proposal.

Under the proposal, the amount of receipts of the scholarship granting organization for the taxable year which are distributed before the distribution deadline with respect to such receipts must be at least equal to the required distribution amount for the taxable year. The "required distribution amount" with respect to a taxable year is equal to 100 percent of the total receipts of the scholarship granting organization for the taxable year, (a) reduced by the sum of the receipts that are retained for reasonable administrative expenses for the taxable year or are carried to the succeeding taxable year, and (b) increased by the amount of carryover from the preceding taxable year. Administrative expenses of a scholarship granting organization are deemed to be reasonable if the expenses do not exceed 10 percent of the organization's total receipts for the taxable year. At the election of the scholarship granting organization, an amount of up to 15 percent of the total receipts of the organization may be carried to the succeeding taxable year.

Under the proposal, a "distribution" includes amounts which are formally committed but not distributed. A formal commitment may include contributions set aside for eligible students for more than one year. The distribution deadline with respect to receipts for a taxable year is the first day of the third taxable year following the taxable year in which the scholarship granting organization receives the receipts.

Volume cap

The proposal sets an aggregate volume cap on the total amount of credits at $5 billion for each of calendar years 2026 through 2029, and zero for any calendar years after 2029. In the case of a calendar year for which the volume cap is in effect and which follows a high use calendar year, the volume cap is increased to 105 percent of the dollar amount in effect for the high use calendar year. The term "high use calendar year" means any calendar year for which 90 percent or more of the volume cap in effect for such calendar year is allocated to taxpayers. The proposal provides that the volume cap in effect for a calendar year must at least equal the volume cap in effect for the preceding calendar year. Thus, if the volume cap is increased in a year following a high-use calendar year, it is not subsequently reduced.

Generally, for purposes of allocating volume cap for a calendar year, the Secretary is directed to allocate the credit on a first-come, first-served basis, based on the time (during that calendar year) at which the taxpayer made the qualified contribution with respect to which the allocation is made. The Secretary may not allocate volume cap for a calendar year after December 31 of that calendar year. However, 10 percent of the annual volume cap is evenly divided among the States,[291] with such amounts being available to individuals residing in such States. The Secretary is directed to develop a system to track the amount of qualified distributions made during the calendar year for which a credit may be claimed, with such information updated in real time.

Effective Date

The proposal is effective for taxable years ending after December 31, 2025.

[291] For purposes of the volume cap, the term "State" includes the District of Columbia. Therefore, for calendar year 2026, a total of $500 million (10 percent of $5 billion) is divided equally among the 50 States and the District of Columbia, with each State receiving approximately $9.8 million in allocations.

J. Additional Elementary, Secondary, and Home School Expenses Treated as Qualified Higher Education Expenses for Purposes of 529 Accounts

Present Law

Section 529 qualified tuition programs

To describe programs that are known colloquially as 529 plans, the Code uses the term "qualified tuition programs" and distinguishes between two types of programs.[292] One type of program, sometimes referred to as a prepaid tuition program, allows a person to purchase on behalf of a designated beneficiary tuition credits or certificates that entitle the beneficiary to the waiver or payment of the beneficiary's qualified higher education expenses.[293] Prepaid tuition programs are established and maintained by State governments (or their agencies or instrumentalities) and eligible educational institutions.[294] The other type of program, sometimes referred to as a college savings plan, allows a person to make contributions to an account that is established for the purpose of satisfying the qualified higher education expenses of the designated beneficiary of the account.[295] A college savings plan may be established and maintained by State governments (or their agencies or instrumentalities), not by educational institutions.[296]

A qualified tuition program generally is exempt from Federal income taxation (but is subject to unrelated business income tax).[297] As a consequence, contributors to, and beneficiaries of, these programs (whether prepaid tuition programs or college savings plans) generally have no taxable income inclusions from earnings on assets held in the programs.

To be treated as a qualified tuition program that is generally exempt from Federal income taxation, a program must satisfy several requirements. The program must provide that purchases of tuition credits or certificates or contributions to a program must be made only in cash.[298] The program must provide separate accounting for each designated beneficiary.[299] The program must provide that a contributor to, or a designated beneficiary under, the program may direct the investment of any contributions to the program (or earnings on those investment) no more than twice a year.[300] The program must not allow any interest in the program to be used as a security

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[292] Sec. 529(a), (b).

[293] Sec. 529(b)(1)(A)(i).

[294] *Ibid.*

[295] Sec. 529(b)(1)(A)(ii).

[296] *Ibid.*

[297] Sec. 529(a).

[298] Sec. 529(b)(2).

[299] Sec. 529(b)(3).

[300] Sec. 529(b)(4).

for a loan.[301] The program must provide adequate safeguards to prevent contributions on behalf of a designated beneficiary that exceed the amount necessary to pay the beneficiary's qualified higher education expenses (referred to below as the "prohibition on excess contributions").[302]

When there is a cash distribution under a qualified tuition program, the portion of the distribution that is considered to be earnings on contributions to the account is includible in the gross income of the recipient of the distributions only to the extent that the total amount of cash distributions during the taxable year exceeds the amount of qualified higher education expenses of the account beneficiary during that year.[303] The income tax that is imposed on a recipient of a distribution that is included in the recipient's gross income is, with certain exceptions, increased by 10 percent of the amount of the inclusion.[304]

Qualified higher education expenses include, among other expenses, tuition, fees, books, supplies, and equipment required for the enrollment or attendance of the account beneficiary at an eligible post-secondary educational institution; in the case of a beneficiary who is at least a half-time student, reasonable costs for room and board; expenses for the purchase of computer equipment and software to be used primarily by the beneficiary when enrolled at an eligible educational institution; fees, books, supplies, and equipment required for a beneficiary's participation in an eligible apprenticeship program; up to a $10,000 lifetime maximum in payments of principal and interest on a beneficiary's student loan; and, for certain purposes of section 529 – not including for purposes of the prohibition on excess contributions, expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, private, or religious school.[305] There is a $10,000 limitation on the total amount of nontaxable cash distributions that may be made in a taxable year from all qualified tuition programs with respect to a beneficiary to pay for that beneficiary's elementary or secondary school tuition.[306]

For certain purposes, including the rules allowing tax-free distributions from a qualified tuition program to pay qualified higher education expenses, qualified higher education expenses also include amounts for books, supplies, and equipment required for the participation of a beneficiary in an apprenticeship program registered and certified with the Secretary of Labor under section 1 of the National Apprenticeship Act. (29 U.S. Code 50).[307]

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[301] Sec. 529(b)(5).

[302] Sec. 529(b)(6).

[303] Sec. 529(c)(3)(A), (B)(ii). A payor of a distribution generally is required to report to the IRS and the recipient of the distribution on Form 1099-Q the amount of the distribution and the portions of the distributions representing contributions and earnings.

[304] Sec. 529(c)(6).

[305] Sec. 529(c)(7), (c)(8), (c)(9), (e)(3).

[306] Sec. 529(e)(3)(A).

[307] Sec. 529(c)(8).

A contribution to a qualified tuition program is treated as a completed gift for gift tax purposes (and, as a consequence, may benefit from the gift tax annual exclusion).[308] If an individual's total contributions to a qualified tuition program during a year exceed the gift tax annual exclusion amount in that year, the individual may elect to take the total amount of the contributions into account for purposes of the annual exclusion ratably over the five-year period beginning with the year of the excess contributions.[309] An individual's interest in a qualified tuition program generally is excluded from the individual's gross estate for estate tax purposes.[310]

A distribution from a qualified tuition program that otherwise would be included in the income of the recipient of the distribution (for example, the beneficiary of the account) may be excluded under rules allowing, subject to limitations, tax-free rollovers to, among other alternatives, an ABLE account of the beneficiary or of a member of the family of the beneficiary, a Roth IRA of the beneficiary, or the credit of another beneficiary of a qualified tuition program who is a member of the family of the beneficiary with respect to whom the distribution was made.[311]

Description of Proposal

The proposal provides that the following expenses in connection with the enrollment or attendance of a designated beneficiary at an elementary or secondary public, private, or religious school, or in connection with a homeschool, are qualified higher education expenses: tuition (as under present law), curriculum and curricular materials, books or other instructional materials, online educational materials, tuition for certain tutoring or educational classes outside of the home, fees for certain tests, fees for dual enrollment in an institution of higher education, and certain educational therapies for students with disabilities.

Under the proposal, these elementary and secondary school expenses are considered qualified higher education expenses for all purposes of section 529, including the prohibition on excess contributions. As a consequence, a beneficiary's elementary and secondary school expenses may be taken into account in determining whether a contribution to a qualified tuition program is prohibited because the contribution would be in excess of the amount necessary to provide for the beneficiary's qualified higher education expenses.

Effective Date

The proposal is effective for distributions made after the date of enactment.

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[308] Sec. 529(c)(2)(A).

[309] Sec. 529(c)(2)(B).

[310] Sec. 529(c)(4)(A).

[311] Sec. 529(c)(3)(C), (E).

K. Certain Postsecondary Credentialing Expenses Treated as Qualified Higher Education Expenses for Purposes of 529 Accounts

Present Law

For a general description of 529 Accounts, see section I of this document.

Description of Proposal

The proposal treats a broad category of postsecondary credentialing expenses as qualified higher education expenses for all purposes of section 529. These "qualified postsecondary credentialing expenses" are tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary in a recognized "postsecondary credential program," or any other expense in connection with enrollment in or attendance at such a program if such expenses would, if incurred in connection with enrollment in or attendance at an eligible educational institution, be considered qualified higher education expenses before application of the proposal; fees for testing required to obtain or maintain a recognized credential; and, fees for continuing education if such education is required to maintain a recognized postsecondary credential.

For this purpose, a "recognized postsecondary credential program" means a program to obtain a recognized postsecondary credential if (a) such program is included on a list prepared under section 122(d) of the Workforce Innovation and Opportunity Act; (b) such program is listed in the WEAMS Public directory (or successor) maintained by the Department of Veterans Affairs; (c) an examination (developed or administered by an organization widely recognized as providing reputable credentials in the occupation) is required to obtain or maintain a postsecondary credential and the organization recognizes the program as providing training or education that prepares individuals to take the examination; or, (d) such program is identified by the Treasury Secretary, after consultation with the Labor Secretary, as being a reputable program for obtaining a recognized postsecondary credential.

A "recognized postsecondary credential" means any postsecondary employment credential that is industry recognized, any certificate of completion of an apprenticeship that is registered and certified with the Secretary of Labor under the National Apprenticeship Act, any occupational or professional license issued or recognized by a State or the Federal government, and any recognized postsecondary credential as defined under section 3 of the Workforce Innovation and Opportunity Act.

Effective Date

The proposal is effective for distributions made after the date of enactment.

L. Reinstatement of Partial Deduction for Charitable Contributions of Individuals Who Do Not Elect to Itemize

Present Law

Itemized deduction for charitable contributions

An income tax deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the recipient organization.[312] For individuals, the deduction for charitable contributions is available only to a taxpayer who elects to itemize deductions.

Charitable contributions of cash are deductible in the amount contributed. In general, contributions of capital gain property to a qualified charity are deductible at fair market value with certain exceptions. Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of other appreciated property generally are deductible at the donor's basis in the property. Contributions of depreciated property generally are deductible at the fair market value of the property.

For individuals, in any taxable year, the amount deductible as a charitable contribution is limited to a percentage of the taxpayer's contribution base. The applicable percentage of the contribution base varies depending on the type of recipient organization and property contributed. The contribution base is defined as the taxpayer's adjusted gross income computed without regard to any net operating loss carryback.[313]

Charitable contributions that exceed the applicable percentage limit generally may be carried forward for up to five years.[314] In general, contributions carried over from a prior year are taken into account after contributions for the current year that are subject to the same percentage limit.

Temporary Charitable Deduction for Nonitemizers

Under section 170(p), an individual who does not itemize deductions may claim a deduction in an amount not to exceed $300 ($600 in the case of a joint return) for certain charitable contributions made during a taxable year that begins in 2021. The deduction is not available for contributions made during a taxable year that begins after 2021.

Contributions taken into account for this purpose include only contributions made in cash during the taxable year to a charitable organization described in section 170(b)(1)(A), other than contributions to (i) a supporting organization described in section 509(a)(3) or (ii) for the establishment of a new, or maintenance of an existing, donor advised fund (as defined in

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[312] Sec. 170.

[313] Sec. 170(b)(1)(H).

[314] Sec. 170(b)(1)(G)(ii) and (d).

section 4966(d)(2)). Contributions of noncash property, such as securities, are not qualified contributions. Qualified contributions must be to an organization described in section 170(b)(1)(A); thus, contributions to, for example, a charitable remainder trust generally are not qualified contributions, unless the charitable remainder interest is paid in cash to an eligible charity during the applicable time period. A qualifying charitable contribution does not include an amount that is treated as a contribution in the taxable year by reason of being carried forward from a prior contribution year under section 170(b)(1)(G) or (d)(1).

There is an increased penalty under section 6662 for an underpayment of tax resulting from an overstatement of the section 170(p) deduction.[315] The penalty is increased from 20 percent of the underpayment to 50 percent of the underpayment. The section 6662 penalty relating to an overstatement of the temporary nonitemizer charitable deduction is exempt from the requirement for supervisory approval under section 6751(b).

<u>Description of Proposal</u>

The proposal reinstates the section 170(p) deduction for taxable years beginning after December 31, 2024, and before January 1, 2029. The proposal lowers the maximum deduction amount to $300 for taxpayers who are married filing jointly and to $150 for all other taxpayers.

<u>Effective Date</u>

The proposal applies to taxable years beginning after December 31, 2024.

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[315] Sec. 6662(l).

M. Exclusion for Certain Employer Payments of Student Loans Under Educational Assistance Programs Made Permanent and Adjusted for Inflation

Present Law

Under section 127, an employee may exclude from gross income for income tax purposes[316] and the employer may exclude from wages for employment tax purposes[317] up to $5,250 annually of educational assistance provided by the employer to the employee.[318] For the exclusion to apply, certain requirements must be satisfied: (1) the educational assistance must be provided pursuant to a separate written plan of the employer; (2) employers must provide reasonable notification of the terms and availability of the program to eligible employees; (3) the employer's educational assistance program must not discriminate in favor of highly compensated employees; and (4) no more than five percent of the amounts paid or incurred by the employer during the year for educational assistance under a qualified educational assistance program may be provided for the class of individuals consisting of (i) more than five-percent owners of the employer and (ii) the spouses or dependents of such owners.[319]

For purposes of the exclusion, "educational assistance" means the payment by an employer of expenses incurred by or on behalf of the employee for education of the employee including, but not limited to, tuition, fees and similar payments, books, supplies, and equipment, and the provision by the employer of courses of instruction for the employee, including books, supplies, and equipment.[320] Educational assistance also includes the payment by an employer to the employee or to a lender of principal or interest on any qualified education loan (as defined in section 221(d)(1)) incurred by the employee for education of the employee. Only student loan payments made before January 1, 2026, qualify as educational assistance.

Educational assistance does not include payment for or the provision of tools or supplies that may be retained by the employee after completion of a course, meals, lodging, or transportation, or any education involving sports, games, or hobbies. The education need not be job-related or part of a degree program.[321] Educational assistance qualifies for the exclusion only if the employer does not give the employee a choice between educational assistance and other remuneration includible in the employee's income.

The exclusion for employer-provided educational assistance applies only with respect to education provided to the employee. The exclusion does not apply, for example, to assistance provided directly or indirectly for the education of the spouse or a child of the employee.

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[316] See also sec. 3401(a)(18).

[317] Secs. 3121(a)(18) and 3306(b)(13).

[318] Sec. 127(a).

[319] Sec. 127(b).

[320] Sec. 127(c)(1).

[321] Treas. Reg. sec. 1.127-2(c)(4).

The employer's costs for providing such educational assistance are generally deductible as a trade or business expense.[322]

In the absence of the specific exclusion for employer-provided educational assistance under section 127, employer-provided educational assistance is excludable from gross income for income tax purposes[323] and wages for employment tax purposes[324] only if the education expenses qualify as a working condition fringe benefit under section 132(d) or as a qualified tuition reduction under section 117(d). In general, education qualifies as a working condition fringe benefit if the employee could have deducted the education expenses under section 162 if the employee paid for the education.[325] In general, education expenses are deductible by an individual under section 162 if the education (1) maintains or improves a skill required in a trade or business currently engaged in by the taxpayer, or (2) meets the express requirements of the taxpayer's employer, applicable law, or regulations imposed as a condition of continued employment.[326] However, education expenses are generally not deductible if they relate to certain minimum educational requirements or to education or training that enables a taxpayer to begin working in a new trade or business.[327]

Description of Proposal

The proposal removes the requirement that a student loan payment must be made before January 1, 2026, to qualify as "educational assistance." As a result, the proposal makes the exclusion for employer payments of qualified education loans permanent.

The proposal would inflation adjust the maximum exclusion under section 127 for taxable years beginning after 2026.

Effective Date

The proposal applies to payments made after December 31, 2025.

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[322] See sec. 162.

[323] See also sec. 3401(a)(19).

[324] Secs. 3121(a)(20) and 3306(b)(16).

[325] Sec. 132(d).

[326] Treas. Reg. sec. 1.162-5.

[327] For taxable years beginning before January 1, 2026, trade or business expenses relating to the trade or business of the performance of services by the taxpayer as an employee are disallowed miscellaneous itemized deductions. Secs. 62(a)(1), 67(g), and 162(a).

N. Extension of Rules for Treatment of Certain Disaster-Related Personal Casualty Losses

Present Law

Personal casualty losses

In general

An individual taxpayer may claim an itemized deduction for a personal casualty loss.[328] If the loss is attributable to a disaster declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (the "Stafford Act"),[329] then the loss is deductible only to the extent of the sum of the individual's personal casualty gains plus the amount by which aggregate net disaster-related losses exceed 10 percent of the individual taxpayer's adjusted gross income.[330] In any taxable year beginning after December 31, 2017, and before January 1, 2026, all other personal casualty losses are deductible only to the extent that the losses do not exceed the individual's personal casualty gains.

For individual taxpayers, personal casualty losses are losses of property not connected with a trade or business or a transaction entered into for profit, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft.[331] Personal casualty gains are recognized gains from any involuntary conversion of property not connected with a trade or business or a transaction entered into for profit, if such gains arise from fire, storm, shipwreck, or other casualty, or from theft.[332] Personal casualty losses are deductible to the extent they exceed $100 per casualty.[333]

Additional relief for certain disasters

Congress has at times enacted more generous casualty loss provisions in response to specific natural disasters.[334]

[328] Sec. 165(h).

[329] Sec. 165(h)(5).

[330] Sec. 165(h)(2). Personal casualty gains are reduced for this purpose by any gain used to offset any personal casualty loss which is not attributable to a disaster.

[331] Sec. 165(c)(3)(B).

[332] Sec. 165(c)(3)(A).

[333] Sec. 165(h)(1).

[334] See, *e.g.*, sec. 204(b) of Pub. L. No. 116-94 (Hurricanes Florence and Michael); sec. 20104(b) of Pub. L. No. 115-123 (certain California wildfires); sec. 504(b) of Pub. L. No. 115-63 (Hurricanes Harvey, Irma, and Maria); and former sec. 1400S(b) (Hurricanes Katrina, Rita, and Wilma).

Division EE of Public Law 116-260, the Taxpayer Certainty and Disaster Tax Relief Act of 2020 ("TCDTRA"), [335] as modified by the Federal Disaster Tax Relief Act of 2023 ("FDTRA"),[336] provides special rules for "qualified disaster-related personal casualty losses." These losses include personal casualty losses arising in a qualified disaster area on or after the first day of the incident period of the applicable qualified disaster which are attributable to that qualified disaster.[337] These losses are deductible without regard to whether aggregate net losses exceed 10 percent of a taxpayer's adjusted gross income and to the extent they exceed $500 per casualty.[338] These losses are allowed as a deduction in addition to the standard deduction and are allowed against alternative minimum taxable income.

As modified by FDTRA, a "qualified disaster area" refers to an area with respect to which a major disaster has been declared by the President during the period beginning on January 1, 2020, and ending on the date which is 60 days after the date of enactment of FDTRA,[339] under section 401 of the Stafford Act, if the incident period of the disaster with respect to which the declaration is made begins on or after December 28, 2019, and on or before the date of enactment of FDTRA.[340] A qualified disaster area does not include any area with respect to which a major disaster had been declared only by reason of COVID-19.

A "qualified disaster" is, with respect to the applicable qualified disaster area, the disaster by reason of which a major disaster was declared with respect to that area.[341]

The "incident period" is, with respect to the applicable qualified disaster, the period specified by the Federal Emergency Management Agency as the period during which the disaster occurred, except that the period is not treated as ending after the date which is 30 days after the date of enactment of FDTRA.[342]

Description of Proposal

For purposes of personal casualty losses arising in a qualified disaster area, the provision broadens TCDTRA's definition of qualified disaster area (as modified by FDTRA) to include any area with respect to which a major disaster was declared by the President during the period beginning on January 1, 2020, and ending on the date which is 60 days after the date of enactment of the provision, under section 401 of Stafford Act if the incident period of the

[335] Sec. 304(b) of Div. EE. of Pub. L. No. 116-260, December 27, 2020.

[336] Sec. 2 of Pub. L. No. 118-148, December 12, 2024.

[337] Sec. 304(b)(3) of Div. EE. of Pub. L. No. 116-260, December 27, 2020.

[338] Sec. 304(b)(1) of Div. EE. of Pub. L. No. 116-260, December 27, 2020.

[339] FDTRA became law on December 12, 2024.

[340] Sec. 301(1) of Div. EE. of Pub. L. No. 116-260; sec. 2 of Pub. L. No. 118-148.

[341] Sec. 301(3) of Div. EE. of Pub. L. No. 116-260, December 27, 2020, December 12, 2024.

[342] Sec. 301(4) of Div. EE. of Pub. L. No. 116-260, December 27, 2020; sec. 2 of Pub. L. No. 118-148, December 12, 2024.

disaster begins on or after December 28, 2019, and on or before the date of enactment of the provision. The incident period will be treated as ending no later than the date which is 30 days after the date of enactment of the provision.

Thus, under the provision, certain disaster-related personal casualty losses attributable to major disasters beginning any time after the date of enactment of TCDTRA and through the date of enactment of the provision are provided the same treatment as qualified disaster-related personal casualty losses under TCDTRA.

Effective Date

The proposal is effective on the date of enactment.

O. MAGA Accounts

Present Law

The Code permits various types of tax-advantaged accounts for individuals. For example, qualified tuition programs under section 529 and Coverdell education savings accounts[343] allow individuals to save for the education expenses of a beneficiary on a tax-preferred basis. Similarly, qualified ABLE accounts allow individuals to pay the disability expenses of a beneficiary with similar tax benefits.[344] Retirement accounts such as those in qualified retirement plans (such as 401(k) plans)[345] and individual retirement plans[346] allow individuals to save for retirement in tax-advantaged accounts.

As a general rule, section 6103 provides that returns and return information are confidential. The definition of return information is very broad and includes any information received or collected by the Internal Revenue Service ("IRS") with respect to the liability under the Code of any person for any tax, penalty, interest, or offense. Returns and return information cannot be disclosed unless there is an applicable exception in the Code. Section 6103 contains numerous narrowly tailored exceptions to the general rule of confidentiality, grouped into 13 general categories.[347] Criminal penalties apply to the willful unauthorized disclosure or inspection of a return or return information.[348] The Code also provides a civil damage remedy for a taxpayer whose return or return information was disclosed or inspected in a manner not authorized by section 6103.[349]

Description of Proposal

In general

The proposal establishes a new type of tax-preferred account, a money account for growth and advancement ("MAGA account"). A MAGA account is a trust created or organized in the United States for the exclusive benefit of an individual and designated at the time of establishment as such (in such manner as the Secretary shall prescribe), provided that the written

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[343] Sec. 530.

[344] Sec. 529A.

[345] Sec. 401(a).

[346] Sec. 408.

[347] Sec. 6103(c)-(o).

[348] Secs. 7213 (relating to felony unauthorized disclosure) and 7213A (relating to misdemeanor unauthorized inspection).

[349] Sec. 7431.

governing instrument creating the trust meets certain requirements, as described below. A MAGA account is subject to the unrelated business income tax but is otherwise exempt from tax.

In order to be eligible for an account, the account beneficiary must not have attained age eight on the date the account is established. The individual establishing the account must provide the trustee his or her social security number as well as the account beneficiary's social security number. In addition, except in the case of a qualified rollover contribution, the MAGA account may not accept a contribution unless (1) it is in cash, (2) the account beneficiary is under age 18, (3) the contribution does not cause the aggregate contributions for the taxable year to exceed the applicable contribution limit, and (4) the contribution is made on or after January 1, 2026. For this purpose, a qualified rollover contribution is an amount paid in a direct trustee-to-trustee transfer to a MAGA account from another MAGA account created for the benefit of the same account beneficiary.

The trustee of the MAGA account must be a bank[350] or another person who demonstrates to the satisfaction of the Secretary that the manner in which the person will administer the trust will be consistent with the proposal's requirements or who has so demonstrated with respect to an individual retirement plan. The account beneficiary's interest in the account must be nonforfeitable. The assets of the trust must not be commingled with other property except in a common trust fund or common investment fund, an no trust funds may be invested in any asset other than eligible investments. For this purpose, eligible investment means an investment managed by a regulated investment company[351] that (1) tracks a well-established index of United States equities (or that invests in an equivalent diversified portfolio of United States equities), (2) does not use leverage, (3) minimizes fees and expenses, and (4) meets such other criteria as the Secretary determines appropriate.

Under the proposal, the contribution limit for a MAGA account for a taxable year is $5,000 (adjusted for inflation), except that qualified rollover contributions and contributions from the Federal Government or any State, local, or tribal government are not subject to this limit. The exception from the $5,000 limit also applies to contributions made by certain tax-exempt organizations through a special program that the proposal directs the Secretary to establish. The Secretary is directed to establish a program through which contributions may be made by an exempt organization described under section 501(c) to a large group of account beneficiaries provided that the MAGA accounts that will receive the contributions are selected on the basis of the location of the residence of the account beneficiaries, the school district in which such beneficiaries attend school, or another basis the Secretary deems appropriate. In addition, all account beneficiaries must receive an equal portion of the contribution. The contributions described in this paragraph that are exempt from the $5,000 limit are not included in the account beneficiary's investment in the contract.

Distributions are not permitted from the MAGA account until the account beneficiary attains age 18. At age 18, and before the account beneficiary attains age 25, the aggregate distributions must not exceed half of the cash equivalent value of the account as of the date the

[350] As defined in sec. 408(n).

[351] Within the meaning of sec. 851.

beneficiary turned 18. Distributions from the account that are used for qualified expenses are taxable as capital gains.[352] Other distributions are includible in income and subject to an additional tax of 10 percent if the beneficiary is under age 30. (The portion of any distribution that is allocable to the investment in the contract is not includible in income). These distribution rules do not apply to the distribution of a qualified rollover contribution. Qualified expenses are (1) qualified higher education expenses,[353] (2) qualified post-secondary credentialing expenses,[354] (3) under regulations provided by the Secretary, amounts paid or incurred with respect to any small business which the beneficiary has obtained through a small business loan, small farm loan, or similar loan, and (4) an amount used for the purchase of a principal residence of an account beneficiary who is a first-time homebuyer.[355] Upon attaining age 31, the account ceases to be a MAGA account and is treated as distributed to the account beneficiary.

An individual is only permitted to be an account beneficiary of one MAGA account. However, an exception applies if the entire amount of a MAGA account is rolled over as a qualified rollover contribution to another MAGA account. In the case of a duplicate MAGA account that does not meet the above exception, such account ceases to be treated as a MAGA account and the entire balance is treated as distributed. In addition, an excise tax is imposed equal to the amount in the account that is allocable to income. The trustee must deduct and withhold the excise tax from the distribution of the account. For this purpose, a duplicate MAGA account means (1) in the case of an account beneficiary for whom an account was established by the Secretary, any other MAGA account of such beneficiary, and (2) in the case of any other account beneficiary, any MAGA account established after the first MAGA account was established for the benefit of such account beneficiary.

If excess contributions are made to a MAGA account, an excise tax is imposed on the account beneficiary equal to six percent of such excess for each taxable year during which excess contributions are in the account.[356] Rules after the death of an account beneficiary are similar to the rules that apply with respect to health savings accounts.[357]

The trustee of a MAGA account must make reports regarding the account to the Secretary and to the account beneficiary with respect to contributions, distributions, the amount of the investment of the contract, and such other matters as the Secretary may require. The reports must be filed and furnished at such time and in such manner as required by the Secretary. The

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[352] Under sec. 1(h)(12).

[353] As defined in section 529(e)(3), determined without regard to section 529(c)(7).

[354] Sec. 529(f).

[355] "Purchase" is defined in section 36(c)(3), "principal residence" in section 121, and "first-time homebuyer" in section 36(c)(1).

[356] Sec. 4973, as amended by this proposal to include MAGA accounts.

[357] Sec. 223(f)(8).

proposal imposes a penalty of $50 for each failure to file the report unless such failure is due to reasonable cause.[358]

The proposal includes a new exception to the general rule of confidentiality in section 6103, authorizing the release of limited taxpayer information for the sole purpose of enabling the Secretary to effect deposits from various governmental or private exempt organizations to the individual accounts of unrelated account beneficiaries. Upon written request signed by the head of the bureau or office of Treasury requesting the inspection or disclosure, and only to the extent necessary to carry out the purpose described in the preceding sentence, the following information for each intended beneficiary may be provided to officers and employees of such bureau or office: information necessary to identify the account holders in a particular class of beneficiaries identified by a donor as the intended recipients; the name, address, and SSN of a beneficiary; the account custodian and address; the account number; and the routing number. To the extent determined by the Secretary in regulations, other information necessary to ensure proper routing of funds may also be provided. The information may only be used for the proper routing of funds and may not be redisclosed by the Secretary.

Pilot program for Federal Government contributions

Under a pilot program, the proposal provides that the Secretary will pay a one-time credit of $1,000 to the MAGA account of each qualifying child[359] of a taxpayer, if such qualifying child is an eligible individual. An eligible individual is a child born after December 31, 2024 and before January 1, 2029 who is a United States citizen at birth. If the Secretary determines that a MAGA account has not been established for an eligible individual by the qualifying date, the Secretary must establish the MAGA account for such eligible individual, and must notify the individual with respect to whom the eligible individual is a qualifying child. The Secretary must provide such individual with the opportunity to elect to decline the Secretary's establishment of the account. The qualifying date is the first date on which a return is filed by an individual with respect to whom such eligible individual is a qualifying child with respect to the taxable year to which the return relates.

For purposes of selecting a trustee for a MAGA account established by the Secretary, the Secretary must take into account (1) the history of reliability and regulatory compliance of such trustee, (2) the customer service experience of such trustee, (3) the costs imposed by such trustee on the account or account beneficiary, and (4) to the extent practicable, the preferences of the individual with respect to whom the eligible individual is a qualifying child.

[358] Sec. 6693, as modified by this proposal to include MAGA accounts.

[359] As defined in sec. 152(c).

In order to receive the $1,000 credit, the taxpayer whose qualifying child is an eligible individual must include on the return the social security numbers of such individual, such individual's spouse, and the eligible individual.[360]

If any taxpayer makes an excessive claim for the $1,000 credit, a penalty of $500 is imposed in the case of negligence or disregard of rules or regulations,[361] and a penalty of $1,000 is imposed in the case of fraud.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2024.

[360] Omission of a correct social security number is treated as a math error. Sec. 6213(g)(2) (as amended by Part 3.E of Subtitle C, "Earned Income Tax Credit Reforms").

[361] Negligence and disregard are defined under section 6662.

PART III—INVESTING IN HEALTH OF AMERICAN FAMILIES AND WORKERS

A. Treatment of Health Reimbursement Arrangements Integrated with Individual Market Coverage

Present Law

Group health plan requirements

The Internal Revenue Code (the "Code") imposes various requirements with respect to employment-related health plans, referred to for this purpose as group health plans.[362] The Patient Protection and Affordable Care Act ("PPACA")[363] expanded the market reform requirements applicable to group health plans.[364] These requirements include a prohibition on lifetime or annual limits,[365] a coverage mandate regarding preventive services,[366] and a requirement to provide summaries of benefits and coverage.[367] In addition, insurance issued to a fully-insured group health plan in the small group market is subject to additional requirements, including a prohibition on group-by-group rating.[368]

Under the Code, an employer is generally subject to an excise tax of $100 a day per employee if it sponsors a group health plan that fails to meet any of these requirements.[369] Generally, if the failure is due to reasonable cause and not to willful neglect, the maximum tax that can be imposed for failures during a taxable year is the lesser of 10 percent of the employer's group health plan expenses for the prior year or $500,000. In some cases, the excise tax does not apply if the failure is due to reasonable cause and not to willful neglect and the

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[362] See, *e.g.*, sec. 4980B (relating to continuation coverage or "COBRA" requirements) and Chapter 100 (secs. 9801-9834, relating to various additional requirements, such as prohibitions on preexisting condition exclusions and discrimination based on health status). Code section 5000 also imposes Medicare secondary payor requirements on group health plans.

[363] Pub. L. No. 111-148, March 23, 2010, as amended by the Health Care and Education Reconciliation Act of 2010 ("HCERA"), Pub. L. No. 111-152, March 30, 2010. PPACA and HCERA are referred to collectively as the PPACA.

[364] See, *e.g.*, secs. 2711 and 2713 of the Public Health Service ("PHS") Act, 42 U.S.C. secs. 300gg-11 and 300gg-13. These provisions of the PPACA are incorporated into the Code through section 9815.

[365] Sec. 2711 of the PHS Act, 42 U.S.C. sec. 300gg-11.

[366] Sec. 2713 of the PHS Act, 42 U.S.C. sec. 300gg-13.

[367] Sec. 2715 of the PHS Act, 42 U.S.C. sec. 300gg-15.

[368] Sec. 2701 of the PHS Act, 42 U.S.C. sec. 300gg.

[369] Section 4980B(a) and (b) apply to a violation of the COBRA requirements, subject to an exception for plans of employers with fewer than 20 employees. Section 4980D(a) and (b) apply to a violation of the requirements under Chapter 100, subject to an exception for a plan of an employer with no more than 50 employees if coverage is provided solely through insurance. In some cases, a party other than the employer, such as a multiemployer plan, may be liable for the tax. For simplicity, this document refers to "employers" to indicate all such entities that may sponsor group health plans.

failure is corrected within a certain period. In addition, in some cases in which failure is due to reasonable cause and not to willful neglect, some or all of the excise tax may be waived to the extent payment of the tax would be excessive relative to the failure involved.

<u>Other health rules under the Code</u>

Under the PPACA, "minimum essential coverage" includes employer-sponsored coverage under a group health plan, other than certain types of limited coverage, such as coverage only for vision or dental medical services.[370] Minimum essential coverage also includes coverage purchased in the individual insurance market, other than certain types of limited coverage, such as coverage only for vision or dental medical services.

An advanceable, refundable income tax credit, the premium tax credit ("premium assistance credit" or "premium tax credit"), is available to certain individuals who purchase health insurance coverage in the individual market through an American Health Benefit Exchange (an "Exchange).[371] However, an employee is generally not eligible for the premium tax credit if his or her employer offers affordable minimum essential coverage under a group health plan and the coverage provides minimum value. For this purpose, coverage is affordable if the employee's share of the premium for self-only coverage under the group health plan is not more than 9.02 percent (for 2025)[372] of the employee's household income. To provide minimum value, the coverage offered under the group health plan must cover at least 60 percent of the total costs of benefits covered under the plan. An individual who applies for advance payment of the premium tax credit with respect to Exchange coverage for a year must provide the Exchange with certain information, including information relating to employer-provided minimum essential coverage.[373]

If an applicable large employer fails to offer employees minimum essential coverage, or offers minimum essential coverage that either is not affordable (under the standard described above) or fails to provide minimum value, and any employee is allowed the premium tax credit, the employer may be subject to a tax penalty.[374] For this purpose, applicable large employer generally means, with respect to a calendar year, an employer that employed an average of at

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[370] Sec. 5000A.

[371] Sec. 36B. An Exchange is established under section 1311 of the PPACA, 42 U.S.C. sec. 13031. Lower-income individuals who are eligible for the premium tax credit and enrolled in health insurance coverage purchased on an Exchange may also be eligible for cost-sharing reductions under section 1402 of the PPACA, 42 U.S.C sec. 18071.

[372] Rev. Proc. 2024-35, 2024-39 I.R.B. 638. This percentage is updated as needed to reflect cost-of-living changes.

[373] Sec. 1411(b) of the PPACA, 42 U.S.C. sec. 18081(b). This information is subject to verification during the Exchange process under section 1411(c) and (d).

[374] Sec. 4980H.

least 50 full-time employees (including full-time equivalents) on business days during the preceding calendar year.[375]

Health reimbursement arrangements

In addition to offering health coverage, employers sometimes reimburse medical expenses of their employees (and their spouses and dependents). These arrangements are sometimes used by employers to pay or reimburse employees for medical expenses that are not covered by health insurance and are commonly referred to as health reimbursement arrangements ("HRAs").[376]

The amounts in an HRA can be used only to reimburse medical expenses (which may include health insurance premiums), and HRAs cannot be funded on a salary reduction basis. HRAs have a maximum dollar amount for each coverage period, and amounts remaining in an HRA at the end of the year may be carried forward to be used to reimburse medical expenses in following years.[377]

An employee may exclude amounts provided through an HRA from gross income. For employer payments or reimbursements under an HRA to be excluded from gross income, expenses must be substantiated and an employee must be entitled to receive payments from the employer only if he or she incurs qualifying expenses.[378]

After the enactment of the PPACA and before the establishment of individual coverage HRAs (as described below), an HRA generally failed to meet the group health plan requirements imposed by the PPACA unless the HRA complied with IRS rules relating to HRAs provided in conjunction with (or "integrated" with) certain other employer-sponsored coverage that met the

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[375] In determining whether an employer is an applicable large employer (that is, whether the employer has at least 50 full-time employees), besides the number of full-time employees, the employer must include the number of its full time equivalent employees for a month, determined by dividing the aggregate number of hours of service of employees who are not full-time employees for the month by 120. In addition, in determining applicable large employer status, members of the same controlled group, group under common control, and affiliated service group under section 414(b), (c), (m) and (o) are treated as a single employer.

[376] See secs. 105(b) and 106; Rev. Rul. 61-146, 1961-2 C.B. 25; Notice 2002-45, 2002-2 C.B. 93, July 15, 2002, and Rev. Rul. 2002-41, 2002-2 C.B. 75. Under section 105(h), a self-insured HRA must meet certain nondiscrimination requirements in order for the benefits provided to a highly compensated individual to be excluded from income. For this purpose, the following groups of employees may be excluded: employees who have not completed three years of service with the employer, employees under age 25, part-time or seasonal employees, employees covered by a collective bargaining agreement if health benefits were the subject of good faith bargaining, and nonresident aliens with no earned income from sources within the United States. Employer payments and reimbursements for health insurance and medical expenses are also excluded from wages for employment tax purposes. Secs. 3121(a)(2), 3231(e)(1), 3306(b)(2), 3401(a)(20); Rev. Rul. 56-632, 1956-2 C.B. 101. For simplicity, this document refers to "HRAs" to indicate all arrangements to which the individual coverage HRA final rules (described later in this document) apply.

[377] General guidance with respect to HRAs is provided in Notice 2002-45.

[378] Treas. Reg. sec. 1.105-2.

group health plan requirements.[379] An HRA that is integrated with such employer-sponsored coverage is often referred to as an "integrated" HRA, and an HRA that is not integrated with such employer-sponsored coverage is often referred to as a "stand-alone" HRA. Thus, an employer could be subject to an excise tax if it provided employees a stand-alone HRA covering medical expenses, with the exception of certain limited benefits, for example, coverage only for vision or dental medical services.[380]

Individual coverage HRAs

In 2019, final rules were issued permitting employers to contribute to HRAs used in conjunction with the purchase of individual health insurance coverage, without violating the group health plan requirements (the "final rules").[381] The final rules provide that employers may offer employees an "individual coverage HRA," and that, if those individuals use the amounts contributed to that HRA in conjunction with the purchase of health insurance coverage on the individual market, the group health plan meets the relevant group health plan requirements. An individual coverage HRA may also be used in conjunction with coverage under Medicare Part A and B or C.[382]

Individual coverage HRAs are subject to detailed regulations, including the following requirements: the terms of the individual coverage HRA must require that employees, spouses, and dependents enrolled in the HRA also be enrolled in individual health insurance coverage;[383] employers are not permitted to allow employees to choose between an individual coverage HRA and traditional employment-related health coverage;[384] employers are required to offer individual coverage HRAs on the same terms to all employees within enumerated classes of employees;[385] generally, employers are required to provide employees notice regarding the individual coverage HRA at least 90 calendar days before the beginning of the plan year;[386] and employers are required to adopt reasonable procedures for substantiation regarding individuals' enrollment in qualifying individual coverage.[387]

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[379] See, *e.g.*, Notice 2013-54, 2013-40 I.R.B. 287, September 30, 2013. The 21st Century Cures Act created a limited exception to this rule in the form qualified small employer health reimbursement arrangements ("QSEHRAs"). Unlike traditional HRAs, QSEHRAs are designed so that small employers may subsidize employees' purchase of individual coverage on an Exchange. Pub. L. No. 114-255, sec. 18001, December 13, 2016.

[380] See Notice 2015-87, 2015-52 I.R.B. 889, December 28, 2015.

[381] T.D. 9867, 84 Fed. Reg. 28888, June 20, 2019. The final rules were issued in conjunction with the Departments of Labor and Health and Human Services.

[382] Treas. Reg. sec. 54.9802-4(e).

[383] Treas. Reg. sec. 54.9802-4(c)(1).

[384] Treas. Reg. sec. 54.9802-4(c)(2).

[385] Treas. Reg. sec. 54.9802-4(c)(3).

[386] Treas. Reg. sec. 54.9802-4(c)(6).

[387] Treas. Reg. sec. 54.9802-4(c)(5).

Because individual coverage HRAs are employer-sponsored group plans, individuals enrolled in individual coverage HRAs are not eligible for the premium tax credit. Furthermore, the final rules include an affordability test, under which the value of the employer contribution to the individual coverage HRA is compared to the price of the lowest cost silver plan available to the employee. Similar to the rule for traditional group health plans, if the employee's share of the premium for self-only coverage under that plan is more than 9.02 percent (for 2025) of the employee's household income, the individual coverage HRA is not considered affordable and the employee may be entitled to the premium tax credit for individual health coverage purchased on an Exchange.[388]

In addition to amounts contributed to an individual coverage HRA by the employer, employees may make contributions through a cafeteria plan to purchase individual coverage if, for example, the employer's contribution to the individual coverage HRA is less than the premium for the individual coverage selected by the employee. However, amounts available through a cafeteria plan may not be used to purchase individual health coverage on an Exchange, so, in these circumstances, employees must purchase off-Exchange coverage.[389]

Description of Proposal

The proposal generally codifies the final rules permitting employers to offer individual coverage HRAs – renamed as Custom Health Option and Individual Care Expense, or "CHOICE," arrangements – without violating the group health plan requirements. Thus, the proposal specifies that a CHOICE arrangement that otherwise satisfies the requirements prescribed in the proposal complies with sections 2711 and 2713 of the PHS Act. In addition, the proposal specifies that a CHOICE arrangement complies with section 9802 of the Code and section 2705 of the PHS Act relating to non-discrimination.

The proposal makes three changes from the final rules. First, it specifies that CHOICE arrangements that otherwise satisfy the requirements prescribed in the proposal also satisfy the requirement of section 2715 of the PHS Act to provide a summary of benefits and coverage. Second, the proposal allows an employer that offers its employees a fully-insured group health plan subject to the requirements of the small group market to offer the employees offered that plan a choice between that plan and a CHOICE arrangement. Third, the proposal amends the notice requirement to provide that employers generally must provide the required notice no later than 60 days before the beginning of the plan year.

In detail, the proposal defines a CHOICE arrangement as an HRA under which payments or reimbursements may be made only for medical care during periods during which a covered individual is also covered under individual health insurance coverage offered in the individual

[388] Treas. Reg. sec. 1.36B-2(c)(3). An individual coverage HRA that is affordable is also treated as providing minimum value.

[389] Sec. 125(f)(3), providing that an employer generally may not provide for a qualified health plan offered through an Exchange as a cafeteria plan benefit.

market (other than coverage that consists solely of excepted benefits) or under Medicare parts A and B or C. In addition, a CHOICE arrangement must meet the following requirements:

- The CHOICE arrangement must be offered to all employees in the same class of employees on the same terms.
- The employer may not offer any other group health plan (other than an account-based plan or a plan consisting solely of excepted benefits) to any employees in such a class, with an exception for the offer of a fully-insured plan subject to the small group market requirements.
- The CHOICE arrangement must have reasonable procedures to substantiate that the covered individuals are, or will be, enrolled in qualifying individual market coverage as of the beginning date of coverage under the arrangement; and that the covered individuals remain so enrolled when requests are made for payment or reimbursement of medical care.
- A CHOICE arrangement generally must provide each employee eligible to participate in the in the CHOICE arrangement with written notice of the employee's rights and obligations under the arrangement not later than 60 days before the beginning of the plan year. The notice must be sufficiently accurate and comprehensive to apprise the employee of such rights and obligations and be written in a manner calculated to be understood by the average employee eligible to participate.

The proposal includes the following classes of employees:

- Full-time employees;
- Part-time employees;
- Salaried employees;
- Non-salaried employees;
- Employees whose primary site of employment is in the same rating area;
- Employees who are included in a collective bargaining unit;
- Employees who have not met a waiting period requirement;
- Seasonal employees;
- Employees who are non-resident aliens and who receive no earned income (within the meaning of section 911(d)(2)) from the employer which constitutes income from sources within the United States;[390] and
- Such other classes as designated by the Treasury.

[390] Under the section 861(a)(3) rules for the source of income from personal services.

Under the proposal, an employer may designate two or more of the classes as specified classes to which the arrangement is offered, and distinctions regarding full-time, part-time, and seasonal employees must be made under rules similar to those that apply under sections 105(h) or 4980H, at the election of the employer for the upcoming plan year. An arrangement does not fail to qualify as a CHOICE arrangement merely because the maximum dollar amount varies within a class provided that the variation is due to an increase in the number of additional individuals covered under an employee's arrangement, or increases as the age of the employee increases (as long as the increase is not in excess of 300 percent of the lowest maximum dollar amount available). Finally, an employer that currently offers a traditional group health plan to a class of employees is permitted to prospectively offer newly-hired employees in that class a CHOICE arrangement while continuing to offer previously-hired employees a traditional health plan without violating the rule prohibiting differing offers within a class of employees.

The proposal provides that, to the extent not inconsistent with the proposal, no inference is intended with respect to the individual coverage HRA final rules. The proposal also specifies that all references in the proposal to CHOICE arrangements must be treated as including references to individual coverage HRAs, so that references in statute and regulations referring to CHOICE arrangements refer equally to CHOICE arrangements and individual coverage HRAs offered under the final rules.

The proposal directs the Secretaries of the Treasury, Labor, and Health and Human Services ("HHS") to modify the final rules as may be necessary to conform them with the three amendments made by this proposal.

Finally, the proposal provides that employers are required to report the total permitted benefits for enrolled individuals in the CHOICE arrangement on Form W-2.[391]

Effective Date

The proposal is effective for plans years beginning after December 31, 2025.

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[391] Sec. 6051(a).

B. Participants in CHOICE Arrangement Eligible for Purchase of Exchange Insurance under Cafeteria Plan

Present Law

For a general description of individual coverage HRAs and CHOICE arrangements, see Section A of this Part.

There is no Federal requirement that employers offer health insurance coverage to employees or their families. However, as with other compensation, the cost of employer-provided health coverage is a deductible business expense under section 162.[392] In addition, employer-provided health insurance coverage is generally not included in an employee's gross income.[393]

Definition of a cafeteria plan

If an employee receives a qualified benefit (as defined below) based on the employee's election between the qualified benefit and a taxable benefit under a cafeteria plan, the qualified benefit generally is not includable in gross income.[394] However, if a plan offering an employee an election between taxable benefits (including cash) and nontaxable qualified benefits does not meet the requirements for being a cafeteria plan, the election between taxable and nontaxable benefits results in gross income to the employee, regardless of what benefit is elected and when the election is made.[395] A cafeteria plan is a separate written plan under which all participants are employees, and participants are permitted to choose among at least one permitted taxable benefit (for example, current cash compensation) and at least one qualified benefit. Finally, a cafeteria plan generally must not provide for deferral of compensation.[396]

Qualified benefits

Qualified benefits under a cafeteria plan are generally employer-provided benefits that are not includable in gross income under an express provision of the Code. Examples of qualified benefits include employer-provided health insurance coverage, group term life insurance coverage not in excess of $50,000, and benefits under a dependent care assistance program. In order to be excludable, any qualified benefit elected under a cafeteria plan must independently satisfy any requirements under the Code section that provides the exclusion. However, some employer-provided benefits that are not includable in gross income under an express provision of the Code are explicitly not allowed in a cafeteria plan. These benefits are generally referred to as nonqualified benefits. Examples of nonqualified benefits include

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[392] Sec. 162. However, see special rules in sections 419 and 419A for the deductibility of contributions to welfare benefit plans with respect to medical benefits for employees and their dependents.

[393] Sec. 106.

[394] Sec. 125(a).

[395] Prop. Treas. Reg. sec. 1.125-1(b).

[396] There are exceptions enumerated in in section 125(d)(2)(B), (C), and (D).

scholarships;[397] educational assistance;[398] and fringe benefits.[399] A plan offering any nonqualified benefit is not a cafeteria plan.[400]

Payment of health insurance premiums through a cafeteria plan

Employees participating in a cafeteria plan may be able to pay the portion of premiums for health insurance coverage not otherwise paid for by their employers on a pre-tax basis through salary reduction.[401] Such salary reduction contributions are treated as employer contributions for purposes of the Code, and are thus excluded from gross income.

Prior to the enactment of the PPACA, one way that employers could offer employer-provided health insurance coverage for purposes of the tax exclusion was to offer to reimburse employees for the premiums for health insurance purchased by employees in the individual health insurance market. The payment or reimbursement of employees' substantiated individual health insurance premiums was excludible from employees' gross income.[402] This reimbursement for individual health insurance premiums could also be paid for through salary reduction under a cafeteria plan.[403]

Such an offer to reimburse individual health insurance premiums constituted a group health plan. Before the publication of the individual coverage HRA final rules, however, the PPACA market reforms generally made it impossible for a group health plan offered in this manner to satisfy the group health plan requirements.[404]

In addition, the PPACA generally forbids employees from purchasing Exchange coverage using funds provided by an employer under a cafeteria plan. Specifically, the PPACA provides that reimbursement (or direct payment) for the premiums for coverage under any qualified health plan offered through an Exchange is a qualified benefit under a cafeteria plan only if the employer is a qualified employer.[405] Under section 1312(f)(2) of the PPACA, a qualified employer is generally a small employer that elects to make all its full-time employees eligible for one or more qualified plans offered in the small group market through an

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[397] Sec. 117.

[398] Sec. 127.

[399] Sec. 132.

[400] Prop. Treas. Reg. sec. 1.125-1(q).

[401] Sec. 125.

[402] Rev. Rul. 61-146, 1961-2 C.B. 25.

[403] Prop. Treas. Reg. sec. 1.125-1(m).

[404] See Notice 2013-54, 2013-40 I.R.B. 287, September 30, 2013; FAQs about Affordable Care Act Implementation (PART XXII), November 6, 2014.

[405] Sec. 125(f)(3).

Exchange.[406] Otherwise, reimbursement (or direct payment) for the premiums for coverage under any qualified health plan offered through an Exchange is not a qualified benefit under a cafeteria plan. Thus, an employer cannot offer to reimburse an employee for the premium for a qualified plan that the employee purchases through the individual market in an Exchange as a health insurance coverage option under its cafeteria plan, including in conjunction with an individual coverage HRA.

Description of Proposal

The proposal permits employees enrolled in a CHOICE arrangement in conjunction with a cafeteria plan to use salary reduction to purchase health insurance coverage on an Exchange. Therefore, employees participating in a CHOICE arrangement that is available in conjunction with a cafeteria plan may now purchase individual Exchange coverage using a cafeteria plan election, similar to CHOICE arrangement participants not using salary reduction.[407]

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

[406] State may allow issuers of health insurance coverage in the large group market to offer qualified plans on an Exchange. In that event, a qualified employer includes a large employer that elects to make all its full-time employees eligible for one or more qualified plans offered in the large group market through an Exchange. See sec. 1312(f)(2) of the PPACA.

[407] As described in the description of the proposal in Section A of this Part, all references to CHOICE arrangements incorporate reference to individual coverage HRAs offered under the individual coverage HRA final rules.

C. Employer Credit for CHOICE Arrangement

Present Law

For a general description of individual coverage HRAs and CHOICE arrangements, see Section A of this Part.

Description of Proposal

The proposal establishes a new credit for employers whose employees are enrolled in CHOICE arrangements maintained by the employer. The credit is determined with respect to each employee enrolled in such a CHOICE arrangement during the credit period, which is the first two one-year periods beginning with the month during which the employer first establishes a CHOICE arrangement of behalf of its employees.

The credit equals (1) $100 multiplied by the number of months for which the employee is enrolled in the CHOICE arrangement during the first year of the credit period, and (2) one-half of the dollar amount in (1), multiplied by the number of months the employee is enrolled in the CHOICE arrangement during the second year of the credit period. The $100 amount is adjusted for inflation beginning in 2027.

In order to be eligible for the credit, the employer must not (with respect to any taxable year beginning in a calendar year) be an applicable large employer for the calendar year under section 4980H. In addition, an employee is not taken into account for the credit unless the employee would be treated as eligible for minimum essential coverage for purposes of the premium tax credit, without regard to whether the employee has enrolled in the Choice arrangement offered by the employer. Therefore, the credit is available only when the employer's offer of a CHOICE arrangement constitutes affordable minimum essential coverage that provides minimum value.[408]

The credit is part of the general business credit and is allowed against the alternative minimum tax.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

[408] The IRS has published regulations for determining when an individual coverage HRA (and thus a CHOICE arrangement) constitutes such coverage at Treas. Reg. sec. 1.36B-2(c)(5).

D. Individuals Entitled to Part A of Medicare by Reason of Age Allowed to Contribute to Health Savings Accounts

Present Law

Health savings accounts

An individual may contribute to a health savings account (an "HSA") only if the individual is covered under a plan that meets the requirements for a high deductible health plan, as described below. In general, HSAs provide tax-favored treatment for current medical expenses, as well as the ability to save on a tax-favored basis for future medical expenses. In general, an HSA is a tax-exempt trust or custodial account created exclusively to pay for the qualified medical expenses of the account holder and his or her spouse and dependents.

Within limits,[409] contributions to an HSA made by or on behalf of an eligible individual (with the exception of contributions by the individual's employer) are deductible by the individual. HSA contributions made on behalf of an eligible individual by their employer are excludible from income and from wages for employment tax purposes. Earnings on amounts in HSAs are not taxable. Distributions from an HSA used for qualified medical expenses are not includible in gross income. Distributions from an HSA that are not used for qualified medical expenses are includible in gross income and are subject to an additional tax of 20 percent. The 20-percent additional tax does not apply if the distribution is made after death, disability, or the individual attains the age of Medicare eligibility (age 65).

High deductible health plans

A high deductible health plan (an "HDHP") is a health plan that has an annual deductible which is not less than $1,650 (for 2025) for self-only coverage (twice this amount for family coverage), and for which the sum of the annual deductible and other annual out-of-pocket expenses (other than premiums) for covered benefits does not exceed $8,300 (for 2025) for self-only coverage (twice this amount for family coverage).[410] These dollar thresholds are adjusted for inflation.[411]

An individual who is covered under an HDHP is eligible to contribute to an HSA, provided that while such individual is covered under the HDHP, the individual is not covered under any health plan that (1) is not an HDHP and (2) provides coverage for any benefit (subject to certain exceptions) covered under the HDHP.[412]

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409 For 2025, the basic limit on annual contributions that can be made to an HSA is $4,300 in the case of self-only coverage and $8,550 in the case of family coverage. Rev. Proc. 2024-25, 2024-22 I.R.B. 1333. The basic annual contribution limits are increased by $1,000 for individuals who have attained age 55 by the end of the taxable year (referred to as "catch-up" contributions). Sec. 223(b)(3).

410 *Ibid.* Sec. 223(c)(2).

411 Sec. 223(g).

412 Sec. 223(c)(1).

Various types of coverage are disregarded for this purpose, including coverage of any benefit provided by permitted insurance, coverage (whether through insurance or otherwise) for accidents, disability, dental care, vision care, or long-term care, as well as certain limited coverage through health flexible spending arrangements.[413] Permitted insurance means insurance under which substantially all of the coverage provided relates to liabilities incurred under workers' compensation laws, tort liabilities, liabilities relating to ownership or use of property, or such other similar liabilities as specified by the Secretary of the Treasury (the "Secretary") under regulations. Permitted insurance also means insurance for a specified disease or illness and insurance paying a fixed amount per day (or other period) of hospitalization.[414]

Under a safe harbor, an HDHP is permitted to provide coverage for preventive care before satisfaction of the minimum deductible.[415] IRS guidance provides for the types of coverage that constitute preventive care for this purpose.[416]

Health savings accounts and entitlement to Medicare

After an individual has attained age 65 and becomes enrolled in Medicare benefits, contributions can no longer be made to the individual's HSA.[417] An individual who is receiving retirement benefits from Social Security or the Railroad Retirement Board is automatically enrolled in both Medicare Part A (hospital insurance benefits) and Part B (supplementary medical insurance benefits) starting the first day of the month in which he or she attains age 65.[418] When an individual is automatically enrolled in Medicare at age 65, the amount that can be deducted by that individual for contributions to the HSA drops to zero for the first month (and

[413] Sec. 223(c)(1)(B).

[414] Sec. 223(c)(3).

[415] Sec. 223(c)(2)(C).

[416] Notice 2004-23, 2004-1 C.B. 725. See also Notice 2004-50, 2004-33 I.R.B. 196, August 16, 2004, Q&A's-26 and 27; Notice 2008-59, 2008-29 I.R.B. 123, July 21, 2008; Notice 2013-57, 2013-40 I.R.B. 293, September 30, 2013; Notice 2019-45, 2019-32 I.R.B. 593, August 5, 2019; and Notice 2024-75, 2024-44 I.R.B. 1026, October 28, 2024.

[417] See sec. 223(b)(7), as interpreted by Notice 2004-2, 2004-2 I.R.B. 269, January 12, 2004, corrected by Announcement 2004-67, 2004-36 I.R.B. 459, September 7, 2004 ("After an individual has attained age 65 and becomes enrolled in Medicare benefits, contributions, including catch-up contributions, cannot be made to an individual's HSA."). See also Notice 2004-50, 2004-33 I.R.B. 196, August 16, 2004, Q&A-2 ("Thus, an otherwise eligible individual under section 223(c)(1) who is not actually enrolled in Medicare Part A or Part B may contribute to an HSA until the month that individual is enrolled in Medicare."); Notice 2008-59, 2008-29 I.R.B. 123, July 21, 2008, Q&A-5 and Q&A-6 ("[A]n individual is not an eligible individual under section 223(c)(1) in any month during which such individual is both eligible for benefits under Medicare and enrolled to receive benefits under Medicare[, including Part D (or any other Medicare benefit)]"). See also Treas. Reg. sec. 54.4980B-7 Q&A(3)(b) (regarding "entitlement" to Medicare benefits: "A qualified beneficiary becomes entitled to Medicare benefits upon the effective date of enrollment in either part A or B, whichever occurs earlier. Thus, merely being eligible to enroll in Medicare does not constitute being entitled to Medicare benefits.").

[418] Sec. 226(a) of the Social Security Act, 42 U.S.C. sec. 426(a). Medicare Part B, however, is a voluntary program, and enrollees must pay premiums. See sec. 1839 of the Social Security Act, 42 U.S.C. sec. 1395r.

each subsequent month) that the individual is entitled to Medicare benefits.[419] In addition, the 20-percent additional tax that otherwise applies to distributions not used for qualified medical expenses does not apply if the distribution is made after the individual attains age 65.

Qualified medical expenses

Generally, for purposes of distributions from HSAs, qualified medical expenses[420] mean amounts paid for medical care[421] or menstrual care products. Medical care generally means amounts paid for the diagnosis, cure, mitigation, treatment and prevention of disease, or for the purpose of affecting any structure or function of the body, as well as transportation primarily for and essential to medical care. Health insurance premiums are generally not qualified medical expenses,[422] but an individual who attains the age of Medicare eligibility (age 65) may use an HSA to pay for health insurance other than a Medicare supplemental policy.[423]

Description of Proposal

Under the proposal, with respect to an individual who is Medicare eligible but enrolled only in Medicare Part A, such coverage does not cause the allowable deduction for contributions to an HSA to become zero during any month for such individual. Such coverage also does not cause an individual to be considered as having a health plan or other coverage that would cause that individual to fail to be an eligible individual for purposes of making contributions to an HSA. Thus, an individual eligible for Medicare but enrolled only in Medicare Part A would not fail to be treated as eligible to make HSA contributions merely by reason of enrollment in Medicare Part A.

In addition, the proposal provides that individuals who have attained age 65 and who are eligible to contribute to an HSA generally may not use HSA funds to pay for health insurance, unlike other individuals who have attained age 65, and that the 20-percent additional tax on HSA distributions that otherwise does not apply to individuals who have attained age 65 continues to apply if the individual is an eligible individual.

Effective Date

The proposal applies to months beginning after December 31, 2025.

[419] Sec. 223(b)(7).

[420] Sec. 223(d)(2).

[421] Based on the definition under sec. 213(d). `

[422] Sec. 223(d)(2)(B).

[423] As defined in section 1882 of the Social Security Act, 42 U.S.C. sec. 1395ss. Sec. 223(d)(2)(C)(iv).

E. Treatment of Direct Primary Care Service Arrangements

Present Law

Direct primary care service arrangements

For a general description of HSA eligibility, see Section D of this Part.

Under present law, a direct primary care service arrangement may constitute other health coverage, depending on the specific attributes of the arrangement, and therefore an individual covered by a direct primary care service arrangement may not be eligible to contribute to an HSA.[424]

Description of Proposal

Under the proposal, a direct primary care service arrangement is not treated as a health plan that makes an individual ineligible to contribute to an HSA. For this purpose, a direct primary care service arrangement means, with respect to any individual, an arrangement under which such individual is provided medical care consisting solely of primary care services provided by primary care practitioners[425] if the sole compensation for such care is a fixed periodic fee. With respect to any individual for any month, the aggregate fees for all direct primary care service arrangements for such individual for such month cannot exceed $150 per month (in the case of an individual with any such arrangement that covers more than one individual, twice such dollar amount). The aggregate limit is adjusted annually for inflation.

For this purpose, the term "primary care services" does not include (1) procedures that require the use of general anesthesia, (2) prescription drugs other than vaccines (therefore, vaccines are permitted primary care services), and (3) laboratory services not typically administered in an ambulatory primary care setting. The Secretary, after consultation with the Secretary of HHS, is required to issue regulations or other guidance related to application of this rule. Finally, fees paid for any direct primary care service arrangement are treated as medical expenses (and not the payment of insurance).

Effective Date

The proposal applies to months beginning after December 31, 2025.

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[424] See IRS, Certain Medical Care Arrangements, proposed rule, 85 Fed. Reg. 35398, June 10, 2020. In the proposed rule, the IRS proposed defining a direct primary care arrangement as a contract between an individual and one or more primary care physicians under which the physician or physicians agree to provide medical care for a fixed annual or periodic fee without billing a third party.

[425] As defined in section 1833(x)(2)(A) of the Social Security Act, 42 U.S.C. sec. 13951, without regard to clause (ii) thereof.

F. Allowance of Bronze and Catastrophic Plans in Connection with Health Savings Accounts

Present Law

For a general description of HDHPs, see Section D of this Part.

Plans available on the Exchanges[426] are defined by reference to various metal categories which correspond to the percentage of costs an enrollee is expected to incur, including bronze, silver, gold, and platinum plans.[427] A bronze plan provides coverage that is designed to provide benefits that are actuarially equivalent to 60 percent of the full actuarial value of the benefits provided under the plan.[428] This percentage increases to 70 percent in a silver plan, 80 percent in a gold plan, and 90 percent in a platinum plan.

Catastrophic plans[429] do not fall into any of these categories and have low monthly premiums and very high deductibles. Catastrophic plans are available only to individuals under age 30 or individuals of any age with a hardship exemption. Under present law, catastrophic plans cannot be HDHPs.

Description of Proposal

Under the proposal, any bronze or catastrophic plan offered in the individual market on an Exchange is treated as an HDHP.

Effective Date

The proposal is applicable to months beginning after December 31, 2025.

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[426] See secs. 1311 and 1321 of the PPACA.

[427] See sec. 1302 of the PPACA.

[428] Sec. 1302(d)(1)(A) of the PPACA.

[429] See sec. 1302(e) of the PPACA.

G. On-Site Employee Clinics

Present Law

For a general description of HSAs and HDHPs, see Section D of this Part.

On-site employee clinics

On-site employer-sponsored health clinics may provide a range of health services to employees for free or at a reduced cost. Under IRS guidance, an otherwise eligible individual who has access to free health care or health care at charges below fair market value from a clinic on an employer's premises does not fail to be eligible to contribute to an HSA merely because of this free or reduced cost care as long as the clinic does not provide significant benefits in the nature of medical care in addition to disregarded coverage or preventive care.

For example, an employer that provides the following free health care (in addition to disregarded coverage or preventive care) for employees does not provide significant benefits in the nature of medical care: (1) physicals and immunizations, (2) injecting antigens provided by employees, such as performing allergy injections, (3) a variety of aspirin and other nonprescription pain relievers, and (4) treatment for injuries caused by accidents at a plant. However, a hospital that permits its employees to receive care at its facilities for all their medical needs for free (when the employee does not have insurance) or that waives copays and deductibles (when the employee has health insurance) provides significant benefits in the nature of medical care, and the hospital's employees fail to be eligible individuals for purposes of HSA contributions.[430]

Preventive care

The IRS has issued guidance providing a safe harbor for preventive care benefits allowed under an HDHP.[431] In that guidance, the IRS defines preventive care as including, but not limited to (1) periodic health evaluations, including tests and diagnostic procedures ordered in connection with routine examinations, such as annual physicals; (2) routine prenatal and well-child care; (3) immunizations; (4) tobacco cessation programs; (5) obesity weight-loss programs; and (6) screening services (such as screening for cancer, heart and vascular diseases, infectious diseases, mental health conditions and substance abuse, metabolic, nutritional, and endocrine conditions, musculoskeletal disorders, obstetric and gynecologic conditions, pediatric conditions, and vision and hearing disorders).

Although the guidance provides that preventive care does not generally include any service or benefit intended to treat an existing illness, injury or condition (with the exception of

[430] Notice 2008-59, 2008-29 I.R.B. 123, July 21, 2008, Q&A-10.

[431] Notice 2004-23, 2004-1 C.B. 725. See also Notice 2004-50, 2004-33 I.R.B. 196, August 16, 2004; Notice 2008-59, 2008-29 I.R.B. 123, July 21, 2008; Notice 2013-57, 2013-40 I.R.B. 293, September 30, 2013; Notice 2018-12, 2018-12 I.R.B. 441, March 19, 2018; Notice 2019-45, 2019-32 I.R.B. 593, August 5, 2019; and Notice 2024-75, 2024-44 I.R.B. 1026, October 28, 2024.

chronic conditions, as described below), any treatment that is incidental or ancillary to a safe harbor preventive care service or screening (in situations where it would be unreasonable or impracticable to perform another procedure to treat the condition), such as the removal of polyps during a diagnostic colonoscopy, also falls within the safe harbor. In addition, drugs or medications are considered to be preventive care when taken by a person who has developed risk factors for a disease that has not yet manifested itself or not yet become clinically apparent, or to prevent the reoccurrence of a disease from which a person has recovered.

A 2019 executive order included a requirement that Treasury issue guidance to expand the ability of patients to select an HDHP that could be used with an HSA to cover, before the deductible, low-cost preventive care for individuals with chronic conditions.[432] The IRS then issued guidance expanding the list of preventive care benefits permitted to be provided by an HDHP, without a deductible, to include limited preventive care for specified chronic conditions (including congestive heart failure, diabetes, coronary artery disease, osteoporosis and/or osteopenia, hypertension, asthma, diabetes, liver disease and/or bleeding disorders, heart disease, and depression).[433]

Preventive care also encompasses such services that are required to be included by a group health plan or health insurance issuer offering group or individual health insurance coverage under section 2713 of the PHS Act.[434]

Description of Proposal

Under the proposal, qualified items and services an otherwise eligible individual is eligible to receive at (1) a health care facility located at a facility owned or leased by the eligible individual's employer (or the employer of the individual's spouse) or (2) at a health care facility operated primarily for the benefit of employees of the individual's employer (or the employees of the individual's spouse's employer) are not treated as coverage under a health plan for purposes of determining the individual's eligibility to contribute to an HSA. Qualified items and services include: (1) physical examinations, (2) immunizations, including injections of antigens provided by employees, (3) drugs or biologicals other than a prescribed drug, (4) treatment for injuries occurring in the course of the individual's employment, (5) preventive care for chronic conditions,[435] (6) drug testing, and (7) hearing or vision screenings and related services.

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[432] Executive Order 13877, "Improving Price and Quality Transparency in American Healthcare to Put Patients First," 84 Fed. Reg. 30849, June 27, 2019.

[433] Notice 2019-45, 2019-32 I.R.B. 593, August 5, 2019. The IRS further updated its understanding of preventive care in Notice 2024-75, 2024-44 I.R.B. 1026, October 28, 2024.

[434] Notice 2013-57, 2013-40 I.R.B. 293, September 30, 2013.

[435] Defined as any item or service specified in the Appendix of Notice 2019-45 (including any amendment, addition, removal or other modification made by the Secretary to that Appendix subsequent to the date Notice 2019-45 was published) which is prescribed to treat an individual diagnosed with an associated chronic condition for the purpose of preventing (1) the exacerbation of such condition or (2) the development of a secondary condition.

All entities treated as a single employer[436] under the Code are treated as a single employer under this proposal.

Effective Date

The proposal applies to months in taxable years beginning after December 31, 2025.

[436] Under sec. 414(b), (c), (m), or (o).

H. Certain Amounts Paid for Physical Activity, Fitness, and Exercise Treated as Amounts Paid for Medical Care

Present Law

For a general description of HSAs and HDHPs, see Section D of this Part.

Sports and fitness expenses, such as membership fees at a fitness facility or costs associated with participation or instruction in a program of physical exercise or physical activity, generally are not treated as medical care.[437] Therefore, tax-advantaged distributions from an HSA are generally not available to pay for these expenses.

Description of Proposal

The proposal amends the Code to expand the definition of qualified medical expenses for HSA purposes to include certain sports and fitness expenses paid for the purpose of participating in a physical activity, including (1) membership at a fitness facility and (2) participation or instruction in physical exercise or physical activity.

For this purpose, a fitness facility means a facility providing instruction in a program of physical exercise, offering facilities for the preservation, maintenance, encouragement, or development of physical fitness, or serving as the site of such a program of a State or local government: (1) which is not a private club owned and operated by its members; (2) which does not offer golf, hunting, sailing, or riding facilities; (3) the health or fitness facility component of which is not incidental to its overall function and purpose; and (4) which is fully compliant with applicable State and Federal anti-discrimination laws. In the case of any program that includes physical exercise or physical activity and also other components (such as travel or accommodations), expenses paid for other components may not be taken into account.[438]

Amounts paid for videos, books, or similar materials are not treated as qualifying expenses, nor are amounts paid for one-on-one personal training. Amounts paid for remote or virtual instruction in physical exercise or activity are not qualifying expenses unless the virtual or remote instruction is provided live in real-time. Amounts also do not qualify unless, in the case of a membership at a fitness facility, the membership lasts for more than one day, and, in the case of a participation or instruction in physical exercise or physical activity, the amount paid constitutes payment for more than one occasion of the participation or instruction.

The proposal limits distributions from an HSA for sport and physical activity expenses for any taxable year to $500 for single taxpayers and $1,000 in the case of a joint or head of household return. These amounts are indexed to inflation. The limit for every month is 1/12th of the relevant total amount.

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[437] See, *e.g.*, CCA 201622031, May 27, 2016. Under guidance, certain expenses may be treated as medical care. For example, taxpayers may deduct the cost of a weight loss program if the individual is diagnosed as obese or is directed by a doctor to lose weight as treatment for a specific disease. See Rev. Rul. 2002-19, 2002-16 I.R.B. 778.

[438] Rules similar to those applied under section 213(d)(6) are specified for this purpose.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

I. Allow Both Spouses to Make Catch-up Contributions to the Same Health Savings Account

Present Law

Health savings accounts

For a general description of HSAs, see Section D of this Part.

Within limits, contributions to an HSA made by or on behalf of an eligible individual (with the exception of contributions by the individual's employer) are deductible by the individual. For 2025, the basic limit on annual contributions that can be made to an HSA is $4,300 in the case of self-only coverage and $8,550 in the case of family coverage.[439] The basic annual contributions limits are increased by $1,000 for individuals who have attained age 55 by the end of the taxable year (referred to as "catch-up" contributions).[440] If eligible individuals are married to each other and either spouse has family coverage, both spouses are treated as having only family coverage, so that the coverage limit for family coverage applies. The contribution limit, after being reduced by the aggregate amount paid to the Archer Medical Savings Accounts ("Archer MSAs") of the spouses but without regard to any catch-up contribution amounts, is divided equally between the spouses unless they agree to a different division.[441]

If both spouses of a married couple are eligible individuals, each may contribute to an HSA, but they cannot have a joint HSA.[442] Under the rule described above, however, the spouses may divide their basic contribution limit for the year by allocating the entire amount to one spouse to be contributed to that spouse's HSA.[443] However, this allocation rule does not apply to catch-up contribution amounts. Thus, if both spouses are at least age 55 and eligible to make catch-up contributions, each must make the catch-up contribution to his or her own HSA.[444]

Description of Proposal

Under the proposal, if both spouses of a married couple are eligible for catch-up contributions (*i.e.*, both spouses are at least age 55) and either has family coverage under a high deductible health plan as of the first day of any month, the annual contribution limit that can be allocated between them (after being reduced by the aggregate amount paid to the Archer MSAs of the spouses) includes the catch-up contribution amounts of both spouses. Thus, for example,

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[439] Rev. Proc. 2022-24, 2022-20 I.R.B. 1075.

[440] Sec. 223(b)(3).

[441] Sec. 223(b)(5).

[442] Notice 2004-50, 2004-2 C.B. 196, Q&A-63.

[443] Notice 2004-50, 2004-2 C.B. 196, Q&A-32. Funds from the spouse's HSA may be used to pay qualified medical expenses for either spouse on a tax-free basis. Notice 2004-50, Q&A-36.

[444] Notice 2004-50, 2004-2 C.B. 196, Q&A-22.

the spouses may agree to have their combined basic and catch-up contribution amounts allocated to one spouse to be contributed to that spouse's HSA.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

J. FSA and HRA Terminations or Conversions to Fund HSAs

Present Law

Flexible spending arrangements

A flexible spending arrangement (an "FSA") generally is defined as a benefit program which provides employees with coverage under which specific incurred expenses may be reimbursed (subject to reimbursement maximums and other conditions) and the maximum amount of reimbursement reasonably available is less than 500 percent of the value of such coverage.[445] An FSA under a cafeteria plan[446] allows an employee to make salary reduction contributions for use in receiving reimbursements for certain incurred expenses.[447] The arrangement can also include non-elective employer contributions (known as employer flex-credits) that the employer makes available for every employee eligible to participate in the employer's cafeteria plan, to be used only for certain tax-excludable benefits (but not as cash or a taxable benefit).[448] Types of expenses that may be reimbursed under an FSA in a cafeteria plan include medical expenses (a "health FSA") and dependent care expenses.

FSAs that are funded on a salary reduction basis are subject to the requirements for cafeteria plans, including a requirement that amounts remaining in a health FSA at the end of a plan year generally must be forfeited by the employee (referred to as the "use-it-or-lose-it rule").[449] However, a cafeteria plan may allow a grace period not to exceed two and one-half months immediately following the end of the plan year during which unused amounts may be paid or reimbursed to participants for qualified expenses incurred during the grace period.[450] Alternatively, a cafeteria plan may permit up to $660 (for 2025) of unused amounts remaining in a health FSA at the end of a plan year to be paid or reimbursed to plan participants for qualifying medical expenses during the following plan year.[451] Such a carryover is not permitted in a dependent care FSA. A cafeteria plan may permit a carryover of amounts in a health FSA only if the plan does not also allow a grace period with respect to the health FSA.

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[445] See sec. 106(c)(2) and Prop. Treas. Reg. sec. 1.125-5(a).

[446] A cafeteria plan is a separate written plan of an employer under which all participants are employees, and participants are permitted to choose among at least one permitted taxable benefit (for example, current cash compensation) and at least one qualified benefit. Sec. 125(d). Qualified benefits are generally employer-provided benefits that are not includible in gross income by reason of an express provision of the Code. Sec. 125(f). Examples of qualified benefits include employer-provided health coverage (including a health FSA), group term life insurance coverage not in excess of $50,000, and benefits under a dependent care assistance program.

[447] Sec. 125 and Prop. Treas. Reg. sec. 1.125-5.

[448] Prop. Treas. Reg. sec. 1.125-5(b).

[449] Sec. 125(d)(2).

[450] Notice 2005-42, 2005-1 C.B. 1204, and Prop. Treas. Reg. sec. 1.125-1(e).

[451] Rev. Proc. 2024-40, 2024-45 I.R.B. 1100. See also Notice 2020-33, 2020-22 I.R.B. 868, May 26, 2020; Notice 2013-71, 2013-47 I.R.B. 532, November 18, 2013.

Health FSAs

In order for coverage and reimbursements under a health FSA to qualify for tax-favored treatment, the health FSA must qualify as an accident and health plan.[452] Under the Code, the value of employer-provided health coverage under an accident or health plan is generally excludable from gross income,[453] as are reimbursements under the plan for medical care expenses for employees, their spouses, and their dependents.[454] A health FSA may reimburse only medical expenses as defined in section 213(d), but may not be used to reimburse health insurance premiums.[455]

A benefit provided under a cafeteria plan through employer contributions to a health FSA is not treated as a qualified benefit unless the cafeteria plan provides that an employee may not elect salary reduction contributions in excess of $2,500, adjusted for inflation, for any taxable year.[456] For taxable year 2025, the limit is $3,300.

Health reimbursement arrangements

As described in greater detail in Section A of this Part, Health reimbursement arrangements ("HRAs") operate in a manner similar to health FSAs, in that they are employer-maintained arrangements that reimburse employees and their dependents[457] for medical expenses. Some of the rules applicable to HRAs and health FSAs are similar (e.g., the amounts in the arrangements can be used only to reimburse medical expenses), but the rules are not identical. In particular, HRAs cannot be funded on a salary reduction basis and the use-it-or-lose-it rule does not apply. Thus, amounts remaining in an HRA at the end of the year may be carried forward to be used to reimburse medical expenses in following years.[458] Unlike a health FSA, an HRA is permitted to reimburse an employee for health insurance premiums.

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[452] Secs. 105 and 106; Prop. Treas. Reg. sec. 1.125-5(k)(1).

[453] Sec. 106. Health coverage provided to active members of the uniformed services, military retirees, and their dependents are excludable from gross income under section 134. That section provides an exclusion for "qualified military benefits," defined as benefits received by reason of status or service as a member of the uniformed services and which were excludable from gross income on September 9, 1986, under any provision of law, regulation, or administrative practice then in effect.

[454] Sec. 105(b).

[455] Prop. Treas. Reg. sec. 1.125-5(k)(2).

[456] Sec. 125(i).

[457] As defined in sec. 152.

[458] Guidance with respect to HRAs, including the interaction of FSAs and HRAs in the case of an individual covered under both, is provided in Notice 2002-45, 2002-2 C.B. 93.

Health savings accounts and high deductible health plans

For a general description of HSAs and HDHPs, see Section D of this Part.

Interactions of HSAs with FSAs and HRAs

Individuals who are covered by a health plan that is not an HDHP generally are not eligible to contribute to an HSA. Under IRS guidance, a health FSA and an HRA are generally considered health plans under this definition.[459] However, FSA and HRA terminations could be used to fund HSAs within a certain period (as described further below). In addition, an individual does not fail to be an eligible individual for the purpose of making contributions to an HSA if the individual is covered under the following HSA-compatible arrangements (or some combination of the following arrangements): (1) a limited-purpose health FSA that pays or reimburses only permitted coverage or preventive care services, (2) a limited-purpose HRA that pays or reimburses benefits for permitted insurance, permitted coverage, or preventive care services, (3) a suspended HRA that does not pay or reimburse any medical expense incurred during the suspension period except permitted insurance, permitted coverage, or preventive care services, or (4) a post-deductible health FSA or HRA, which does not pay or reimburse medical expenses incurred below the minimum annual deductible for a plan to be an HDHP.[460]

If a general purpose health FSA allows reimbursement for expenses incurred during a grace period following the end of the plan year, a participant in the health FSA is generally not eligible to make contributions to an HSA until the first day of the first month following the end of the grace period.[461] However, this rule does not apply if the participant has a zero balance in the general purpose health FSA on the last day of the health FSA plan year (as determined on a cash basis[462]).[463] Thus, in that case the individual's health FSA coverage during the grace period does not cause the individual to fail to be eligible to contribute to an HSA, and the individual (if otherwise eligible) would be eligible to contribute to the HSA as of the first day after the end of the health FSA plan year. Similarly, an individual with a zero balance in a general purpose HRA, determined on a cash basis, on the last day of the HRA plan year, does not fail to be an eligible individual on the first day of the immediately following HRA plan year, as long as certain requirements are satisfied.[464] Coverage by an HSA-compatible health FSA or HRA does

[459] Rev. Rul. 2004-45, 2004-1 C.B. 971.

[460] As defined in sec. 223(c)(2)(A)(i). Rev. Rul. 2004-45, 2004-1 C.B. 971.

[461] Notice 2005-42, 2005-1 C.B. 1204.

[462] "Cash basis" means the balance as of any date, without taking into account expenses incurred that have not been reimbursed as of that date. Thus, pending claims, claims submitted, claims received or claims under review that have not been paid as of a date are not taken into account for purposes of determining the account balance as of that date.

[463] Sec. 223(c)(1)(B)(iii)(I).

[464] One of the following requirements must be satisfied: (1) effective on the first of the immediately following HRA plan year, the employee elects to waive participation in the HRA, or (2) effective on or before the first day of the following HRA plan year, the employer terminates the general purpose HRA with respect to all

not affect an employee's eligibility to contribute to an HSA, including during a health FSA grace period.[465]

FSA and HRA terminations to fund HSAs

The Health Opportunity Empowerment Act of 2006[466] amended the Code to allow for certain amounts in a health FSA or HRA to be rolled over into an HSA with favorable tax treatment ("qualified HSA distributions"). However, such distributions were permitted only for contributions made to an HSA before January 1, 2012.[467]

As implemented by the IRS, a plan implementing the provision must be amended in writing, the employee must elect the rollover, and the year-end balance must be frozen.[468] The amount of the qualified HSA distribution may not exceed the lesser of the balance in the health FSA or HRA on September 21, 2006 or the date of distribution.[469] Funds must be transferred by the employer within two and a half months after the end of the plan year and result in a zero balance in the health FSA or HRA.[470]

In addition, a qualified HSA distribution must be contributed directly to the HSA trustee by the employer.[471] Only one qualified HSA distribution is allowed with respect to each health FSA or HRA of an individual. Qualified HSA distributions are not taken into account in applying the annual limit for HSA contributions. Qualified HSA distributions are treated as rollovers, and thus are not deductible.

If an employee fails to remain HSA-eligible for 12 months (the "testing period")[472] following the distribution, the employee is not eligible directly following the distribution, and the amount of the rollover is included in gross income and is subject to an additional 20-percent tax

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employees, or (3) effective on or before the first day of the following HRA plan year, with respect to all employees, the employer converts the general purpose HRA to an HSA-compatible HRA. See Rev. Rul. 2004-45, 2004-1 C.B. 971.

465 Rev. Rul. 2004-45, 2004-1 C.B. 971.

466 The Health Opportunity Patient Empowerment Act of 2006, included in the Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, sec. 302, December 20, 2006.

467 Sec. 106(e)(2)(B).

468 Notice 2007-22, 2007-1 C.B. 670.

469 Sec. 106(e)(2)(A).

470 The IRS provided guidance on special transition relief for amounts remaining at the end of 2006. See Notice 2007-22, 2007-1 C.B. 670.

471 Sec. 106(e)(2)(B).

472 The testing period is defined to be the period beginning with the month in which the qualified HSA distribution is contributed to the HSA and ending on the last day of the 12th month following that month.

unless the individual dies or becomes disabled.[473] Failure to remain an eligible individual does not require the withdrawal of the qualified HSA distribution, and the amount is not an excess contribution.

An individual making a qualified HSA distribution from a health FSA does not fail to be eligible to participate in an HSA at the beginning of the next plan year merely because the health FSA includes a grace period, provided that the qualified HSA distribution equals the remaining balance in the FSA at the end of the FSA plan year and is made at the end of such plan year.[474]

Description of Proposal

The proposal amends the provision permitting certain amounts in a health FSA or HRA to be rolled over into an HSA by no longer requiring such rollovers to be completed by January 1, 2012. Rather, under the proposal, a "qualified HSA distribution" is a distribution from an employee's health FSA or HRA contributed directly to an employee's HSA if (1) such distribution is made in connection with the employee establishing coverage under an HDHP, and (2) during the four-year period preceding the establishment of such coverage, the employee was not covered under an HDHP. In addition, if the qualified HSA distribution is made before the end of the plan year, the health FSA or HRA from which the distribution is made must be converted to an HSA-compatible FSA or HRA, as applicable, for the portion of the plan year after the distribution is made, if the individual remains enrolled in the health FSA or HRA.

Under the proposal, the aggregate amount of qualified HSA distributions may not exceed the total annual limit on FSA contributions ($3,300 in 2025)[475] or twice this amount in the case of an eligible individual who has family coverage under an HDHP. The proposal does not limit individuals to one qualified HSA distribution, as under the prior standard. Qualified HSA distributions also reduce the amount of contributions that an individual is permitted to make to an HSA during the taxable year.[476]

The proposal also specifies that if a general purpose health FSA or HRA is converted to an HSA-compatible FSA or HRA, coverage under this health FSA or HRA for the portion of the plan year after a qualified HSA distribution is made is disregarded in determining whether the individual is eligible to make deductible contributions to an HSA.

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[473] Sec. 106(e)(3).

[474] Sec. 223(c)(1)(B)(iii)(II); Notice 2007-22, 2007-1 C.B. 670.

[475] See sec. 125(i).

[476] The deductible contribution limit with respect to an HSA is reduced by so much of any qualified HSA distribution made by an individual during the taxable year that does not exceed the aggregate increases in the balance of the arrangement from which the distribution is made that occur during the portion of the plan year preceding the distribution (other than any balance carried over to such plan year and determined without regard to any decrease in the balance during such portion of the plan year).

Finally, the proposal provides that the amount of any qualified HSA distribution is to be included on the information to be reported on Form W-2.[477]

Effective Date

The proposal is effective for distributions made after December 31, 2025.

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[477] Sec. 6051(a).

K. Special Rule for Certain Medical Expenses Incurred Before Establishment of Health Savings Account

Present Law

Health savings accounts and high deductible health plans

For a general description of HSAs and HDHPs, see Section D of this Part.

In order for a distribution from an HSA to be excludable as a payment for a qualified medical expense, the medical expense must be incurred on or after the date that the HSA is established.[478] Thus, a distribution from an HSA is not excludable as a payment for a qualified medical expense if the medical expense is incurred after a taxpayer enrolls in a high deductible health plan but before the taxpayer establishes an HSA.

Description of Proposal

Under the proposal, if an HSA is established during the 60-day period beginning on the date that an individual's coverage under an HDHP begins, then, solely for purposes of determining whether an amount paid is used for a qualified medical expense, the HSA is treated as having been established on the date that coverage under the HDHP begins. Thus, if a taxpayer establishes an HSA within 60 days of the date that the taxpayer's coverage under an HDHP begins, any distribution from an HSA used as a payment for a qualified medical expense incurred during that 60-day period after the HDHP coverage began is excludable from gross income as a payment for a qualified medical expense even though the expense was incurred before the date that the HSA was established.

Effective Date

The proposal is effective with respect to coverage beginning after December 31, 2025.

[478] Notice 2004-2, 2004-1 C.B. 269, Q&A-26.

L. Contributions Permitted If Spouse Has Health Flexible Spending Arrangement

Present Law

Flexible spending arrangements

For a description for FSAs, see Section J of this Part.

Health savings accounts and high deductible health plans

For a general description of HSAs and HDHPs, see Section D of this Part.

Description of Proposal

The proposal provides that for purposes of determining whether an individual is eligible to contribute to an HSA, coverage under the employee's spouse's health FSA for any plan year of such FSA is disregarded, provided that certain requirements are met. In order to qualify for this exception, the aggregate reimbursements under the health FSA for the plan year must not exceed the aggregate expenses that would be eligible for reimbursement under the FSA if the expenses were determined without regard to any expenses paid or incurred with respect to the otherwise HSA-eligible individual.

Effective Date

The proposal is effective for plan years beginning after December 31, 2025.

M. Increase in Health Savings Account Contribution Limitation for Certain Individuals

Present Law

Health savings accounts and high deductible health plans

For a general description of HSAs and HDHPs, see Section D of this Part.

Within limits, contributions to an HSA made by or on behalf of an eligible individual (with the exception of contributions by the individual's employer) are deductible by the individual. The annual HSA contribution limit for an individual is generally the sum of the limits determined separately for each month (*i.e.*, 1/12 of the limit for the year, including the catch-up limit, if applicable), based on the individual's status and health plan coverage as of the first day of the month.[479] For 2025, the basic limit on annual contributions that can be made to an HSA is $4,300 in the case of self-only coverage and $8,550 in the case of family coverage.[480] The basic annual contribution limits are increased by $1,000 for individuals who have attained age 55 by the end of the taxable year (referred to as "catch-up" contributions).[481]

Description of Proposal

Subject to limitations based on income, the proposal increases the limit on deductions related to aggregate HSA contributions for a year by $4,300 for taxpayers with self-only coverage and by $8,550 for those with family coverage. These amounts are subject to an inflation adjustment.

The increased amount is phased out above certain income levels.[482] For eligible individuals with self-only coverage or filing a return as a single filer, married filing separately, or head of household, the increased amount phases out ratably over a range beginning at $75,000 and ending at $100,000 of adjusted gross income. For eligible individuals with family coverage and who are filing as married filing jointly the increased amount phases out ratably over a range beginning at $150,000 and ending at $200,000 of adjusted gross income. These income limitations are subject to inflation adjustment.

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[479] Sec. 223(b).

[480] Rev. Proc. 2024-25, 2024-22 I.R.B. 1333.

[481] Sec. 223(b)(3).

[482] Sec. 223(b)(9)(B).

For purposes of the income limitation and phaseout, adjusted gross income is determined in the same manner as under section 219(g), related to retirement plan contributions, except that this amount excludes any deduction allowed for a contribution to an HSA.[483]

The increased limit applies only to the deductible amount. There is no increase in the limit for employer contributions to an employee's HSA, including contributions made under a cafeteria plan.[484]

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

[483] Under section 219(g), adjusted gross income is determined after application of sections 86 and 469, and without regard to sections 85(c), 135, 137, 221, 911, and the deduction allowed under section 219. Sec. 219(g)(3)(A). Adjusted gross income is defined in section 62.

[484] Sec. 106(d)(1).

N. Regulations

The proposal provides that the Secretary of the Treasury may prescribe such rules and other guidance as may be necessary or appropriate to carry out the amendments by this Part of Subtitle A, including proposals related to CHOICE arrangements and HSAs.

SUBTITLE B—MAKE RURAL AMERICA AND MAIN STREET GROW AGAIN

PART I—EXTENSION OF TAX CUTS AND JOBS ACT REFORMS FOR RURAL AMERICA AND MAIN STREET

A. Extension of Special Depreciation Allowance for Certain Property

Present Law

A taxpayer generally must capitalize the cost of property used in a trade or business or held for the production of income and recover the cost over time through annual deductions for depreciation or amortization.[485] The period for depreciation or amortization generally begins when the asset is placed in service by the taxpayer.[486] Tangible property generally is depreciated using the modified accelerated cost recovery system ("MACRS"), which determines depreciation for different types of property based on an assigned applicable depreciation method, recovery period, and convention.[487]

Bonus depreciation

An additional first-year depreciation deduction equal to 100 percent of the adjusted basis of qualified property[488] is allowed for property acquired after September 27, 2017,[489] and placed in service before January 1, 2023 (January 1, 2024 for certain property with a recovery period of

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[485] See secs. 263(a) and 167. In general, only the tax owner of property (i.e., the taxpayer with the benefits and burdens of ownership) is entitled to claim cost recovery deductions for the property. Where property is not used exclusively in a taxpayer's business, the amount eligible for a deduction must be reduced by the amount related to personal use. See, *e.g.*, sec. 280A.

[486] See Treas. Reg. secs. 1.167(a)-10(b), -3, -14, and 1.197-2(f). See also Treas. Reg. sec. 1.167(a)-11(e)(1)(i).

[487] Sec. 168.

[488] Sec. 168(k). The bonus depreciation deduction is generally subject to the rules regarding whether a cost must be capitalized under section 263A. For a description of section 263A, see Joint Committee on Taxation, Present Law and Background Regarding the Federal Income Taxation of Small Businesses (JCX-10-23), June 5, 2023, pp. 15-17. This document can be found on the Joint Committee on Taxation website at www.jct.gov.

[489] For a description of section 168(k) as it applies to qualified property acquired before September 28, 2017, as well as a transition rule that permits a taxpayer to elect to apply a 50-percent allowance instead of the 100 percent allowance for a taxable year that includes September 28, 2017, see Joint Committee on Taxation, *General Explanation of Public Law No. 115-97* (JCS-1-18), December 2018, pp. 115-128. This document can be found on the Joint Committee on Taxation website at www.jct.gov.

at least 10 years, or certain transportation property[490] and aircraft[491]). The 100 percent allowance is phased down by 20 percentage points per calendar year for property acquired after September 27, 2017, and placed in service after December 31, 2022 (after December 31, 2023, for longer production period property and certain aircraft).[492] This additional first-year depreciation is commonly referred to as "bonus depreciation." The bonus depreciation applicable percentages for qualified property acquired and placed in service after September 27, 2017 (as well as for specified plants which are planted or grafted after September 27, 2017 (described below)) are as follows.

Placed in Service Year[493]	**Bonus Depreciation Applicable Percentage**	
	Qualified Property in General/Specified Plants	**Longer Production Period Property and Certain Aircraft**
Sept. 28, 2017 – Dec. 31, 2022	100 percent	100 percent
2023	80 percent	100 percent
2024	60 percent	80 percent
2025	40 percent	60 percent
2026	20 percent	40 percent
2027	None	20 percent[494]
2028 and thereafter	None	None

The bonus depreciation deduction is allowed for both regular tax and alternative minimum tax purposes, but is not allowed in computing earnings and profits.[495] The basis of the property and the depreciation allowances in the placed in service year and later years are

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[490] Property qualifying for the extended placed-in-service date must have a recovery period of at least 10 years or constitute transportation property, have an estimated production period exceeding one year, and have a cost exceeding $1 million. Transportation property generally is defined as tangible personal property used in the trade or business of transporting persons or property. Sec. 168(k)(2)(B). Property defined in section 168(k)(2)(B) is hereinafter collectively referred to as "longer production period property."

[491] Certain aircraft which is not transportation property, other than for agricultural or firefighting uses, also qualifies for the extended placed-in-service date, if at the time of the contract for purchase, the purchaser made a nonrefundable deposit of the lesser of 10 percent of the cost or $100,000, and which has an estimated production period exceeding four months and a cost exceeding $200,000. Sec. 168(k)(2)(C).

[492] Sec. 168(k)(6)(A) and (B).

[493] In the case of specified plants, this is the year of planting or grafting, as discussed below.

[494] 20 percent applies to the adjusted basis attributable to its manufacture, construction, or production before January 1, 2027. The remaining adjusted basis does not qualify for bonus depreciation. 20 percent applies to the entire adjusted basis of certain aircraft described in section 168(k)(2)(C) and placed in service in 2027.

[495] Secs. 56A(c)(13), 168(k)(2)(G), and 312(k)(3).

adjusted to reflect the bonus depreciation deduction.[496] The amount of the bonus depreciation deduction is not affected by a short taxable year.[497] A taxpayer may elect out of bonus depreciation for any class of property for any taxable year.[498] An election out of bonus depreciation may be revoked only with the consent of the Secretary.[499]

Qualified property

Property qualifying for the bonus depreciation deduction must meet the following requirements:

- The property must be:
    - (1) property to which MACRS applies with an applicable recovery period of 20 years or less,
    - (2) computer software other than computer software required to be amortized under section 197,
    - (3) water utility property,[500] or
    - (4) a qualified film, television, or live theatrical production,[501] for which a deduction otherwise would have been allowable under section 181 without regard to the dollar limitation or termination of that section;[502]
- Either (i) the original use of the property must commence with the taxpayer,[503] or (ii) the property must not have been used by the taxpayer at any time before acquisition

[496] Sec. 168(k)(1).

[497] Treas. Reg. sec. 1.168(k)-2(e)(1)(ii).

[498] For the definition of a class of property, see Treas. Reg. sec. 1.168(k)-2(f)(1)(ii). Treas. Reg. sec. 1.168(k)-2(f)(1) provides the procedures for making an election not to deduct bonus depreciation.

[499] Sec. 168(k)(7). See also Treas. Reg. sec. 1.168(k)-2(f)(5).

[500] As defined in sec. 168(e)(5).

[501] As defined in sec. 181(d) and (e).

[502] Under section 181, a taxpayer may generally elect to deduct up to $15 million of the aggregate production costs ($20 million in the case of productions in certain areas) of any qualified film, television or live theatrical production, commencing prior to January 1, 2026, in the year the costs are paid or incurred by the taxpayer, in lieu of capitalizing the costs and recovering them through depreciation allowances once the production is placed in service. The costs of the production in excess of the applicable dollar limitation are capitalized and recovered under the taxpayer's method of accounting for the recovery of such property once placed in service (*e.g.*, under section 168(k) if eligible). For a description of section 181, see Joint Committee on Taxation, *General Explanation of Certain Tax Legislation Enacted in the 116th Congress* (JCS-1-22), February 2022, pp. 480-482. This document can be found on the Joint Committee on Taxation website at www.jct.gov.

[503] See Treas. Reg. sec. 1.168(k)-2(b)(3)(ii).

and the acquisition must meet the requirements of section 179(d)(2)(A)-(C) and (3),[504] and

- The property must be placed in service before January 1, 2027.[505]

The bonus depreciation deduction is not allowed for any property that is required to be depreciated under the alternative depreciation system ("ADS"),[506] or for listed property in respect of which the business use is not greater than 50 percent (as determined under section 280F(b)).[507]

In the case of longer production period property and certain aircraft, the property must also be acquired (or acquired pursuant to a written binding contract entered into) before January 1, 2027, and placed in service before January 1, 2028.[508] With respect to such property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer, the taxpayer must begin the manufacture, construction, or production of the property before January 1, 2027.[509] Additionally, a special rule limits the amount of costs of longer production period property eligible for bonus depreciation. With respect to this property, only the portion of

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[504] Thus, used property must be purchased in an arm's length transaction. The property must not be acquired (i) from a member of the taxpayer's family, including a spouse, ancestors, and lineal descendants, or from another related entity as defined in section 267; (ii) from a person who controls, is controlled by, or is under common control with, the taxpayer; nor (iii) in a nontaxable exchange such as a reorganization. The property must not be received as a gift or from a decedent. In the case of trade-ins, like-kind exchanges, or involuntary conversions, bonus depreciation applies only to any money paid in addition to the traded-in property or in excess of the adjusted basis of the replaced property. See sec. 179(d)(2)(A)-(C) and (3); Treas. Reg. secs. 1.168(k)-2(b)(3)(iii) and 1.179-4(c) and (d). A special rule applies in the case of a syndication transaction. See sec. 168(k)(2)(E)(iii); Treas. Reg. sec. 1.168(k)-2(b)(3)(vi).

[505] A qualified production is considered placed in service, and thus eligible for the bonus depreciation allowance, at the time of initial release, broadcast, or live staged performance. Sec. 168(k)(2)(H); Treas. Reg. sec. 1.168(k)-2(b)(4)(iii).

[506] See sec. 168(g) (determined without regard to an election to use ADS under section 168(g)(7)). See also Treas. Reg. sec. 1.168(k)-2(b)(2)(ii)(B). ADS is required to be used for tangible property used predominantly outside the United States, certain tax-exempt use property, tax-exempt bond financed property, certain imported property covered by an Executive order, and certain property held by either a real property trade or business or a farming business electing out of the business interest limitation under section 163(j). In addition, an election to use ADS is available to taxpayers for any class of property for any taxable year. Under ADS, all property is depreciated using the straight line method and the applicable convention over recovery periods which generally are equal to the class life of the property, with certain exceptions.

[507] Sec. 168(k)(2)(D). For a description of section 280F, see Joint Committee on Taxation, *General Explanation of Public Law No. 115-97* (JCS-1-18), December 2018, pp. 128-130. This document can be found on the Joint Committee on Taxation website at www.jct.gov.

[508] Sec. 168(k)(2)(B)(i)(II) and (III).

[509] Sec. 168(k)(2)(E)(i).

the basis that is properly attributable to the costs incurred before January 1, 2027 ("progress expenditures") is eligible for the bonus depreciation deduction.[510]

Exception for certain businesses not subject to the limitation on interest expense

Qualified property eligible for the bonus depreciation deduction does not include any property which is primarily used in the trade or business of the furnishing or sale of (1) electrical energy, water, or sewage disposal services, (2) gas or steam through a local distribution system, or (3) transportation of gas or steam by pipeline, if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, by a public service or public utility commission or other similar body of any State or political subdivision thereof, or by the governing or ratemaking body of an electric cooperative.[511]

Qualified property also does not include any property used in a trade or business that has had floor plan financing indebtedness[512] if the floor plan financing interest related to the indebtedness was taken into account to increase the taxpayer's section 163(j) interest limitation under section 163(j)(1)(C).[513]

Special rules

Passenger automobiles

The limitation under section 280F on the amount of depreciation deductions allowed with respect to certain passenger automobiles is increased in the first year by $8,000 for automobiles that qualify for (and for which the taxpayer does not elect out of) bonus depreciation.[514] While the underlying section 280F limitation is indexed for inflation,[515] the section 280F increase amount is not indexed for inflation.

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[510] Sec. 168(k)(2)(B)(ii). See also Treas. Reg. sec. 1.168(k)-2(e)(1)(iii).

[511] Secs. 168(k)(9)(A) and 163(j)(7)(A)(iv). See also Treas. Reg. sec. 1.168(k)-2(b)(2)(ii)(F).

[512] As defined in sec. 163(j)(9).

[513] Sec. 168(k)(9)(B). See also Treas. Reg. sec. 1.168(k)-2(b)(2)(ii)(G).

[514] Sec. 168(k)(2)(F). See Rev. Proc. 2019-13, 2019-09 I.R.B. 744, for a safe harbor method of accounting for determining depreciation deductions for passenger automobiles that qualify for bonus depreciation and are subject to the section 280F depreciation limitations.

[515] Sec. 280F(d)(7). See Rev. Proc. 2025-16, 2025-11 I.R.B. 1100, for the section 280F limitations that apply to passenger automobiles placed in service during calendar year 2025.

Certain plants bearing fruits and nuts

A farming business[516] is allowed a special election in respect of certain costs of planting or grafting certain plants bearing fruits and nuts.[517] Under the election, the applicable percentage of the adjusted basis of a specified plant which is planted or grafted after September 27, 2017, and before January 1, 2027, is deductible for regular tax and alternative minimum tax purposes in the year planted or grafted by the taxpayer in the ordinary course of the taxpayer's farming business (rather than in the year the specified plant is placed in service by the taxpayer[518]), and the adjusted basis is reduced by the amount of the deduction.[519] The applicable percentage is 100 percent for specified plants planted or grafted after September 27, 2017, and before January 1, 2023, and then is phased down by 20 percentage points per calendar year beginning in 2023.[520] Thus, the applicable percentage is 80 percent for 2023, 60 percent for 2024, 40 percent for 2025, and 20 percent for 2026.

A specified plant is (i) any tree or vine that bears fruits or nuts, and (ii) any other plant that will have more than one crop or yield of fruits or nuts and which generally has a pre-productive period of more than two years from the time of planting or grafting to the time it begins bearing a marketable crop or yield of fruits or nuts.[521] A specified plant does not include any property that is planted or grafted outside of the United States. If the election is made with respect to any specified plant, the plant is not treated as qualified property eligible for bonus depreciation in the subsequent taxable year in which it is placed in service.[522] Once made, the election is revocable only with the consent of the Secretary.[523]

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[516] For this purpose, the term "farming business" means the trade or business of farming, including the trade or business of operating a nursery or sod farm, the raising or harvesting of trees bearing fruit, nuts, or other crops, or ornamental trees (other than evergreen trees that are more than six years old at the time they are severed from their roots). Sec. 263A(e)(4).

[517] Sec. 168(k)(5). Treas. Reg. sec. 1.168(k)-2(f)(2) provides the procedures for making a section 168(k)(5) election.

[518] In the case of any tree or vine bearing fruits or nuts, the placed in service date generally does not occur until the tree or vine first reaches an income-producing stage. See Treas. Reg. sec. 1.46-3(d)(2). See also Rev. Rul. 80-25, 1980-1 C.B. 65; and Rev. Rul. 69-249, 1969-1 C.B. 31.

[519] Any amount deducted under this election is not subject to capitalization under section 263A. Sec. 263A(c)(7).

[520] Sec. 168(k)(6)(C).

[521] Sec. 168(k)(5)(B).

[522] Sec. 168(k)(5)(D). However, when placed in service, the remaining adjusted basis of the specified plant may be eligible for expensing under section 179.

[523] Sec. 168(k)(5)(C). See also Treas. Reg. sec. 1.168(k)-2(f)(5).

Long-term contracts – percentage-of-completion method

In general, in the case of a long-term contract, the taxable income from the contract is determined under the percentage-of-completion method.[524] Solely for purposes of determining the percentage of completion under section 460(b)(1)(A), the cost of qualified property with a MACRS recovery period of seven years or less is taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted for property placed in service before January 1, 2027 (January 1, 2028, in the case of longer production period property.[525]

Description of Proposal

The proposal extends and modifies the additional first-year depreciation deduction through 2029 (through 2030 for longer production period property and certain aircraft). The allowance is increased to 100 percent for property acquired and placed in service after January 19, 2025, and before January 1, 2030 (January 1, 2031, for longer production period property and certain aircraft),[526] as well as for specified plants planted or grafted after January 19, 2025, and before January 1, 2030.

The proposal makes permanent the rules under the percentage-of-completion method for the allocation of bonus depreciation to a long-term contract.

Effective Date

The proposal generally applies to property acquired[527] and placed in service after January 19, 2025, and to specified plants planted or grafted after such date.

[524] Sec. 460.

[525] Sec. 460(c)(6).

[526] One-hundred percent bonus depreciation applies to the adjusted basis attributable to manufacture, construction, or production before January 1, 2030, and the remaining adjusted basis does not qualify for bonus depreciation.

[527] Property is treated as acquired not after the date on which a written binding contract is entered into for such acquisition. See Treas. Reg. sec. 1.168(k)-2(b)(5).

B. Deduction of Domestic Research and Experimental Expenditures

Present Law

For taxable years beginning after December 31, 2021, taxpayers must capitalize and amortize specified research or experimental expenditures ratably over a five-year period (or, in the case of expenditures attributable to research that is conducted outside of the United States, over a 15-year period),[528] beginning with the midpoint of the taxable year in which those costs are paid or incurred.[529] Specified research or experimental expenditures are research or experimental expenditures paid or incurred in connection with a taxpayer's trade or business.[530]

Research or experimental expenditures generally include all costs incurred in the experimental or laboratory sense incident to developing or improving a product,[531] including software.[532] Qualifying experimental or laboratory activities are those intended to discover information that eliminates uncertainty concerning product development or improvement.[533] Uncertainty exists when information available to the taxpayer is insufficient to ascertain the capability or method for developing, improving, or appropriately designing the product.[534]

Whether expenditures qualify as research depends on the nature of the activity to which the costs relate, not the nature of the product or improvement or the level of technological advancement.[535] The ultimate success, failure, sale, or other use of research or property is irrelevant.[536] Examples of qualifying costs include salaries for those engaged in research or experimentation efforts, overhead incurred to operate and maintain research facilities (*e.g.*,

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[528] For this purpose, the term "United States" includes the United States, the Commonwealth of Puerto Rico, and any possession of the United States. Sec. 174(a)(2)(B), by reference to sec. 41(d)(4)(F).

[529] Sec. 174(a)(2)(B).

[530] Sec. 174(b).

[531] Treas. Reg. sec. 1.174-2(a)(1) and (2). Product is defined to include any pilot model, process, formula, invention, technique, patent, or similar property, and includes products to be used by the taxpayer in its trade or business as well as products to be held for sale, lease, or license. Treas. Reg. sec. 1.174-2(a)(11), Example 10, provides an example of new process development costs for which the cost recovery rules of section 174 apply.

[532] Sec. 174(c)(3).

[533] Treas. Reg. sec. 1.174-2(a)(1).

[534] *Ibid.*

[535] *Ibid.*

[536] *Ibid.*

utilities, depreciation, and rent), and materials and supplies used and consumed in the course of research or experimentation (including amounts incurred in conducting trials).[537]

Research or experimental expenditures exclude expenditures for (1) quality control testing;[538] (2) efficiency surveys; (3) management studies; (4) consumer surveys; (5) advertising or promotions; (6) the acquisition of another's patent, model, production, or process; or (7) research in connection with literary, historical, or similar projects.[539] Also excluded are expenditures incurred to acquire or improve land, for depreciable or depletable property used in connection with the research or experimentation,[540] and exploration expenditures incurred for ore or other minerals (including oil and gas).[541]

In the case of retired, abandoned, or disposed property with respect to which specified research or experimental expenditures are paid or incurred, any remaining basis may not be recovered in the year of retirement, abandonment, or disposal, but instead must continue to be amortized over the remaining recovery period.[542]

If a taxpayer's research credit under section 41 exceeds the amount allowed as a deduction under section 174 for that taxable year, the taxpayer must reduce the amount chargeable to capital account by that excess amount.[543] A taxpayer may instead elect to claim a reduced research credit amount under section 41.[544] Under this election, the research credit is reduced by an amount equal to the amount of the credit multiplied by the highest corporate tax rate.[545]

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[537] See Treas. Reg. sec. 1.174-4(c). The definition of research or experimental expenditures also includes the costs to obtain a patent such as attorneys' fees incurred to make and perfect a patent application. Treas. Reg. sec. 1.174-2(a)(1).

[538] Quality control testing means testing to determine whether units of materials or products conform to specified parameters but does not include testing to determine if the design of the product is appropriate. Treas. Reg. sec. 1.174-2(a)(7).

[539] Treas. Reg. sec. 1.174-2(a)(6).

[540] Sec. 174(c)(3). However, depreciation and depletion allowances may be considered section 174 expenditures. *Ibid*.

[541] Sec. 174(c)(2).

[542] Sec. 174(d).

[543] Sec. 280C(c)(1).

[544] Sec. 280C(c)(2)(A).

[545] Sec. 280C(c)(2)(B).

Research or experimental expenditures under section 174 are not required to be capitalized under either section 263(a)[546] or section 263A.[547]

Description of Proposal

The proposal suspends required capitalization of domestic research or experimental expenditures for amounts paid or incurred in taxable years beginning after December 31, 2024, and before January 1, 2030. Under the proposal, taxpayers may (1) deduct domestic research or experimental expenditures,[548] (2) elect to capitalize and recover domestic research or experimental expenditures ratably over the useful life of the research (but in no case less than 60 months)[549] beginning with the midpoint of the taxable year in which such expenditures are paid or incurred, or (3) elect to capitalize and recover domestic research or experimental expenditures over 10 years beginning with the taxable year of the expenditure.[550] Taxpayers must continue to capitalize and amortize foreign research or experimental expenditures over 15 years[551] beginning with the midpoint of the taxable year in which they pay or incur the expenditures.

Taxpayers may recover domestic capitalized research or experimental expenditures upon the disposition, retirement, or abandonment with respect to which such expenditures are paid or incurred. However, taxpayers may not recover foreign capitalized research or experimental expenditures, either as a deduction or a reduction to the amount realized for any property disposed, retired, or abandoned after the date of introduction (*i.e.*, May 12, 2025).[552]

The proposal requires taxpayers to reduce their domestic research or experimental expenditures (whether expensed or capitalized) by the amount of the research credit allowed under section 41 for taxable years beginning after December 31, 2024, and before January 1,

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[546] Sec. 263(a)(1)(B).

[547] Sec. 263A(c)(2).

[548] The proposal defines "domestic research or experimental expenditures" as research or experimental expenditures paid or incurred by the taxpayer in connection with its trade or business that are not attributable to foreign research as defined by section 41(d)(4)(F) (*i.e.*, any research conducted outside the United States, the Commonwealth of Puerto Rico, or any possession of the United States).

[549] The election does not apply to property subject to the depreciation allowance under section 167 or depletion under section 611.

[550] Taxpayer may only recover domestic research or experimental expenditures charged to capital account under the rules of proposed section 174A(c) or section 59(e)(2). After the provision terminates, taxpayers will be required to capitalize domestic research or experimental expenditures and recover them over five years beginning with the midpoint of the taxable year in which such expenditures are paid or incurred under section 174(a)(2).

[551] The proposal clarifies that taxpayers must recover both domestic and foreign research or experimental expenditures over 10 years for alternative minimum tax purposes under section 56(b)(2).

[552] The modification to the disposition rule in section 174(d) is permanent.

2030.[553] Similar to current law, taxpayers may instead elect to claim a reduced section 41 research credit.

The proposal treats the requirement to capitalize and amortize research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2029 (*i.e.*, after the temporary provision terminates), as an automatic accounting method change on a cutoff basis (*i.e.*, no section 481(a) catch-up adjustment).

Effective Date

The proposal is generally effective for amounts paid or incurred in taxable years beginning after December 31, 2024, and before January 1, 2030. The conforming amendments, apart from the change to section 280C(c), are permanent.

A transition rule requires taxpayers to adopt the changes to domestic research or experimental expenditures as an automatic accounting method change on a cutoff basis for taxable years beginning after December 31, 2024. The proposal authorizes the Secretary to prescribe rules for short taxable years that begin after December 31, 2024, and end before the date of enactment.

[553] Assume that a taxpayer (1) elects to capitalize and amortize $1,000 of domestic research or experimental expenditures and (2) claims a $100 section 41 research credit. Absent an election under proposed section 280C(c)(2), the taxpayer must reduce the amount it charges to capital account to $900 ($1,000 less $100 credit). Similarly, a taxpayer that opts to expense domestic research or experimental expenditures must reduce the amount it expenses to $900 ($1,000 less $100 credit).

C. Modified Calculation of Adjusted Taxable Income for Purposes of Business Interest Deduction

Present Law

Limitation on deduction of business interest expense

Interest paid or accrued by a business generally is deductible in the computation of taxable income, subject to a number of limitations.[554] The deduction for business interest expense[555] is generally limited to the sum of (1) business interest income of the taxpayer for the taxable year,[556] (2) 30 percent of the adjusted taxable income of the taxpayer for the taxable year (not less than zero), and (3) the floor plan financing interest[557] of the taxpayer for the taxable year.[558] Thus, other than floor plan financing interest, business interest expense in excess of business interest income is generally deductible only to the extent of 30 percent of adjusted taxable income.[559]

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[554] Sec. 163(a). Interest deductions limitations that are not described in this document include: denial of the deduction for the disqualified portion of the original issue discount on an applicable high yield discount obligation (sec. 163(e)(5)), denial of deduction for interest on certain obligations not in registered form (sec. 163(f)), reduction of the deduction for interest on indebtedness with respect to which a mortgage credit certificate has been issued under section 25 (sec. 163(g)), disallowance of deduction for interest on debt with respect to certain life insurance contracts (sec. 264(a)), and disallowance of deduction for interest relating to tax-exempt income (sec. 265(a)(2)). In some circumstances, interest expense is required to be capitalized. See, *e.g.*, secs. 263A(f) (capitalization of interest incurred to produce certain tangible property) and 263(g) (capitalization of certain interest and carrying costs in the case of straddles). Section 385 also recharacterizes as equity some instruments that are purported to be indebtedness with the results that payments on the interest are treated as nondeductible dividends rather than deductible interest.

[555] Business interest means any interest paid or accrued on indebtedness properly allocable to a trade or business and does not include investment interest (within the meaning of section 163(d)). Sec. 163(j)(5). Section 163(j) applies only to business interest that would otherwise be deductible in the current taxable year, absent the application of section 163(j). Treas. Reg. sec. 1.163(j)-3(b)(1). Thus, section 163(j) applies after the application of provisions that subject interest to deferral, capitalization, or other limitation (*e.g.*, sections 163(e)(3), 163(e)(5)(A)(ii), 246A, 263A, 263(g), 267, 1277, and 1282), but before application of sections 461(l), 465, and 469. See Treas. Reg. sec. 1.163(j)-3(b)(2)-(6).

[556] Business interest income means the amount of interest includible in the gross income of the taxpayer for the taxable year that is properly allocable to a trade or business and does not include investment income (within the meaning of section 163(d)). Sec. 163(j)(6).

[557] Floor plan financing interest means interest paid or accrued on floor plan financing indebtedness. Floor plan financing indebtedness means indebtedness used to finance the acquisition of motor vehicles held for sale or lease to retail customers and secured by the inventory so acquired. A motor vehicle means a motor vehicle that is: (1) any self-propelled vehicle designed for transporting person or property on a public street, highway, or road; (2) a boat; or (3) farm machinery or equipment. Sec. 163(j)(9).

[558] These rules were modified for taxable years beginning in 2019 or 2020 to permit certain taxpayers to deduct more business interest than would be allowed under the rules described herein. See sec. 163(j)(10).

[559] The business interest limitation does not apply in certain cases. The business interest limitation does not apply to any taxpayer (other than a tax shelter prohibited from using the cash method under section 448(a)(3)) that meets the $25 million gross receipts test of section 448(c). At a taxpayer's election, (1) any real property

The limitation generally applies at the taxpayer level (although special rules apply in the case of partnerships, described below). In the case of a group of affiliated corporations that file a consolidated return, the limitation applies at the consolidated tax return filing level.[560] The amount of any business interest expense not allowed as a deduction for any taxable year is generally treated as business interest expense paid or accrued by the taxpayer in the succeeding taxable year. This business interest expense may be carried forward indefinitely.[561]

Application to passthrough entities

In general

In the case of a partnership, the section 163(j) interest limitation is generally applied at the partnership level.[562] A partner generally must apply section 163(j) separately to any business interest expense it incurs. To prevent double counting, the business interest income and adjusted taxable income of each partner are generally determined without regard to the partner's distributive share of any items of income, gain, deduction, or loss of the partnership.[563] However, in cases in which the partnership has an excess amount of business interest income, an excess amount of adjusted taxable income, or both, section 163(j) partnership items generally may support additional business interest expense deductions by the partnership's partners. Specifically, a partner's business interest deduction limitation is increased by the sum of the partner's distributive share of the partnership's excess business interest income and 30 percent of the partner's distributive share of the partnership's excess taxable income.[564]

Similar rules apply to an S corporation and its shareholders.[565]

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development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business (referred to as an "electing real property trade or business") or (2) any farming business or any business engaged in the trade or business of a specified agricultural or horticultural cooperative (referred to as an "electing farming business") is not treated as a trade or business for purposes of the limitation. The limitation does not apply to certain regulated public utilities. See sec. 163(j)(7).

[560] See Treas. Reg. sec. 1.163(j)-4(d) (providing that a consolidated group has a single sec. 163(j) limitation and generally treating all members of the consolidated group as a single taxpayer for sec. 163(j) purposes).

[561] Sec. 163(j)(2). With respect to corporations, any carryforward of disallowed business interest of a corporation is an item taken into account in the case of certain corporate acquisitions described in section 381 and is subject to limitation under section 382. Secs. 381(c)(20) and 382(d)(3).

[562] Sec. 163(j)(4)(A)(i).

[563] Sec. 163(j)(4)(A)(ii)(I); Treas. Reg. sec. 1.163(j)-6(e)(1).

[564] Sec. 163(j)(4)(A)(ii)(II); Treas. Reg. sec. 1.163(j)-6(e)(1).

[565] Sec. 163(j)(4)(D).

Carryforward rules for partnerships

Special rules for the carryforward of disallowed business interest expense apply only to partnerships and their partners.[566] In the case of a partnership, the general taxpayer-level carryforward rule does not apply. Instead, any business interest expense that is not allowed as a deduction to the partnership for the taxable year (referred to as "excess business interest expense") is allocated to the partners.[567] A partner may not deduct excess business interest expense in the year in which it is allocated to a partner. A partner may deduct its share of the partnership's excess business interest expense in any future year, but only in an amount that is based on the partner's distributive share of excess business interest income and excess taxable income of the partnership the activities of which gave rise to the disallowed business interest expense carryforward.[568] Any amount that is not allowed as a deduction generally continues to be carried forward.[569]

When excess business interest expense is allocated to a partner, the partner's basis in its partnership interest is reduced (but not below zero) by the amount of the allocation, even though the excess business interest expense does not give rise to a deduction in the year of the basis reduction.[570] The partner's deduction in a subsequent year for excess business interest expense does not reduce the partner's basis in its partnership interest. If the partner disposes of a partnership interest the basis of which has been reduced by an allocation of excess business interest expense, the partner's basis in the interest is increased immediately before the disposition by the amount by which the basis reduction exceeds any amount of excess business interest expense that has been treated as business interest expense paid or accrued by the partner as a result of an allocation of excess business interest income or excess taxable income by the same partnership.[571] This rule applies to both total and (on a proportionate basis) partial dispositions of a partnership interest.[572]

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[566] Sec. 163(j)(4)(B).

[567] Sec. 163(j)(4)(B)(i)(II).

[568] Sec. 163(j)(4)(B)(ii)(I); Treas. Reg. sec. 1.163(j)-6(g)(2). See also Joint Committee on Taxation, *General Explanation of Public Law 115–97* (JCS–1–18), December 2018, pp. 175-178 (describing section 163(j)(4) as it was intended to work).

[569] Sec. 163(j)(4)(B)(ii)(II).

[570] Sec. 163(j)(4)(B)(iii)(I); Treas. Reg. sec. 1.163(j)-6(h)(2).

[571] Sec. 163(j)(4)(B)(iii)(II); Treas. Reg. sec. 1.163(j)-6(h)(3). The special rule for dispositions also applies to transfers of a partnership interest (including by reason of death) in transactions in which gain is not recognized in whole or in part. *Id*. No deduction is allowed to the transferor or transferee for any disallowed business interest resulting in a basis increase under this rule. *Id*.

[572] *Ibid*.

The special carryforward rules do not apply to S corporations or their shareholders.[573] Rather, any disallowed business interest expense is carried forward by the S corporation (as opposed to the shareholder) to the succeeding taxable year.[574]

Adjusted taxable income

For purposes of the section 163(j) interest limitation, adjusted taxable income means the taxable income of the taxpayer computed without regard to: (1) any item of income, gain, deduction, or loss that is not properly allocable to a trade or business; (2) any business interest or business interest income; (3) the amount of any net operating loss deduction; or (4) the amount of any deduction allowed under section 199A.

For taxable years beginning before January 1, 2022, adjusted taxable income also is computed without regard to any deduction allowable for depreciation, amortization, or depletion.[575] This definition of adjusted taxable income generally corresponds with the financial accounting concept of earnings before interest, taxes, depreciation, and amortization, or "EBITDA" (hereinafter referred to as the "EBITDA limitation").

For taxable years beginning after December 31, 2021, adjusted taxable income is computed to include deductions allowable for depreciation, amortization, or depletion. This definition of adjusted taxable income generally corresponds with the financial accounting concept of earnings before interest and taxes, or "EBIT."

Description of Proposal

The proposal reinstates the EBITDA limitation under section 163(j) for taxable years beginning after December 31, 2024, and before January 1, 2030. Therefore, for purposes of the section 163(j) interest deduction limitation for these years, adjusted taxable income is computed without regard to the deduction for depreciation, amortization, or depletion.

The proposal also modifies the definition of "motor vehicle," for purposes of the floor plan financing interest and floor plan financing indebtedness definitions, to include any trailer or camper which is designed to provide temporary living quarters for recreational, camping, or seasonal use and is designed to be towed by, or affixed to, a motor vehicle.

The proposal allows the Secretary of Treasury to provide such rules as are necessary or appropriate to provide for the application of the proposal for taxable years of less than 12 months that begin after the effective date and end before the date of enactment.

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[573] Sec. 163(j)(4)(D).

[574] Treas. Reg. sec. 1.163(j)-6(l)(5).

[575] Sec. 163(j)(8)(A). Treasury regulations provide other adjustments to the definition of adjusted taxable income. Sec. 163(j)(8)(B); Treas. Reg. sec. 1.163(j)-1(b)(1).

Effective Date

The proposal applies to taxable years beginning after December 31, 2024. The Secretary of Treasury may provide such rules as are necessary or appropriate to provide for the application of the proposal for taxable years of less than 12 months that begin after December 31, 2024, and end before the date of enactment.

D. Extension of Deduction for Foreign-Derived Intangible Income and Global Intangible Low-Taxed Income

Present Law

Global intangible low-taxed income ("GILTI")

A U.S. shareholder of a controlled foreign corporation ("CFC")[576] must include in gross income its GILTI. GILTI is the excess of the shareholder's net CFC tested income over the shareholder's net deemed tangible income return. The shareholder's net deemed tangible income return equals the excess of 10 percent of the aggregate of its pro rata share of the qualified business asset investment ("QBAI") of each CFC over certain interest expense.

The formula for GILTI is:

GILTI = Net CFC Tested Income - [(10% × QBAI) - Interest Expense]

Net CFC tested income

Net CFC tested income means the excess of the aggregate of a U.S. shareholder's pro rata share of the tested income of each CFC over the aggregate of its pro rata share of the tested loss of each CFC.[577] In other words, GILTI is calculated on a worldwide basis.

The tested income of a CFC is the excess of the gross income of the CFC determined without regard to certain amounts that are exceptions to tested income (referred to in this document as "gross tested income") over deductions (including taxes) properly allocable to such gross tested income. The exceptions to tested income are: (1) any effectively connected income described in section 952(b); (2) any gross income taken into account in determining the CFC's subpart F income;[578] (3) any gross income excluded from foreign base company income or insurance income by reason of the high-tax exception under section 954(b)(4);[579] (4) any

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[576] U.S. shareholders are U.S. persons that own at least 10 percent (measured by vote or value) of the stock of a foreign corporation. A CFC generally is any foreign corporation in which U.S. shareholders own (directly, indirectly, or constructively) more than 50 percent of the corporation's stock (measured by vote or value). See secs. 951(b), 957, 958.

[577] Sec. 951A(c)(1). Pro rata shares are determined under subpart F principles (*i.e.*, the rules of section 951(a)(2) and the regulations thereunder).

[578] Earnings of a CFC may constitute income to U.S. shareholders under the traditional anti-deferral regime of subpart F of the Code, which applies to certain passive income and certain other related-party income that is readily movable from one jurisdiction to another. Subpart F income is taxed at full rates with related foreign income taxes generally eligible for the foreign tax credit.

[579] In general, if a taxpayer so elects, subpart F income and tested income for purposes of determining GILTI inclusions exclude any item of income if the taxpayer establishes that the income was subject to an effective foreign income tax rate greater than 90 percent of the maximum U.S. corporate income tax rate (*i.e.*, currently greater than 90 percent of 21 percent, or 18.9 percent). See sec. 954(b)(4) and Treas. Reg. secs. 1.954-1(d) and 1.951A-2(c)(7).

dividend received from a related person (as defined in section 954(d)(3)); and (5) any foreign oil and gas extraction income (as defined in section 907(c)(1)).

The tested loss of a CFC means the excess of deductions (including taxes) properly allocable to the CFC's gross tested income over the amount of such gross tested income.

Qualified business asset investment

QBAI means, with respect to any CFC for a taxable year, the average of the aggregate of the CFC's adjusted basis in specified tangible property that is both used in its trade or business and of a type with respect to which a deduction is generally allowable under section 167.[580]

Specified tangible property means any property used in the production of tested income.[581]

Preferential rate on GILTI

A preferential rate on GILTI is achieved by allowing corporations a deduction equal to 50 percent[582] of their GILTI (including the corresponding section 78 gross-up amount).[583] For taxable years beginning after December 31, 2025, the deduction for GILTI is reduced to 37.5 percent.[584]

Basis adjustments

A U.S. shareholder's basis in the stock of a CFC (and basis in property by reason of which the U.S. shareholder is treated as owning stock of the CFC) is increased by the amount of the shareholder's subpart F and GILTI inclusions in respect of the CFC stock (but not any section 78 gross-up amounts). The basis in the stock is decreased by the amount of any distributions received from the CFC that are excluded from the shareholder's income as previously taxed income and, for purposes of determining the amount of loss on a disposition of the stock of the CFC, the amount of any dividends-received deductions ("DRDs") under section 245A (unless the basis was already reduced for any such DRD under section 1059).[585]

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[580] Sec. 951A(d)(1).

[581] Sec. 951A(d)(2). Specified tangible property does not include property used in the production of tested loss; thus, a CFC with a tested loss in a taxable year does not have QBAI for such taxable year.

[582] In other words, for taxable years beginning before January 1, 2026, the effective U.S. tax rate (*i.e.*, taking into account the effect of the deduction) on GILTI is 10.5 percent.

[583] Sec. 250(a)(1)(B). Under section 78, a taxpayer claiming the foreign tax credit with respect to foreign-source income generally must include in income the amount of the related foreign taxes paid.

[584] Sec. 250(a)(3)(B). For taxable years beginning after December 31, 2025, the effective U.S. tax rate on GILTI rises to 13.125 percent.

[585] Secs. 951A(f)(1)(A), 961(a), (b), and (d). Similar rules apply to dividends and deemed dividends from lower-tier CFCs. See secs. 961(c) and 964(e)(4).

Foreign tax credit

Subject to certain limitations, U.S. citizens or resident individuals, as well as domestic corporations, are allowed a credit for foreign income taxes paid. In addition, a domestic corporation is allowed a credit for foreign income taxes paid by a CFC with respect to income included by the corporation as subpart F income and GILTI; such taxes are deemed to have been paid by the domestic corporation for purposes of calculating the foreign tax credit.[586]

The foreign tax credit generally is limited to a taxpayer's U.S. tax liability on its foreign-source taxable income. The limit is intended to ensure that the credit mitigates double taxation of foreign-source income without offsetting U.S. tax on U.S.-source income.[587] Generally, the limit is computed by multiplying a taxpayer's total pre-credit U.S. tax liability for the year by the ratio of the taxpayer's foreign-source taxable income for the year to the taxpayer's total taxable income for the year.[588] This limitation is applied separately to different categories of foreign-source income (as discussed below). If the total amount of foreign income taxes paid and deemed paid for the year exceeds the taxpayer's foreign tax credit limitation for the year, the taxpayer may (in certain cases) carry back the excess foreign taxes to the previous year or carry forward to any of the succeeding 10 years.[589] No carryback or carryover of excess foreign tax credits are allowed in the GILTI foreign tax credit limitation category (as discussed below).

Deemed-paid taxes

For any subpart F income included in the gross income of a domestic corporation, the corporation is deemed to have paid foreign taxes equal to the aggregate foreign income taxes paid or accrued with respect to such income by the CFC.[590]

For any GILTI included in the gross income of a domestic corporation, the corporation is deemed to have paid foreign taxes equal to 80 percent of the corporation's inclusion percentage multiplied by the aggregate foreign income taxes paid or accrued with respect to tested income (but not tested loss) by each CFC with respect to which the domestic corporation is a U.S. shareholder.[591]

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[586] Secs. 901 and 960.

[587] Secs. 901 and 904.

[588] Sec. 904(a).

[589] Sec. 904(c).

[590] Sec. 960(a).

[591] Sec. 960(d)(1). The inclusion percentage means, with respect to any domestic corporation, the ratio of such corporation's GILTI divided by the aggregate amount of its pro rata share of the tested income (but not tested loss) of each CFC with respect to which it is a U.S. shareholder.

Allocation and apportionment of expenses

To determine its foreign tax credit limitation, a taxpayer must first determine its taxable income from foreign sources by allocating and apportioning deductions between U.S.-source gross income and foreign-source gross income in each limitation category. In general, deductions are allocated and apportioned to the gross income to which the deductions factually relate.[592] However, subject to certain exceptions, deductions for interest expense, stewardship expenses, and research and experimental expenses, as well as certain other deductions, are apportioned based on certain ratios.[593] For example, interest expense is apportioned based on the ratio of the corporation's foreign or domestic (as applicable) assets to its worldwide assets.[594]

Limitation categories ("baskets")

The foreign tax credit limitation is applied separately to GILTI, foreign branch income,[595] passive category income, and general category income.[596] For this purpose, GILTI and foreign branch income include only income that is not passive category income. Passive category income includes passive income, such as portfolio interest and dividend income, and certain other specified types of income.[597] Dividends (and subpart F inclusions), interest, rents, and royalties received by a U.S. shareholder from a CFC are assigned to the passive category to the extent the payments or inclusions are allocable to passive category income of the CFC.[598] Dividends received by a 10-percent corporate shareholder of a foreign corporation that is not a CFC are also categorized on a look-through basis.[599] All other income (*i.e.*, income other than GILTI, foreign branch, and passive income) is in the general category. Passive income is treated as general category income if earned by a qualifying financial services entity or if highly taxed (*i.e.*, if the foreign tax rate is determined to exceed the highest tax rate specified in section 1 or 11, as applicable).[600]

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[592] Treas. Reg. sec. 1.861-8(b) and (c) and Temp. Treas. Reg. sec. 1.861-8T(c).

[593] Treas. Reg. sec. 1.861-8 through Temp. Treas. Reg. sec. 1.861-14T and Treas. Reg. sec. 1.861-17 set forth detailed rules relating to the allocation and apportionment of expenses.

[594] Sec. 864(e)(2).

[595] Foreign branch income is defined for this purpose as "the business profits of [the U.S. taxpayer] which are attributable to 1 or more qualified business units (as defined in section 989(a)) in 1 or more foreign countries." Sec. 904(d)(2)(J).

[596] Sec. 904(d); Treas. Reg. sec. 1.904-4(a). The foreign tax credit limitation is also applied separately to certain additional separate categories. See Treas. Reg. sec. 1.904-4(m).

[597] Sec. 904(d)(2)(A)(i) and (B).

[598] Sec. 904(d)(3).

[599] Sec. 904(d)(4).

[600] Sec. 904(d)(2)(B).

Special rules apply to the allocation of income and losses from foreign and U.S. sources within each category of income.[601] Foreign losses from one category first offset foreign-source income from other categories. Any remaining overall foreign loss offsets U.S.-source income. The same principle applies to losses from U.S. sources. In subsequent years, any losses deducted against another category or source of income are recaptured. That is, an equal amount of income from the same category or source that generated a loss in a prior year is recharacterized as income from the other category or source against which the loss was deducted. Foreign-source income in a particular category may be fully recharacterized as income in another category, whereas only up to 50 percent of income from one source in any subsequent year may be recharacterized as income from the other source.

A taxpayer's ability to claim a foreign tax credit may be further limited by a matching rule that prevents the separation of creditable foreign taxes from the associated foreign income. Under this rule, a foreign tax generally is not taken into account for U.S. tax purposes, and thus no foreign tax credit is available with respect to that foreign tax, until the taxable year in which the related income is taken into account for U.S. tax purposes.[602]

Foreign-Derived Intangible Income ("FDII")

Domestic corporations generally are taxed at preferential rates on their foreign-derived intangible income ("FDII").[603] The preferential rate is achieved by allowing corporations a deduction equal to 37.5 percent of their FDII.[604] For taxable years beginning after December 31, 2025, the deduction for FDII is reduced to 21.875 percent.[605]

FDII is calculated by multiplying a corporation's "deemed intangible income" by the percentage of its "deduction eligible income" that is derived from serving foreign markets (*i.e.*, "foreign-derived deduction eligible income").[606] A corporation's deemed intangible income equals the excess, if any, of its deduction eligible income over a 10-percent return on its qualified business asset investment ("QBAI").[607] The formula for FDII can be expressed as the following:

$$FDII = [Deduction\ Eligible\ Income - (10\% \times QBAI)] \times \frac{Foreign\ Derived\ Deduction\ Eligible\ Income}{Deduction\ Eligible\ Income}$$

[601] Sec. 904(f) and (g).

[602] Sec. 909.

[603] Sec. 250(a)(1)(A).

[604] Sec. 250(a)(1)(A). For taxable years beginning before January 1, 2026, the effective U.S. tax rate (*i.e.*, taking into account the effect of the deduction) on FDII is 13.125 percent.

[605] Sec. 250(a)(3)(A). For taxable years beginning after December 31, 2025, the effective U.S. tax rate on FDII is 16.406 percent.

[606] Sec. 250(b)(1).

[607] Sec. 250(b)(2). If the quantity in this formula is negative, deemed intangible income is zero.

For purposes of computing FDII, a domestic corporation's QBAI is the average of the aggregate of its adjusted basis, determined as of the close of each quarter of the taxable year, in specified tangible property[608] used in its trade or business and of a type with respect to which a deduction is allowable under section 167.[609] The adjusted basis in any property generally must be determined using the alternative depreciation system under section 168(g) as in effect on December 22, 2017.

Deduction eligible income and foreign-derived deduction eligible income

Deduction eligible income means, with respect to any domestic corporation, the excess (if any) of the gross income of the corporation determined without regard to certain amounts that are excluded from deduction eligible income over deductions (including taxes) properly allocable to such gross income.[610]

Foreign-derived deduction eligible income means, with respect to a taxpayer for its taxable year, any deduction eligible income of the taxpayer that is derived in connection with (1) property that is sold[611] by the taxpayer to any person who is not a U.S. person and that the taxpayer establishes to the satisfaction of the Secretary is for a foreign use[612] or (2) services provided by the taxpayer that the taxpayer establishes to the satisfaction of the Secretary are provided to any person, or with respect to property, not located within the United States.[613]

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[608] Specified tangible property means any tangible property used in the production of deduction eligible income. For this reason, the adjusted basis of tangible depreciable property held by a foreign branch generally is excluded from QBAI because foreign branch income is excluded from gross deduction eligible income.

[609] The definition of QBAI for purposes of computing FDII relies on the definition of QBAI for purposes of computing GILTI under section 951A(d), determined by substituting "deduction eligible income" for "tested income" in section 951A(d)(2) and without regard to whether the corporation is a controlled foreign corporation. Sec. 250(b)(2)(B).

[610] Sec. 250(b)(3)(A). The amounts excluded from deduction eligible income are: (1) subpart F income; (2) GILTI; (3) financial services income; (4) any dividend received from a CFC with respect to which the corporation is a U.S. shareholder; (5) any domestic oil and gas extraction income of the corporation; and (6) any foreign branch income.

[611] For purposes of determining FDII, the terms "sold," "sells," and "sale" include any lease, license, exchange, or other disposition. Sec. 250(b)(5)(E).

[612] If property is sold by a taxpayer to a person who is not a U.S. person and after such sale the property is subject to manufacture, assembly, or other processing (including the incorporation of such property, as a component, into a second product by means of production, manufacture, or assembly) outside the United States by such person, then the property is for a foreign use.

[613] Sec. 250(b)(4).

Foreign use means any use, consumption, or disposition that is not within the United States.[614] Special rules for determining foreign use apply to transactions that involve property or services provided to domestic intermediaries or to certain related parties.[615]

Special rules apply with respect to property or services provided to domestic intermediaries[616] and with respect to certain related party transactions.[617]

Taxable income limitation on deduction for GILTI and FDII

If the sum of a domestic corporation's FDII and GILTI (including GILTI-attributable section 78 gross-up amounts) exceeds its taxable income determined without regard to this provision, then the amount of FDII and GILTI (including GILTI-attributable section 78 gross-up) for which a deduction is allowed is reduced (but not below zero) by an amount determined by such excess.[618]

Description of Proposal

The proposal lowers the preferential rates on GILTI and FDII by increasing the deduction for corporations for taxable years beginning after December 31, 2025, from 37.5 percent to 50 percent of their GILTI (including the corresponding section 78 gross-up amount) and from 21.875 percent to 37.5 percent of their FDII.

Effective Date

The provision is effective for taxable years beginning after December 31, 2025

[614] Sec. 250(b)(5)(A).

[615] Sec. 250(b)(5)(B) and (C).

[616] Sec. 250(b)(5)(B).

[617] Sec. 250(b)(5)(C).

[618] Sec. 250(a)(2).

E. Extension of Base Erosion Minimum Tax Amount

Present Law

The base erosion and anti-abuse tax (the "BEAT") is an additional tax imposed on certain corporations that are members of a multinational group with respect to payments to foreign affiliates.[619]

The BEAT applies only to corporate taxpayers that are members of an aggregate group with average gross receipts in excess of $500 million and is determined, in part, by the extent to which a taxpayer has made payments to foreign related parties.[620] The BEAT generally does not apply to taxpayers that are members of an aggregate group for which reductions to taxable income ("base erosion tax benefits") arising from payments to foreign related parties ("base erosion payments") are less than three percent of total deductions (*i.e.*, a "base erosion percentage" of less than three percent).

For a taxpayer subject to the BEAT (an "applicable taxpayer"), the additional tax (the "base erosion minimum tax amount" or "BEAT liability") for the year generally equals the excess, if any, of 10 percent of its modified taxable income over an amount equal to its regular tax liability reduced (but not below zero) by the sum of a certain tax credits.[621]

Base erosion payments and base erosion tax benefits

A base erosion tax benefit generally reflects the reduction in taxable income arising from the associated base erosion payment.

A base erosion payment generally is any amount paid or accrued by a taxpayer to a foreign person that is a related party of the taxpayer and with respect to which a deduction is allowable.[622] A base erosion payment includes any amount paid or accrued by the taxpayer to a foreign related party in connection with the acquisition by the taxpayer from the related party of property of a character subject to the allowance for depreciation (or amortization in lieu of depreciation).[623]

Base erosion payments generally do not include any amount that constitutes a reduction in gross receipts, including payments for cost of goods sold. Certain other payments are

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[619] Sec. 59A.

[620] For this purpose, a related party is, with respect to the taxpayer, any 25-percent owner of the taxpayer; any person who is related (within the meaning of sections 267(b) or 707(b)(1)) to the taxpayer or any 25-percent owner of the taxpayer; and any other person who is related (within the meaning of section 482) to the taxpayer. Sec. 59A(g). The 25-percent ownership threshold is determined by vote or value.

[621] Sec. 59A(b).

[622] Sec. 59A(d)(1).

[623] Sec. 59A(d)(2).

excluded from the definition of base erosion payments, including certain payments for services[624] and qualified derivative payments.[625] A payment for a service by a U.S. corporation to a foreign related party is a base erosion payment, except to the extent that the services in question meet most requirements for the "services cost method"[626] of transfer pricing and the payment does not include a markup component. In final regulations, the Secretary provided that a portion of a payment meeting these standards is not treated as a base erosion payment. Instead, only the portion of the outbound payment that exceeds actual costs incurred by the recipient of the payment (*i.e.*, the markup component of the price charged) is a base erosion payment.[627]

The BEAT treats as a base erosion payment any reinsurance premium payment paid by a U.S. life insurance company or by a U.S. property and casualty insurance company to a related foreign reinsurer (*e.g.*, a U.S. insurer pays a reinsurance premium to a related foreign reinsurer to cover risk of storm damage in the United States).[628] It also may apply to payment by a U.S. reinsurer to a related foreign insurer on the occurrence of a covered event (*e.g.*, a U.S. reinsurer pays a related foreign insurer when a claim is made for earthquake damage in a foreign country). Such base erosion payments are not reduced for the receipt by the U.S. insurer of reinsurance recovered (*e.g.*, the related foreign reinsurer pays the U.S. insurer when a claim is made for storm damage in the United States), nor for the reinsurance premium paid by a foreign insurer to a related U.S. reinsurer (*e.g.*, the related foreign insurer pays the reinsurance premium to the U.S. reinsurer to cover earthquake risk in a foreign country).

Taxpayers are permitted to waive deductions and thus avoid the "base erosion tax benefits" of such deduction to reduce exposure to the BEAT. The Secretary adopted a rule permitting taxpayers to waive the right to deductions for payments otherwise within the scope of base erosion payments.[629] The waiver extends to insurance-related payments that were reductions from gross premiums and other consideration.

Calculation of BEAT liability

BEAT liability generally equals the excess, if any, of 10 percent of the taxpayer's modified taxable income over the amount of regular tax liability[630] reduced (but not below zero) by the sum of certain tax credits. The amount of regular tax liability is reduced (and the base erosion minimum tax amount increased) by all income tax credits except for the research

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[624] Sec. 59A(d)(5).

[625] Sec. 59A(h).

[626] Treas. Reg. sec. 1.482-9.

[627] Treas. Reg. sec. 1.59A-3(b)(3)(i).

[628] Secs. 59A(d)(3), 803(a)(1)(B), and 832(b)(4)(A).

[629] Treas. Reg. sec. 1.59A-3(c)(6).

[630] As defined in sec. 26(b).

credit[631] and a certain portion of applicable section 38 credits.[632] Modified taxable income is the taxpayer's regular taxable income increased by any base erosion tax benefit with respect to any base erosion payment and a portion of the taxpayer's NOL deduction, if any.[633]

Special rules for taxable years beginning after December 31, 2025

For taxable years beginning after December 31, 2025, the 10-percent rate on modified taxable income is increased to 12.5 percent and regular tax liability is reduced (and the base erosion minimum tax amount is therefore increased) by the sum of all the taxpayer's income tax credits for the taxable year.[634]

Special rules for banks and securities dealers

An applicable taxpayer that is a member of an affiliated group that includes a bank (as defined in section 581) or securities dealer registered under section 15(a) of the Securities Exchange Act of 1934 is subject to a tax rate on its modified taxable income that is one percentage point higher than the generally applicable tax rate.[635] In addition, for purposes of determining whether they are subject to the BEAT, banks and securities dealers are subject to a base erosion percentage threshold of two percent (rather than three percent).[636]

Description of Proposal

Under the proposal, the special rules of subsection 59A(b)(2), which would have increased the rate to 12.5 percent and reduced regular tax liability by all credits, are repealed. Other conforming amendments to reflect renumbering of certain paragraphs are also made.

Effective Date

The provision is effective for taxable years beginning after December 31, 2025.

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[631] Sec. 41(a).

[632] Sec. 59A(b)(4). Applicable section 38 credits are credits allowed under section 38 for the taxable year that are properly allocable to the low-income housing credit (sec. 42(a)), the renewable energy production credit (sec. 45(a)), and the energy investment credit (sec. 48). In general, no more than 80 percent of the amount of applicable section 38 credits for a taxable year can be used to reduce an applicable taxpayer's base erosion minimum tax liability and in no case can applicable section 38 credits reduce the taxpayer's base erosion minimum tax liability by more than 80 percent. Sec. 59A(b)(1)(B)(ii)(II).

[633] Specifically, modified taxable income is increased by the base erosion percentage of any NOL deduction allowed under section 172 for such taxable year. Sec. 59A(c)(1).

[634] Sec. 59A(b)(2).

[635] Sec. 59A(b)(3).

[636] Sec. 59A(e)(1)(C).

PART II—ADDITIONAL TAX RELIEF FOR RURAL AMERICA AND MAIN STREET

A. Special Depreciation Allowance for Qualified Production Property

Present Law

Real property

Recovery period and depreciation method

The applicable recovery period for an asset is determined in art by statute[637] and in part by historic Treasury guidance.[638] The "type of property" of an asset is used to determine the "class life" of the asset, which in turn dictates the applicable recovery period for the asset. The recovery periods for most real property are 39 years for nonresidential real property and 27.5 years for residential rental property.[639] The straight-line depreciation method is required for the aforementioned real property.[640]

For depreciation purposes, residential rental property is defined as a building or structure with respect to which 80 percent or more of the gross rental income is rental income from dwelling units.[641] The term "dwelling unit" means a house or apartment used to provide living accommodations, but does not include a unit in a hotel, motel or other establishment more than one-half of the units in which are used on a transient basis. If any portion of the building or structure is occupied by the taxpayer, the gross rental income from such property includes the rental value of the portion so occupied. Alternatively, the term "nonresidential real property" means section 1250 property that is not residential rental property or property with a class life of less than 27.5 years.[642]

Qualified improvement property

Qualified improvement property is any improvement made by the taxpayer to an interior portion of a building that is nonresidential real property if such improvement is placed in service

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[637] See sec. 168(e) and (g).

[638] Exercising authority granted by Congress, the Secretary issued Rev. Proc. 87-56, 1987-2 C.B. 674, laying out the framework of recovery periods for enumerated classes of assets. The Secretary clarified and modified the list of asset classes in Rev. Proc. 88-22, 1988-1 C.B. 785. In November 1988, Congress revoked the Secretary's authority to modify the class lives of depreciable property. Rev. Proc. 87-56, as modified, remains in effect except to the extent that the Congress has, since 1988, statutorily modified the recovery period for certain depreciable assets, effectively superseding any administrative guidance regarding such property.

[639] Sec. 168(c).

[640] Sec. 168(b)(3)(A) and (B).

[641] Sec. 168(e)(2)(A).

[642] Sec. 168(e)(2)(B).

by the taxpayer after the date such building was first placed in service by any taxpayer.[643] Qualified improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, or the internal structural framework of the building.[644] Qualified improvement property is generally depreciable using the straight line method,[645] half-year convention,[646] and a 15-year recovery period.[647] Improvements made to residential rental property do not meet the definition of qualified improvement property. Hence, the cost of an improvement to residential rental property is generally recovered over 27.5 years using the straight-line method and mid-month convention.

Recapture rules

In general

Upon disposition of most depreciable or amortizable property used in a trade or business, the characterization of the resulting gain or loss as ordinary or capital depends on whether there is a net gain or a net loss under section 1231.[648] If there is a net gain, then, subject to the

[643] Sec. 168(e)(6)(A).

[644] Sec. 168(e)(6)(B).

[645] Sec. 168(b)(3)(G).

[646] Sec. 168(d)(1). The half-year convention treats all property placed in service during any taxable year (or disposed of during any taxable year) as placed in service (or disposed of) on the mid-point of such taxable year. Sec. 168(d)(4)(A). However, if substantial property is placed in service during the last three months of a taxable year, a special rule requires use of the mid-quarter convention, which treats all property placed in service (or disposed of) during any quarter as placed in service (or disposed of) on the mid-point of such quarter. Sec. 168(d)(3) and (d)(4)(C). The mid-quarter convention does not apply to nonresidential real property or residential rental property; thus, such property is not taken into account in determining if the mid-quarter convention applies. Sec. 168(d)(3)(B); Treas. Reg. sec. 1.168(d)-1.

[647] Sec. 168(e)(3)(E)(vii). Note that as 15-year property, qualified improvement property is generally eligible for the additional first-year depreciation deduction under section 168(k) (this additional first-year depreciation is commonly referred to as "bonus depreciation"). Qualified improvement property is also eligible for section 179 expensing. See sec. 179(e)(1). Note that the amount of the bonus depreciation deduction is determined after basis adjustments for any section 179 expensing. See Treas. Reg. sec. 1.168(k)-1(a)(2)(iii). For a discussion of expensing under sections 168(k) and 179, see Joint Committee on Taxation, *Tax Incentives for Domestic Manufacturing* (JCX-8-24), March 18, 2024, pp. 7-14.

[648] Section 1231 applies to gains and losses on the sale, exchange, or involuntary conversion of certain assets used in the taxpayer's trade or business. These assets are not capital assets, as that term is generally defined in the Code (see sec. 1221(a)). The assets eligible for this treatment include depreciable property or real property held for more than one year and used in a trade or business (if not includible in inventory, held primarily for sale to customers in the ordinary course of business, or property described in section 1221(a)(3) or (5)). Also included are certain special assets, such as interests in timber, coal, domestic iron ore, certain livestock, and certain unharvested crops.

depreciation recapture rules, long-term capital gain treatment generally results.[649] If there is a net loss, the loss is fully deductible against ordinary income.[650]

The depreciation recapture rules require taxpayers to recognize ordinary income in an amount equal to all or a portion of the gain realized because of the disposition of property. In addition, sections 1245 and 1250 generally override various nonrecognition provisions in the Code.[651]

Section 1245

Depreciable personal property, whether tangible or intangible, and certain depreciable real property disposed of at a gain are subject to depreciation recapture under section 1245.[652] In addition to depreciation under section 167, the section 1245 recapture rules apply to other cost recovery provisions, including first-year expensing provisions.[653] For example, any deduction allowed under section 179 or 181 is treated as if it were a deduction allowable for amortization. Similarly, for recapture purposes, an amortizable section 197 intangible is considered section 1245 property and is subject to the section 1245 recapture rules.[654]

When a taxpayer disposes of section 1245 property, the taxpayer must recapture the gain on disposition of the property as ordinary income to the extent of earlier depreciation or amortization deductions taken with respect to the asset.[655] Any remaining gain recognized upon the sale of section 1245 property is generally treated as section 1231 gain.

Section 1250

Depreciable real property, other than that included within the definition of section 1245 property, disposed of at a gain is known as section 1250 property.[656] For example, depreciable residential rental property is section 1250 property. Gain on the disposition of section 1250 property is treated as ordinary income, rather than capital gain, only to the extent of the excess

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[649] Sec. 1231(a)(1). However, net section 1231 gain is converted into ordinary income to the extent net section 1231 losses in the previous five years were treated as ordinary losses. Sec. 1231(c). In addition, net gains may be denied capital gains treatment (and taxed as ordinary income) if the transaction is between certain related taxpayers. Sec. 1239.

[650] Sec. 1231(a)(2).

[651] See Treas. Reg. secs. 1.1245-6(b) and 1.1250-1(c)(2).

[652] Sec. 1245(a)(3); Treas. Reg. sec. 1.1245-3.

[653] Secs. 1245(a)(2)(C) and (a)(3)(C).

[654] Secs. 196(f)(7) and 1245(b)(8).

[655] Sec. 1245(a)(1). Generally, all depreciation or amortization adjustments allowed or allowable must be taken into account. However, if a taxpayer can establish by adequate records or other sufficient evidence that the amount allowed for depreciation or amortization for any period was less than the amount allowable for such period, the taxpayer may take into account only the amount allowed. Treas. Reg. sec. 1.1245-2(a)(7).

[656] Sec. 1250(c); Treas. Reg. sec. 1.1250-1(e).

depreciation or amortization taken over what would have been available under the straight line method.[657] However, if section 1250 property is held for one year or less, all depreciation is recaptured, regardless of whether it exceeds the depreciation that would have been available under the straight line method.[658] Special rules phase out the recapture for certain types of property held over a specified period of time.[659]

Since section 1250 recaptures only the excess of accelerated depreciation taken over straight-line depreciation and MACRS requires straight line depreciation for nonresidential real property and residential rental property placed in service after 1986, such property placed in service after 1986 generally will not be subject to recapture under section 1250 (except to the extent that section 291(a) applies in the case of a corporation (discussed below)). However, bonus depreciation allowed or allowable with respect to qualified improvement property or land improvements constitutes additional depreciation for purposes of computing section 1250 recapture (*i.e.*, the bonus depreciation deduction is not a straight-line method).[660]

For corporations, under section 291(a), the amount treated as ordinary income on the disposition of section 1250 property is increased by 20 percent of the additional amount that would be treated as ordinary income if the property were subject to recapture under the rules for section 1245 property. For example, if a corporation sells residential rental property that it held for more than one year, even though the corporation did not claim accelerated depreciation, it is required to recognize ordinary income equal to 20 percent of the lesser of the total amount of depreciation deducted or the gain on the sale. While no separate rate structure exists for corporate capital gains,[661] a corporation may not deduct the amount of capital losses in excess of capital gains for any taxable year. Disallowed capital losses may be carried back three years or carried forward five years.[662]

For individuals, estates, and trusts, any capital gain that would be treated as ordinary income if the property were subject to recapture under the rules for section 1245 property is generally taxed at a maximum rate of 25 percent.[663] This is referred to as "unrecaptured section

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[657] Sec. 1250(a).

[658] Sec. 1250(b)(1).

[659] Sec. 1250(a)(1)(B). The special phase-out rule applies to residential low-income rental property, certain types of subsidized housing, and property for which rapid depreciation of rehabilitation expenditures was claimed under section 167(k) as in effect on the date before the date of the enactment of the Revenue Reconciliation Act of 1990.

[660] See Treas. Reg. sec. 1.168(k)-2(g)(3). Similarly, in the case of qualified real property (*e.g.*, qualified improvement property) for which the unadjusted basis is reduced by a section 179 deduction, the amount of such reduction is treated as section 1245 property, and the remaining unadjusted basis is treated as section 1250 property. See Notice 2013-59, 2013-40 I.R.B. 297, for special rules for determining the portion of the gain that is attributable to section 1245 property upon the sale or other disposition of qualified real property.

[661] Income of a corporation is generally taxed at 21 percent (sec. 11).

[662] Sec. 1212(a).

[663] Sec. 1(h)(1)(E) and (h)(6)(A).

1250 gain."[664] The amount of unrecaptured section 1250 gain (before the reduction for the net loss) attributable to the disposition of property to which section 1231 applies may not exceed the net section 1231 gain for the year.[665] Any gain in excess of unrecaptured section 1250 gain is eligible for the 15 percent capital gains rate.[666]

Description of Proposal

100 percent depreciation allowance for qualified production property

The proposal provides for an elective 100 percent depreciation allowance for qualified production property. Qualified production property is that portion of any nonresidential real property that meets the following requirements:

1. subject to depreciation under section 168,
2. used by the taxpayer as an integral part of a qualified production activity,
3. placed in service in the United States or any possession of the United States,
4. original use commences with the taxpayer,
5. construction begins after January 19, 2025, and before January 1, 2029,
6. subject to an election by the taxpayer to treat such portion as qualified production property, and
7. placed in service after the date of enactment and before January 1, 2033.

Qualified production property does not include the portion of any nonresidential real property used for offices, administrative services, lodging, parking, sales activities, software engineering activities, or other functions unrelated to manufacturing, production, or refining of tangible personal property.

A qualified production activity is the manufacturing, production, or refining of a qualified product. Such activities of the taxpayer must result in a substantial transformation of the property comprising the product. Production does not include activities other than agricultural production and chemical production.

A qualified product is any tangible personal property.

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[664] See section 1(h)(6), which defines "unrecaptured 1250 gain" as any long-term capital gain from the sale or exchange of section 1250 property held more than one year to the extent of the gain that would have been treated as ordinary income if section 1250 applied to all depreciation, reduced by the net loss (if any) attributable to the items taken into account in computing 28-percent rate gain of an individual.

[665] Sec. 1(h)(6)(B).

[666] Sec. 1(h)(1)(C).

Qualified production property does not include any property subject to a special allowance for bonus depreciation,[667] qualified second generation biofuel plant property,[668] or qualified reuse and recycling property.[669] For the purposes of the elections not to apply the provisions for accelerated depreciation for bonus depreciation,[670] qualified second generation biofuel plant property,[671] or qualified reuse and recycling property,[672] qualified production property is treated as a separate class of property.

Qualified production property does not include any property to which the alternative depreciation system applies. For the purposes of election to use the alterative deprecation system,[673] qualified production property is treated as a separate class of property.

Special rule for certain property not previously used in qualifying production activities

For property acquired by the taxpayer after January 19, 2025, and before January 1, 2029, the original use requirement and the beginning of construction requirement are treated as satisfied if such property was not used in a qualified production activity by any person at any time between January 1, 2021, and the date of introduction. For the purposes of the special rule, the determination of whether property was previously used in a qualified production activity is made without regard to whether the activities of any taxpayer result in a substantial transformation of the property.

For purposes of determining whether property previously not used in qualifying activities is acquired after December 31, 2024, such property is treated as acquired not later than the date that the taxpayer enters into a written binding contract for acquisition. For purposes of determining whether such property is acquired after January 1, 2030, such property is treated as acquired not earlier than the date that the taxpayer enters into a written binding contract for acquisition.

Recapture

Generally, qualified production property disposed of at a gain is subject to depreciation recapture under section 1245.

Special recapture rules apply if at any time during the 10-year period beginning on the date that any qualified production property is placed in service by the taxpayer, such property (1)

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[667] Sec. 168(k).

[668] Sec. 168(l).

[669] Sec. 168(m).

[670] Sec. 168(k)(7).

[671] Sec. 168(l)(3)(D).

[672] Sec. 168(m)(2)(B)(iii).

[673] Sec. 168(g)(7)(A).

ceases to be used by the taxpayer as an integral part of a qualified production activity, and (2) is used by the taxpayer in a productive use other than a use that is an integral part of a qualified production activity. If such a change in use occurs, section 1245 is applied to treat such property as disposed of by the taxpayer the first time a change in use occurs with respect to such property. The amount treated as ordinary income under section 1245 equals 100 percent of the amount of depreciation allowable for qualified production property. Such amount increases the taxpayer's basis in such property.

Effective Date

The proposal applies to property placed in service after the date of enactment.

B. Renewal and Enhancement of Opportunity Zones

Present Law

Overview

Investments in qualified opportunity funds are entitled to three tax benefits, at the taxpayer's election: (1) a temporary deferral of the capital gain reinvested in the qualified opportunity zone (the "rollover gain"); (2) a permanent 10 or 15 percent reduction in the amount of such gain that must be recognized if the investment is held for five or seven years, respectively; and (3) a permanent exclusion of future gains resulting from the investment in the opportunity zone if the investment is held for at least 10 years.[674] To qualify, the rollover gain is generally required to be invested in the qualified opportunity fund during a 180-day period that begins on the date of the sale or exchange that generated the gain.

A qualified opportunity fund is an investment vehicle organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property. The number of communities designated as opportunity zones may be up to 25 percent of the total number of a State's low-income communities, as designated by the governor of a State.[675]

A taxpayer may elect to temporarily defer and partially exclude capital gains from gross income to the extent that the taxpayer invests the amount of those gains in a qualified opportunity fund. The maximum amount of the deferred gain is equal to the amount invested in a qualified opportunity fund by the taxpayer during the 180-day period beginning on the date of the asset sale that produced the gain to be deferred. Capital gains in excess of the deferred amount must be recognized and included in gross income as under present law.

In the case of any investment in a qualified opportunity fund, only a portion of which consists of the investment of gain with respect to which an election is made, such investment is treated as two separate investments, consisting of one investment that includes only amounts to which the election applies (herein "deferred-gain investment"), and a separate investment consisting of other amounts. The temporary deferral and permanent exclusion provisions do not apply to the separate investment. For example, if a taxpayer sells stock at a gain and invests the entire sale's proceeds (capital and return of basis) in a qualified opportunity zone fund, an election may be made only with respect to the capital gain amount. No election may be made with respect to amounts attributable to a return of basis, and no special tax benefits apply to such amounts.

The basis of a deferred-gain investment in a qualified opportunity zone fund immediately after its acquisition is zero. If the deferred-gain investment in the qualified opportunity zone fund is held by the taxpayer for at least five years, the basis in the deferred-gain investment is increased by 10 percent of the original deferred gain. If the opportunity zone asset or investment is held by the taxpayer for at least seven years, the basis in the deferred gain investment is

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[674] Sec. 1400Z-2.

[675] Sec. 1400Z-1.

increased by an additional five percent of the original deferred gain. Some or all of the deferred gain is recognized on the earlier of (i) the date on which the qualified opportunity zone investment is disposed of, or (ii) December 31, 2026. The amount of gain recognized is the excess of (i) the lesser of the amount deferred or the current fair market value of the investment, over (ii) the taxpayer's basis in the investment. The taxpayer's basis in the investment is increased by the amount of gain recognized. No election under the provision may be made after December 31, 2026, or with respect to a disposition if an election previously made is in effect.

The post-acquisition capital gains on deferred-gain investments in opportunity zone funds that are held for at least 10 years are excluded from gross income. Specifically, in the case of the sale or exchange of an investment in a qualified opportunity zone fund held for more than 10 years, a further election is allowed by the taxpayer to modify the basis of such deferred-gain investment in the hands of the taxpayer to be the fair market value of the deferred-gain investment at the date of such sale or exchange.

In the case of a fund organized as a pass-through entity, investors recognize gains and losses associated with both deferred-gain and nondeferred-gain investments in the fund, under the rules generally applicable to pass-through entities. Thus, for example, investor-partners in a fund organized as a partnership would recognize income and increase their basis with respect to their distributive share of the fund's taxable income.

Qualifying geography

To obtain the deferral and exclusion benefits of the qualified opportunity zone provisions, the taxpayer must invest in qualified opportunity zones. The Code allowed for the designation of certain low-income community population census tracts as qualified opportunity zones. The designation remains in effect beginning on the date of the designation and ending at the end of the tenth calendar year following such designation.[676] The Secretary designated qualified opportunity zones in Notice 2018-48.[677] Thus, the designations are in effect until December 31, 2028.

For purposes of the designation, the term "low-income communities" has the same meaning as that term is used in the new markets tax credit provisions under section 45D of the Code. For both the new markets tax credit provisions and the opportunity zone provisions, a low-income community is either a population census tract that meets certain criteria, or specific areas designated by the Secretary. Specifically, a low-income community is a population census tract with either (1) a poverty rate of at least 20 percent, or (2) median family income which does not exceed 80 percent of the greater of metropolitan area median family income or statewide median family income (for a nonmetropolitan census tract, this does not exceed 80 percent of statewide median family income). In the case of a population census tract located within a high migration rural county, low-income is defined by reference to 85 percent (as opposed to 80 percent) of statewide median family income. For this purpose, a high migration rural county is any county that, during the 20-year period ending with the year in which the most recent census

[676] Sec. 1400Z-1(f).

[677] 2018-28 I.R.B. 9 (June 20, 2018).

was conducted, has a net out-migration of inhabitants from the county of at least 10 percent of the population of the county at the beginning of such period.

The Secretary is also authorized to designate "targeted populations" as low-income communities. For this purpose, a "targeted population" is defined by reference to section 103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994 (the "Act") to mean individuals, or an identifiable group of individuals, including an Indian tribe, who are low-income persons or otherwise lack adequate access to loans or equity investments. Section 103(17) of the Act provides that "low-income" means (1) for a targeted population within a metropolitan area, less than 80 percent of the area median family income; and (2) for a targeted population within a nonmetropolitan area, less than the greater of 80 percent of the area median family income or 80 percent of the statewide nonmetropolitan area median family income. A targeted population is not required to be within any census tract. In addition, a population census tract with a population of less than 2,000 is treated as a low-income community for purposes of the qualified opportunity zone rules if such tract is within an empowerment zone, the designation of which is in effect under section 1391, and is contiguous to one or more low-income communities.

In addition to low-income communities, a limited number of other census tracts that are not low-income communities can be so designated if they are contiguous to a designated low-income community and the median family income of such tracts does not exceed 125 percent of the median family income of the contiguous low-income community. The designation of a population census tract as a qualified opportunity zone remains in effect for the period beginning on the date of the designation and ending at the close of the tenth calendar year beginning on or after the date of designation.

The chief executive officer of the State, possession, or the District of Columbia (*i.e.*, Governor, or mayor in the case of the District of Columbia) may submit nominations for a limited number of qualified opportunity zones to the Secretary for certification and designation. If the number of low-income communities in a State is less than 100, the Governor may designate up to 25 tracts, otherwise the Governor may designate tracts not exceeding 25 percent of the number of low-income communities in the State. There is a special rule for Puerto Rico such that each population census tract in Puerto Rico that is a low-income community is deemed certified and designated as a qualified opportunity zone, effective on the date of enactment of Public Law 115-97 (*i.e.*, December 22, 2017).

Project structure and steps required to obtain benefits

As discussed, the opportunity zones provisions allow a taxpayer to make an election when investing in a qualified opportunity fund that results in three tax benefits. To take advantage of the election, a taxpayer generally sells capital assets and then contributes the realized gain to a qualified opportunity fund within 180 days of the sale. The taxpayer can contribute funds in excess of the realized gain, but those funds will not be eligible for the tax benefits. The qualified opportunity fund contributes the amount received to a directly owned qualified opportunity zone business, a corporation in exchange for qualified opportunity zone stock, or a partnership in exchange for a qualified opportunity zone partnership interest.

A qualified opportunity fund is an investment vehicle organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund) that holds at least 90 percent of its assets in qualified opportunity zone property. Qualified opportunity zone property means: (1) qualified opportunity zone stock, (2) qualified opportunity zone partnership interests, and (3) qualified opportunity zone business property.

If a qualified opportunity fund fails to meet the 90 percent requirement, unless the fund establishes reasonable cause, the fund is required to pay a monthly penalty equal to the excess of the amount equal to 90 percent of its aggregate assets, over the aggregate amount of qualified opportunity zone property held by the fund multiplied by the underpayment rate in the Code. If the fund is a partnership, the penalty is taken into account proportionately as part of each partner's distributive share.

Qualified opportunity zone stock consists of stock in a domestic corporation that is a qualified opportunity zone business. There are three requirements that must be met for property to be considered qualified opportunity zone stock. First, the stock must be acquired at original issuance (directly or indirectly through an underwriter) solely for cash after December 31, 2017. Second, the corporation must have been a qualified opportunity zone business when the stock was issued (or, for a new corporation, was being organized to be a qualified opportunity zone business). Third, the corporation must qualify as a qualified opportunity zone business during substantially all of the qualified opportunity fund's holding period for the stock.

Qualified opportunity zone partnership interests consist of capital or profits interests in a domestic partnership that is a qualified opportunity zone business. There are three requirements that must be met for property to be considered a qualified opportunity zone partnership interest. First, the interest must be acquired from the partnership solely for cash after December 31, 2017. Second, the partnership must have been a qualified opportunity zone business when the interest was acquired (or, for a new partnership, was being organized to be a qualified opportunity zone business). Third, the partnership must qualify as a qualified opportunity zone business during substantially all of the qualified opportunity fund's holding period for the interest.

Qualified opportunity zone business property consists of tangible property used in the trade or business of a qualified opportunity fund or qualified opportunity zone business. There are three main requirements that must be met for property to be considered qualified opportunity zone business property. First, the property must be acquired by purchase after December 31, 2017. Second, the original use of the property in the qualified opportunity zone must begin with the qualified opportunity fund or qualified opportunity zone business, or the qualified opportunity fund or qualified opportunity zone business must substantially improve the property. Only new or substantially improved property qualifies as opportunity zone business property. Third, substantially all of the property must be in a qualified opportunity zone during substantially all of the qualified opportunity fund's or qualified opportunity zone business' holding period for the property. Property is treated as substantially improved only if capital expenditures on the property in the 30 months after acquisition exceed the property's adjusted basis on the date of acquisition.

A qualified opportunity zone business is any trade or business in which substantially all of the underlying value of the tangible property owned or leased by the business is qualified opportunity zone business property.

In addition, (1) at least 50 percent of the total gross income of the trade or business must be derived from the active conduct of business in the qualified opportunity zone, (2) a substantial portion of the business's intangible property must be used in the active conduct of business in the qualified opportunity zone, and (3) less than five percent of the average of the aggregate adjusted basis of the property of the business is attributable to nonqualified financial property. Nonqualified financial property means debt, stock, partnership interests, annuities, and derivative financial instruments (including options, futures, forward contracts, and notional principal contracts), other than (1) reasonable amounts of working capital held in cash, cash equivalents, or debt instruments with a term of no more than 18 months, and (2) accounts or notes receivable acquired in the ordinary course of a trade or business for services rendered or from the sale of inventory property.[678] The business cannot be a golf course, country club, massage parlor, hot tub or suntan facility, racetrack or other facility used for gambling, or store whose principal business is the sale of alcoholic beverages for consumption off premises.[679]

Tangible property that ceases to be qualified opportunity zone business property continues to be treated as qualified opportunity zone business property for the lesser of five years after the date on which such tangible property ceases to be so qualified, or the date on which such tangible property is no longer held by the qualified opportunity zone business.

Information reporting and data reporting

The Code does not specifically provide rules for information reporting or data reporting from qualified opportunity funds or qualified opportunity zone businesses. The Code provides the Secretary with the authority to prescribe regulations as necessary to carry out the purposes of the section, including (1) rules for the certification of qualified opportunity funds; (2) rules to ensure a qualified opportunity fund has a reasonable period of time to reinvest the return of capital from investments in qualified opportunity zone stock and qualified opportunity zone partnership interests, and to reinvest proceeds received from the sale or disposition of qualified opportunity zone property; and (3) rules to prevent abuse.[680]

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[678] Sec. 1397C(e).

[679] Treas. Reg. sec. 1.400Z2(d)-1.

[680] Sec. 1400Z-2(e)(4). Three forms require reporting relating to opportunity zones: Form 8996, *Qualified Opportunity Fund*; Form 8949, *Sales and Other Dispositions of Capital Assets, and Form 8997*; *Initial and Annual Statement of Qualified Opportunity Fund Investments.* A corporation or partnership organized as a qualified opportunity fund uses Form 8996 to certify that it is organized to invest in qualified opportunity zone property and to report that the qualified opportunity fund meets the investment standard of the Code or to calculate the penalty if it fails to meet the investment standard. Taxpayers use Form 8949 to report the election to defer capital gain invested in a qualified opportunity fund. Taxpayers use Form 8997 to report qualified opportunity fund investments held at the beginning and end of the year, capital gains for the year that were deferred, and investments disposed of during the year.

Description of Proposal

In general

The proposal allows for the designation of additional qualified opportunity zones under a modified definition of low-income community and modifies the opportunity zone investment incentives. Also, the proposal requires information reporting from qualified opportunity funds, qualified rural opportunity funds (as defined), qualified opportunity zone businesses, and qualified rural opportunity zone businesses (as defined), and imposes penalties for failing to comply with these requirements. Finally, the proposal requires the Secretary to publicly report various data on qualified opportunity funds and qualified rural opportunity funds.

Qualifying geography

The proposal modifies the designation period for the initial qualified opportunity zones by ending the designation on December 31, 2026 rather than on December 31, 2028.

The proposal allows for the designation of additional qualified opportunity zones, in effect from January 1, 2027, through December 31, 2033, under rules similar to those for the initial designation.

For purposes of the additional qualified opportunity zones, the proposal modifies the definition of a low-income community to be a population census tract with either (1) a poverty rate of at least 20 percent, or (2) median family income which does not exceed 70 percent (from 80 percent) of the greater of metropolitan area median family income or statewide median family income (for a nonmetropolitan census tract, the median family income does not exceed 70 percent of statewide median family income). In addition, a low-income community is no longer a low-income community if the median family income equals or exceeds 125 percent of the metropolitan area median family income (for a nonmetropolitan census tract, the median family income does not equal or exceed 125 percent of statewide median family income).

Under rules similar to current law, the Secretary is required to designate tracts nominated by the governors of the States. The Secretary may designate 25 percent of the number of low-income communities (under the modified definition) in each State as qualified opportunity zones. However, at a minimum, the "applicable percentage" of the total number of qualified opportunity zone designations is required to be of low-income communities which are comprised entirely of a rural area, as determined by the Secretary in consultation with the Secretary of Agriculture.[681] The applicable percentage, for any calendar year during which a designations made, is the greater of 33 percent or the percentage of the United States population living within a rural area for the preceding calendar year. If a State does not have enough low-income communities that are comprised entirely of a rural area to meet such requirement, then all low-income communities that are comprised entirely of a rural area within a State are required to be

[681] A rural area, as defined in the Consolidated Farm and Rural Development Act, is a city or town that has a population of fewer than 50,000 inhabitants or any urbanized area contiguous and adjacent to such a city or town.

designated. In contrast to current law, tracts contiguous with low-income communities are not eligible to be designated.

Finally, for purposes of the additional qualified opportunity zones, the proposal modifies the timing for the election for tax benefits and for the recognition of deferred gain from December 31, 2026, to December 31, 2033.

Modification of opportunity zone investment incentives

The proposal also modifies the opportunity zone investment incentives. As with the initial qualified opportunity zones, the basis of a deferred-gain investment in a qualified opportunity zone fund immediately after its acquisition is zero. If the deferred-gain investment in the qualified opportunity zone fund is held by the taxpayer for at least five years, the basis in the deferred-gain investment is increased by 10 percent of the original deferred gain. However, there is no additional five percent increase. Some or all of the deferred gain is recognized on the earlier of (1) the date on which the qualified opportunity zone investment is disposed of, or (2) December 31, 2033. The amount of gain recognized is the excess of (1) the lesser of the amount deferred or the current fair market value of the investment, over (2) the taxpayer's basis in the investment. The taxpayer's basis in the investment is increased by the amount of gain recognized. No election under the provision may be made after December 31, 2033, or with respect to a disposition if an election previously made is in effect.

A different rule applies for investments in qualified rural opportunity funds, defined as a qualified opportunity fund that holds at least 90 percent of its assets in qualified opportunity zone business property which is either (1) qualified opportunity zone business property substantially all of the use of which, during substantially all of the fund's holding period for such property, is in a qualified opportunity zone comprised entirely of a rural area; or (2) qualified opportunity zone stock, or a qualified opportunity zone partnership property interest, in a qualified opportunity zone business in which substantially all of the tangible property owned or leased is qualified opportunity zone business property and substantially all the use of which is in a qualified opportunity zone comprised entirely of a rural area. For these investments, the basis increase at year five is 30 percent rather than 10 percent of the original deferred gain.

Finally, the proposal allows the taxpayer to elect to invest up to $10,000 of ordinary income invested in a qualified opportunity fund. The $10,000 limitation is an aggregate limitation for the taxpayer over the life of the opportunity zone program. The zero initial basis and basis increase provisions do not apply with respect to the ordinary income investment. However, there is a permanent exclusion of future gains resulting from the investment in the opportunity zone if the investment is held for at least 10 years.

Reporting on qualified opportunity funds, qualified rural opportunity funds, qualified opportunity zone businesses, and qualified rural opportunity zone businesses

The proposal requires information reporting from (1) qualified opportunity funds and qualified rural opportunity funds, and (2) qualified opportunity zone businesses and qualified rural opportunity zone businesses. The proposal requires that the qualified opportunity funds and qualified rural opportunity funds electronically file their returns on magnetic media or machinereadable form. The proposal states that any term used in these information reporting sections has the same meaning as used in current law governing qualified opportunity zones.

Qualified opportunity funds

The proposal requires every qualified opportunity fund to file an annual return (at such time and in such manner as the Secretary may prescribe) containing the following information:

- the name, address, and TIN of the qualified opportunity fund;
- whether the qualified opportunity fund is organized as a corporation or a partnership;
- the value of the total assets held by the qualified opportunity fund as of each date described in section 1400Z-2(d)(1);
- the value of all qualified opportunity zone property held by the qualified opportunity fund on each such date;
- with respect to each investment held by the qualified opportunity fund in qualified opportunity zone stock or a qualified opportunity zone partnership interest:
    - the name, address, and TIN of the corporation in which such stock is held or the partnership in which such interest is held,
    - each North American Industry Classification System ("NAICS") code that applies to the trades or businesses conducted by such corporation or partnership,
    - the population census tracts in which the qualified opportunity zone business property of such corporation or partnership is located,
    - the amount of the investment in such stock or partnership interest as of each date described in section 1400Z-2(d)(1) of the Code,
    - the value of tangible property held by such corporation or partnership on each date which is owned by such corporation or partnership,
    - the approximate number of residential units (if any) for any real property held by such corporation or partnership, and
    - the approximate average monthly number of full-time equivalent employees of such corporation or partnership for the year (within numerical ranges identified by the Secretary) or such other indication of the employment impact of such corporation or partnership as determined appropriate by the Secretary;
- with respect to the items of qualified opportunity zone business property held by the qualified opportunity fund:
    - the NAICS code that applies to the trades or businesses in which such property is held,

- the population census tract in which the property is located,
- whether the property is owned or leased,
- the aggregate value of the items of qualified opportunity zone property held by the qualified opportunity fund as of such date described in section 1400Z-2(d)(1) of the Code, and
- in the case of real property, the number of residential units (if any);

- the approximate average monthly number of full-time equivalent employees for the year of the trades or businesses of the qualified opportunity fund in which qualified opportunity zone business property is held (within numerical ranges identified by the Secretary) or such other indication of the employment impact of such trades or businesses as determined appropriate by the Secretary;
- with respect to each person who disposed of an investment in the qualified opportunity fund during the year:
  - the name and TIN of such person,
  - the date(s) on which the investment disposed was acquired, and
  - the date(s) on which any such investment was disposed, and the amount of the investment disposed of; and
- such other information as the Secretary may require.

Every qualified opportunity fund required to file an information return with the IRS as discussed above is also required to provide a written statement to each person whose name is required to be provided on the return because the person disposed of an investment in the qualified opportunity fund during the year. The written statement is required to show:

- the name, address and phone number of the information contact of the qualified opportunity fund required to file the return, and
- the following information with respect to the person who disposed of the investment:
  - the name and TIN of the person,
  - the date(s) on which the investment disposed was acquired, and
  - the date(s) on which any such investment was disposed of, and the amount of the investment disposed of.

The proposal treats this statement as a payee statement under the Code, subject to information reporting penalties as discussed below.

For purposes of this information reporting requirement, the term "full-time equivalent employees" means with respect to any month, the sum of: (1) the number of full-time employees (as defined in section 4980H(c)(4)), for the month plus (2) the number of employees determined (under rules similar to the rules of section 4980H(e)(2)(E)) by dividing the aggregate number of hours of service of employees who are not full-time employees for the month by 120.

Qualified rural opportunity funds

The proposal applies the above information reporting requirements for qualified opportunity funds to qualified rural opportunity funds. Thus, qualified rural opportunity funds are required to file an annual return with the IRS and provide statements to persons who dispose of their investment in the qualified rural opportunity fund during the year.

Qualified opportunity zone businesses

The proposal requires every applicable qualified opportunity zone business to provide to the qualified opportunity fund a written statement in such manner and setting forth such information as the Secretary may prescribe for purposes of enabling the qualified opportunity fund to meet its information return reporting requirements. The term "applicable qualified opportunity zone business" means any qualified opportunity zone business: (1) which is a trade or business of a qualified opportunity fund, (2) in which a qualified opportunity fund holds qualified opportunity zone stock, or (3) in which a qualified opportunity fund holds a qualified opportunity zone partnership interest. The proposal treats this statement as a payee statement under the Code, subject to information reporting penalties as discussed below.

Qualified rural opportunity zone businesses

The proposal applies the information reporting requirements for qualified opportunity zone businesses to qualified rural opportunity zone businesses. Thus, applicable qualified rural opportunity zone businesses are required to provide to the qualified rural opportunity fund a written statement in such manner and setting for such information as the Secretary may prescribe.

Failure to comply with information reporting requirements relating to qualified opportunity funds and qualified rural opportunity funds

The proposal provides penalties for qualified opportunity funds and qualified rural opportunity funds that do not comply with appropriate information reporting requirements. The proposal also provides penalties for qualified opportunity zone businesses and qualified rural opportunity zone businesses that do not furnish the required statements to the qualified opportunity funds and the qualified rural opportunity funds.

Qualified opportunity funds and qualified rural opportunity funds

Any qualified opportunity fund and qualified rural opportunity fund that fails to file a complete and correct information return in the time and manner required must pay a penalty of $500 per day, subject to a maximum penalty with respect to one return of $10,000. The maximum penalty is increased to $50,000 for qualified opportunity funds and qualified rural opportunity funds with gross assets (determined on the last day of the taxable year) in excess of $10,000,000 ("large funds"). For intentional disregard of the reporting information requirements, the penalty is $2,500 per day, subject to a maximum penalty of $50,000, or $250,000 in the case of large funds.

The penalty amounts are subject to inflation adjustments for returns required to be filed after calendar year 2024. For the $500 and $2,500 penalty amounts described in the previous paragraph, if any penalty increase is not a multiple of $10, then the total penalty amount is rounded to the next lowest multiple of $10. For large funds, if any penalty increase is not a multiple of $10,000, then the total penalty amount is rounded to the next lowest multiple of $10,000. For any other dollar amounts, if any penalty increase is not a multiple of $1,000, then the total penalty amount is rounded to the next lowest multiple of $1,000.

In addition, the proposal imposes penalties on qualified opportunity funds and qualified rural opportunity funds for (1) failure to file a complete and correct information return in the time and manner required, and (2) failure to provide the written statement to each person whose name is required to be provided on the return because the person disposed of an investment in the qualified opportunity fund or qualified rural opportunity fund during the year.

Qualified opportunity zone businesses and qualified rural opportunity zone businesses

The proposal also imposes the penalties discussed above on the qualified opportunity zone business and qualified rural opportunity zone businesses for failure of the qualified opportunity zone business and qualified rural opportunity zone business to provide the written statement in such manner and setting forth such information as the Secretary may prescribe for purposes of enabling the qualified opportunity fund and qualified rural opportunity fund to meet its information return reporting requirements.

Overall, the proposal treats the above statements as payee statements under the Code, and as such, subjects the qualified opportunity fund, qualified rural opportunity fund, qualified opportunity fund business, and qualified rural opportunity fund business to the current information reporting penalties for failures relating to payee statements.[682]

Reporting of data on opportunity zone and rural opportunity zone tax incentives

As soon as practical after the date of enactment, and annually thereafter, the Secretary or the Secretary's delegate, in consultation with the Director of the Bureau of the Census and such

[682] A person who fails to furnish correct written statements to recipients of payments for which information reporting is required is subject to a penalty of $250 for each statement with respect to which such a failure occurs, up to a maximum of $3,000,000 in any calendar year, adjusted for inflation. Sec. 6722. These amounts are subject to inflation adjustments under section 6722(f). For information statements due in calendar year 2026, the penalty amount is $340, up to a maximum of $4,098,500 per year. The penalties are reduced if the failure is corrected within a specific amount of time. Sec. 6722(b). The penalties are waived if a person establishes that any failure was due to reasonable cause and not willful neglect. Sec. 6724(a). These failures to furnish penalties are reduced for small businesses (sec. 6722(d)) and increased for failures due to intentional disregard (sec. 6722(e)).

other agencies as the Secretary determines, are required to publish a report on qualified opportunity funds. The report is required to include the following information:

(i) the number of qualified opportunities funds;

(ii) the aggregate dollar amount of assets held in qualified opportunity funds;

(iii) the aggregate dollar amount of investments made by qualified opportunity funds in qualified opportunity fund property, stated separately for each NAICS code;

(iv) the percentage of population census tracts designated as qualified opportunity zones that have received qualified opportunity fund investments;

(v) for each population census tract designated as a qualified opportunity zone, the approximate average monthly number of full-time equivalent employees of the qualified opportunity zone businesses in such qualified opportunity zone for the preceding 12-month period (within numerical wages identified by the Secretary) or other indication of the employment impact of such qualified opportunity fund businesses as determined by the Secretary;

(vi) the percentage of the total amount of investments made by qualified opportunity funds in (1) qualified opportunity zone property which is real property, and (2) other qualified opportunity zone property;

(vii) for each population census tract, the aggregate approximate number of residential units resulting from investments made by qualified opportunity funds in real property; and

(viii) the aggregate dollar amount of investments made by qualified opportunity funds in each population census tract.

In addition to the report described above, for the sixth year after the date of enactment, the Secretary is required to include in the report the impacts and outcomes of a designation of a population census tract as a qualified opportunity zone as measured by economic indicators, such as job creation, poverty reduction, new business starts, and other metrics as determined by the Secretary.

Also, in the sixth year or the 11th year after the date of enactment, the Secretary is required to include in the report, for population census tracts designated as a qualified opportunity zone, a comparison (based on aggregate information) of the factors described below: (1) between the five-year period ending on the date of the enactment of Public Law 115-97 (*i.e.*, December 22, 2017) and the most recent five-year period for which data is available; and (2) for the most recent five-year period for which data is available between such population census tracts and similar population census tracts that were not designated as a qualified opportunity zone. The Secretary is permitted to combine population census tracts into such groups as the Secretary determines appropriate for purposes of making comparisons.

The factors are:

(i) the unemployment rate;

(ii) the number of persons working in the population census tract, including the percentage of such persons who were not residents in the population census tract in the preceding year;

(iii) individual, family, and household poverty rates;

(iv) median family income of residents of the population census tract;

(v) demographic information on residents of the population census tract, including age, income, education, race, and employment;

(vi) the average percentage of income of residents of the population census tract spent on rent annually;

(vii) the number of residences in the population census tract;

(viii) the rate of home ownership in the population census tract;

(ix) the average value of residential property in the population census tract;

(x) the number of affordable housing units in the population census tract;

(xi) the number and percentage of residents in the population census tract that were not employed for the preceding year;

(xii) the number of new business starts in the population census tract; and

(xiii) the distribution of employees in the population census tract by NAICS Code.

The proposal requires the Secretary to establish appropriate procedures to ensure that any amounts reported do not disclose taxpayer return information that can be associated with any taxpayer or competitive or proprietary information, and if necessary to protect taxpayer return information, allows the Secretary to combine information required with respect to individual population census tracts into larger geographic areas.

Reports on qualified rural opportunity funds

The proposal requires the Secretary to separately publish the same reports for qualified rural opportunity funds as those required above for qualified opportunity funds. For this purpose, the date of enactment of the proposal is substituted for the date of enactment of Public Law 115-97 (*i.e.*, December 22, 2017).

Effective Dates

The proposal establishing the designation of additional qualified opportunity zones applies to amounts invested after the date of enactment.

The proposal relating to information reporting requirements applies to taxable years beginning after the date of enactment.

The proposal relating to data to be reported by the Secretary becomes effective on the date of enactment.

C. Increased Dollar Limitations for Expensing of Certain Depreciable Business Assets

Present Law

A taxpayer generally must capitalize the cost of property used in a trade or business or held for the production of income and recover such cost over time through annual deductions for depreciation or amortization.[683] The period for depreciation or amortization generally begins when the asset is placed in service by the taxpayer.[684] Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation for different types of property based on an assigned applicable depreciation method, recovery period, and convention.[685]

Election to expense certain depreciable business assets

Subject to certain limitations, a taxpayer may elect under section 179 to deduct (or "expense") the cost of qualifying property, rather than to recover such costs through depreciation deductions.[686] The maximum amount a taxpayer may expense is $1,000,000 of the cost of qualifying property placed in service for the taxable year.[687] The $1,000,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $2,500,000.[688]

The $1,000,000 and $2,500,000 amounts are indexed for inflation for taxable years beginning after 2018.[689] For taxable years beginning in 2025, the total amount that may be expensed is $1,250,000, and the phaseout threshold amount is $3,130,000.[690] For example, assume that during 2025 a calendar year taxpayer purchased and placed in service $4,080,000 of section 179 property. The $1,250,000 section 179(b)(1) dollar amount for 2025 is reduced by the

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[683] See secs. 263(a) and 167. In general, only the tax owner of property (*i.e.*, the taxpayer with the benefits and burdens of ownership) is entitled to claim cost recovery deductions with respect to the property. In addition, where property is not used exclusively in a taxpayer's business, the amount eligible for a deduction must be reduced by the amount related to personal use. See, *e.g.*, sec. 280A.

[684] See Treas. Reg. secs. 1.167(a)-10(b), -3, -14, and 1.197-2(f). See also Treas. Reg. sec. 1.167(a)-11(e)(1)(i).

[685] Sec. 168.

[686] In the case of property purchased and placed in service by a partnership (or S corporation), the determination of whether the property is section 179 property is made at the partnership (or corporate) level, and the election to expense is made by the partnership (or S corporation). Treas. Reg. sec. 1.179-1(h).

[687] Sec. 179(b)(1).

[688] Sec. 179(b)(2).

[689] Sec. 179(b)(6).

[690] Sec. 3.25 of Rev. Proc. 2024-40, 2024-45 I.R.B. 1100.

excess section 179 property cost amount of $950,000 ($4,080,000 – $3,130,000). The taxpayer's 2025 section 179 expense limitation is $300,000 ($1,250,000 – $950,000).[691]

In general, qualifying property is depreciable tangible personal property, off-the-shelf computer software, and qualified real property[692] that is purchased for use in the active conduct of a trade or business.[693] Qualifying property excludes property used (1) outside the United States, (2) by certain tax-exempt organizations, and (3) by governmental units and foreign persons or entities.[694]

Qualified real property includes (1) qualified improvement property[695] and (2) any of the following improvements to nonresidential real property that are placed in service by the taxpayer after the date such nonresidential real property was first placed in service: roofs; heating, ventilation, and air-conditioning ("HVAC") property;[696] fire protection and alarm systems; and security systems.[697]

Passenger automobiles subject to the section 280F limitation are eligible for section 179 expensing only to the extent of the dollar limitations in section 280F.[698] For sport utility vehicles above the 6,000 pound weight rating and not more than the 14,000 pound weight rating, which are not subject to the limitation under section 280F, the maximum cost that may be expensed for any taxable year under section 179 is $25,000 (the "sport utility vehicle limitation").[699] The

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[691] The taxpayer's remaining basis in the property may be eligible for bonus depreciation under section 168(k). See Treas. Reg. sec. 1.168(k)-1(a)(2)(iii).

[692] At the election of the taxpayer. Sec. 179(d)(1)(B)(ii). See sec. 3.02 of Rev. Proc. 2019-08, 2019-03 I.R.B. 347, January 14, 2019, for guidance regarding the election to treat qualified real property as section 179 property.

[693] Sec. 179(d)(1). If section 179 property is not used predominantly in a trade or business of the taxpayer at any time before the end of its recovery period, recapture rules apply. Sec. 179(d)(10); Treas. Reg. sec. 1.179-1(e).

[694] Sec. 179(d)(1) flush language and section 50(b) (other than paragraph (2) thereof). Thus, section 179 property includes certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging (*e.g.*, beds and other furniture, refrigerators, ranges, and other equipment used in the living quarters of a lodging facility such as an apartment house, dormitory, or any other facility (or part of a facility) where sleeping accommodations are provided and let). Treas. Reg. sec. 1.48-1(h).

[695] As defined in sec. 168(e)(6).

[696] HVAC property includes all components (whether in, on, or adjacent to the building) of a central air conditioning or heating system, including motors, compressors, pipes, and ducts. Treas. Reg. sec. 1.48-1(e)(2). See also sec. 3.01(1)(b)(iii)(B) of Rev. Proc. 2019-08, 2019-03 I.R.B. 347.

[697] Sec. 179(e).

[698] For a description of section 280F, see Joint Committee on Taxation, *General Explanation of Public Law 115-97* (JCS-1-18), December 2018, pp. 128-130. This document can be found on the Joint Committee on Taxation website at www.jct.gov.

[699] Sec. 179(b)(5). For this purpose, a sport utility vehicle excludes any vehicle that: (1) is designed for more than nine individuals sitting behind the driver's seat; (2) is equipped with an open cargo area, or a covered box

$25,000 amount is indexed for inflation for taxable years beginning after 2018. For taxable years beginning in 2025, the sport utility vehicle limitation is $31,300.[700]

The amount eligible to be expensed for a taxable year may not exceed the aggregate taxable income from the active conduct of any trade or business (determined without regard to section 179).[701] Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to limitations).[702] In the case of a partnership (or S corporation), the section 179 limitations are applied at the partnership (or corporate) and partner (or shareholder) levels.[703]

Amounts expensed under section 179 are allowed for both regular tax and alternative minimum tax purposes.[704] However, no general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179.[705] In addition, if a corporation makes an election under section 179, the full amount of the deduction does not reduce earnings and profits. Rather, the expenditures that are deducted reduce corporate earnings and profits ratably over a five-year period.[706]

An expense election is made under rules prescribed by the Secretary.[707] In general, any election made under section 179, and any specification contained therein, may be revoked by the taxpayer with respect to any property without the consent of the Commissioner.[708] Such revocation, once made, is irrevocable.

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not readily accessible from the passenger compartment, of at least six feet in interior length; or (3) has an integral enclosure, fully enclosing the driver compartment and load carrying device, does not have seating rearward of the driver's seat, and has no body section protruding more than 30 inches ahead of the leading edge of the windshield.

700 Sec. 3.25 of Rev. Proc. 2024-40, 2024-45 I.R.B. 1100.

701 Sec. 179(b)(3). Wages, salaries, tips, and other compensation received by a taxpayer as an employee are included in the taxpayer's aggregate amount of taxable income derived from the active conduct of a trade or business. Treas. Reg. sec. 1.179-2(c)(6)(iv).

702 Sec. 179(b)(3)(B).

703 Sec. 179(d)(8).

704 See Senate Finance Committee Report to Accompany H.R. 3838, Tax Reform Act of 1986, S. Rep. No. 99-313, May 29, 1985, p. 522. See also Instructions for Form 6251, *Alternative Minimum Tax - Individuals (2022)*, p. 5.

705 Sec. 179(d)(9).

706 Sec. 312(k)(3)(B).

707 Sec. 179(c)(1).

708 Sec. 179(c)(2).

Description of Proposal

The proposal increases the maximum amount a taxpayer may expense under section 179 to $2,500,000 and increases the phaseout threshold amount to $4,000,000. The proposal provides that the maximum amount a taxpayer may expense for taxable years beginning after 2024 is $2,500,000 of the cost of section 179 property placed in service for the taxable year. The $2,500,000 amount is reduced (but not below zero) by the amount by which the cost of section 179 property placed in service during the taxable year exceeds $4,000,000. The $2,500,000 and $4,000,000 amounts are indexed for inflation for taxable years beginning after 2025.

Effective Date

The proposal applies to property placed in service in taxable years beginning after December 31, 2024.

D. Repeal of Revision to de Minimis Rules for Third Party Network Transactions

Present Law

Present law requires persons to file an information return concerning certain transactions with other persons.[709] The person filing an information return is also required to provide the person for whom the information return is being filed with a written statement showing the information that was reported to the IRS, which generally includes aggregate payments made, and the contact information for the payor.[710] These returns are intended to assist taxpayers in preparing their income tax returns and to help the IRS determine whether such income tax returns are correct and complete.

Returns relating to payments made in settlement of payment card and third party network transactions

Since 2012 (for payments received in 2011), payment settlement entities are required to report to the IRS and to businesses that receive these payments the gross amount of payments made in settlement of payment card transactions and third party network transactions.[711]

Specifically, any payment settlement entity making a payment to a participating payee in settlement of reportable payment transactions must report annually to the IRS and to the participating payee the gross amount of such reportable payment transactions, as well as the name, address, and TIN of the participating payee.[712] A "reportable payment transaction" means any payment card transaction and any third party network transaction.[713]

A "payment settlement entity" means, in the case of a payment card transaction, a merchant acquiring entity (defined below) and, in the case of a third party network transaction, the third party settlement organization.[714] A "participating payee" means, in the case of a payment card transaction, any person who accepts a payment card as payment and, in the case of a third party network transaction, any person who accepts payment from a third party settlement

[709] Secs. 6041 through 6050Y.

[710] See, *e.g.*, sec. 6041(d).

[711] Sec. 6050W; Pub. L. No. 110-289, sec. 3091(a) enacted sec. 6050W, July 30, 2008, effective generally for returns for calendar years beginning after December 31, 2010.

[712] Sec. 6050W(a).

[713] Sec. 6050W(c)(1).

[714] Sec. 6050W(b).

organization in settlement of such transaction.[715] A "person" includes a governmental unit. A "person" generally does not include someone with a foreign address.[716]

Returns relating to payments made in settlement of payment card transactions

For purposes of the reporting requirement, the term "merchant acquiring entity" means a bank or other organization with the contractual obligation to make payments to participating payees in settlement of payment card transactions.[717] A "payment card transaction" means any transaction in which a payment card is accepted as payment.[718] A "payment card" is defined as any card (*e.g.*, a credit card or debit card) which is issued pursuant to an agreement or arrangement which provides for: (1) one or more issuers of such cards; (2) a network of persons unrelated to each other, and to the issuer, who agree to accept such cards as payment; and (3) standards and mechanisms for settling the transactions between the merchant acquiring entities and the persons who agree to accept such cards as payment.[719] Thus, a bank that enrolls a business to accept credit cards and contracts with the business to make payment on credit card transactions must report to the IRS the business's gross credit card transactions for each calendar year on a Form 1099-K, *Payment Card and Third Party Network Transactions*. The bank also must provide a copy of the information return to the business.

Returns relating to payments made in settlement of third party network transactions

The statute also requires reporting on a third party network transaction. The term "third party network transaction" means any transaction which is settled through a third party payment network.[720] A "third party payment network" is defined as any agreement or arrangement: (1) that involves the establishment of accounts with a central organization by a substantial number of persons (generally considered to be more than 50) who are unrelated to such organization, provide goods or services, and agree to settle transactions for the provision of such goods or services pursuant to such agreement or arrangement; (2) that provides for standards and mechanisms for settling such transactions; and (3) that guarantees persons providing goods or services pursuant to such agreement or arrangement will be paid for providing such goods or services.[721]

In the case of a third party network transaction, the payment settlement entity is the third party settlement organization, which is defined as the central organization which has the

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[715] Sec. 6050W(d)(1).

[716] Sec. 6050W(d)(1)(B) and (C).

[717] Sec. 6050W(b)(2).

[718] For this purpose, the acceptance as payment of any account number or other indicia associated with a payment card also qualifies as a payment card transaction.

[719] Sec. 6050W(d)(2).

[720] Sec. 6050W(c)(3).

[721] Sec. 6050W(d)(3).

contractual obligation to make payment to participating payees of third party network transactions.[722] Thus, an organization generally is required to report if it provides a network enabling buyers to transfer funds to sellers who have established accounts with the organization and have a contractual obligation to accept payment through the network. However, an organization operating a network which merely processes electronic payments (such as wire transfers, electronic checks, and direct deposit payments) between buyers and sellers, but does not have contractual agreements with sellers to use such network, is not required to report. Similarly, an agreement to transfer funds between two demand deposit accounts will not, by itself, constitute a third party network transaction.

De minimis payment exception

A third party payment network does not include any agreement or arrangement that provides for the issuance of payment cards as defined by the provision.[723] In addition, there is an exception for *de minimis* payments that applies to payments made by third party settlement organizations but not to payments made by merchant acquiring entities. For calendar years beginning after December 31, 2021, a third party settlement organization is required to report third party network transactions with any participating payee that exceed a minimum threshold of $600 in aggregate payments, regardless of the aggregate number of such transactions.[724] In other words, there is not a threshold requirement for the number of transactions. In addition, third party network transactions only include transactions for the provision of goods or services. Reporting is not required for other transactions, including personal gifts, charitable contributions, and reimbursements.

The previous exception for *de minimis* payments for calendar years beginning prior to January 1, 2022, provided that a third party settlement organization was not required to report unless the aggregate value of third party network transactions with respect to a participating payee for the year exceeds $20,000 and the aggregate number of such transactions with respect to a participating payee exceeds 200.

Notwithstanding the revisions to the *de minimis* payment exception, the IRS allowed third party settlement organizations to delay implementation of the $600 aggregate payment threshold for calendar years 2022 and 2023.[725] As a result, for these years, reporting was not required unless the third party settlement organization's receipts were over the prior threshold - $20,000 and more than 200 transactions. In addition, the IRS provided that penalties would not be asserted under section 6721 or section 6722 for third-party settlement organizations failing to file or failing to furnish Forms 1099-K unless the gross amount of aggregate payments required to be reported exceeded $20,000 and the number of transactions exceeded 200. The IRS stated

[722] Sec. 6050W(b)(3).

[723] Sec. 6050W(d)(3).

[724] Sec. 6050W(e); American Rescue Plan Act, Pub. L. No. 117-2, Title IX, sec. 9674, March 11, 2021, amending sec. 6050W(e), effective generally for returns for calendar years beginning after December 31, 2021.

[725] Notice 2023-10, 2023-3 I.R.B. 403, January 17, 2023 and Notice 2023-74, 2023-51 I.R.B. 1484, December 18, 2023.

that the reason for this delay was the complexity of the threshold change enacted under the American Rescue Plan Act.[726]

The IRS also provided transition relief for third-party settlement organizations regarding transactions during calendar years 2024 and 2025.[727] Under the IRS guidance,[728] third-party settlement organizations are required to report transactions with respect to a participating payee when the amount of total payments for those transactions is more than $5,000, regardless of the number of transactions, in calendar year 2024, and more than $2,500, regardless of the number of transactions, in calendar year 2025. In addition, for calendar year 2024 and calendar year 2025, the IRS will not assert penalties under section 6721 or 6722 for a third-party settlement organization failure to file or furnish Forms 1099-K with respect to a payee unless the gross amount of aggregate payments to be reported exceeds $5,000 or $2,500, respectively, regardless of the number of such transactions. For calendar years beginning after December 31, 2025, a third-party settlement organization is required to report payments in settlement of third party network transactions with respect to any participating payee that exceed a minimum threshold of $600 in aggregate payments, regardless of the number of transactions.

Rules regarding reporting requirements

There are also reporting requirements on intermediaries who receive payments from a payment settlement entity and distribute such payments to one or more participating payees.[729] Such intermediaries are treated as participating payees with respect to the payment settlement entity and as payment settlement entities with respect to the participating payees to whom the intermediary distributes payments. Thus, for example, in the case of a corporation that receives payment from a bank for credit card sales conducted at the corporation's independently-owned franchise stores, the bank is required to report to the corporation and to the IRS the gross amount of reportable payment transactions settled with respect to the corporation (notwithstanding the fact that the corporation does not accept payment cards and would not otherwise be treated as a participating payee). In turn, the corporation, as an intermediary, is required to report the gross amount of reportable payment transactions allocable to each franchise store. The bank has no reporting obligation with respect to payments made by the corporation to its franchise stores.

In addition, if a payment settlement entity contracts with a third party facilitator to settle reportable payment transactions on behalf of the payment settlement entity, the third party

726 IR-2023-221, Nov. 21, 2023.

727 IR-2024-299, Nov. 26, 2024.

728 Notice 2024-85, 2024-51 I.R.B. 1349, November 26, 2024. Notice 2024-84 also provides that, for calendar year 2024, the IRS will not assert penalties under section 6651 or 6656 with respect to a third-party settlement organization failure to withhold and pay backup withholding tax during the calendar year. For calendar year 2025 and after, however, the IRS will assert penalties under section 6651 or 6656 with respect to a third-party settlement organization's failure to withhold and pay backup withholding tax.

729 Sec. 6050W(b)(4).

facilitator is required to file the annual information return in lieu of the payment settlement entity.[730]

The payment settlement entity is required to file information returns to the IRS on or before February 28 (March 31 if filing electronically) of the year following the calendar year for which the returns must be filed.[731] Statements are required to be furnished to the participating payees on or before January 31 of the year following the calendar year for which the return was required to be made.[732]

The Secretary has exercised authority under these rules to issue guidance to implement the reporting requirement, including rules to prevent the reporting of the same transaction more than once.[733]

The reportable payment transactions subject to information reporting generally are subject to backup withholding requirements. In addition, the information reporting penalties apply for any failure to file a correct information return or furnish a correct payee statement with respect to the reportable payment transactions. Any person who is required to file an information return or furnish a payee statement but who fails to do so on or before the prescribed due date is subject to a penalty that varies based on when, if at all, the correct information return is filed or furnished. Penalties are imposed for failure to file the information return[734] or furnish payee statements.[735] No penalty is imposed if the failure is due to reasonable cause.[736] Both the failure to file and failure to furnish penalties are adjusted annually to account for inflation.

Description of Proposal

The proposal reverts to the previous *de minimis* reporting exception for third party settlement organizations, and the same threshold the IRS has followed for calendar years 2022 and 2023. A third party settlement organization is not required to report unless the aggregate value of third party network transactions with respect to a participating payee for the year exceeds $20,000 and the aggregate number of such transactions with respect to a participating payee exceeds 200.

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[730] Sec. 6050W(b)(4)(B); Treas. Reg. sec. 1.6050W-1(d)(2).

[731] Treas. Reg. sec. 1.6050W-1(g). Taxpayers that file these information returns that report reportable payment transactions are entitled to a 30-day automatic extension of time to file. Treas. Reg. sec. 1.6081-8(a) (effective for requests for extension of time to file certain information returns due after December 31, 2016).

[732] Sec. 6050W(f); Treas. Reg. sec. 1.6050W-1(h).

[733] Treas. Reg. sec. 1.6050W-1(a)(4)(ii).

[734] Sec. 6721.

[735] Sec. 6722. Section 6723 also imposes a penalty for failure to timely comply with a specified information reporting requirement. However, this penalty applies in narrow circumstances and is unlikely to apply to payment settlement entities under section 6050W. See Treas. Reg. sec. 301.6723-1(a)(4).

[736] Sec. 6724(a).

The proposal does not change the clarification that reporting is not required on transactions which are not for goods or services.

The obligations of a merchant acquiring entity are unchanged. For example, if a company is considered a merchant acquiring entity, it must issue a Form 1099-K to all participating payees who have received payments of any amount starting with the first dollar. On the other hand, if a business that provides an online marketplace for sales of goods such as clothing, cars, furniture, etc. is considered a third party settlement organization, under this proposal, it does not have to provide a Form 1099-K to sellers participating on its web-based platform who have received payments of $20,000 or less or to sellers who have engaged in 200 or fewer transactions.

The proposal also makes a conforming change to the backup withholding dollar threshold[737] to align with the restoration of the previous *de minimis* reporting threshold. However, under the proposal, the *de minimis* reporting threshold does not apply with respect to payments to any participating payee during any calendar year if one or more payments in settlement of third party network transactions made by the payor to the participating payee during the preceding calendar year were reportable payments.

Effective Dates

The proposal with respect to the reinstatement of the exception for *de minimis* payments applies as if included in section 9674 of Public Law No. 117-2, the American Rescue Plan Act (enacted on March 11, 2021). Thus, the proposal applies to returns for calendar years beginning after December 31, 2021.

The proposal with respect to the application of the *de minimis* rule for third party network transactions to backup withholding applies to calendar years beginning after December 31, 2024.

[737] Sec. 3406(b)(6).

E. Increase in Threshold for Requiring Information Reporting with Respect to Certain Payees

Present Law

Information reporting requirements

Present law requires persons to file an information return concerning certain transactions with other persons.[738] The person filing an information return (the "payor") is also required to provide the person for whom the information return is being filed (the "payee") with a written statement showing the information that was reported to the Internal Revenue Service ("IRS"), which generally includes aggregate payments made, and the contact information for the payor.[739] These returns are intended to assist taxpayers in preparing their income tax returns and to help the IRS determine whether such income tax returns are correct and complete.

For example, every person engaged in a trade or business who makes certain payments aggregating $600 or more in any taxable year to a single payee in the course of such trade or business must report those payments to the IRS.[740] This requirement applies to fixed or determinable payments of income as well as nonemployee compensation, generally reported on either Form 1099-MISC, *Miscellaneous Information*, or Form 1099-NEC, *Nonemployee Compensation*. In addition, any service recipient engaged in a trade or business and paying for services is required to make a return according to regulations when aggregate payments equal $600 or more.[741] Governmental entities are specifically required to make an information return,[742] and in the case of payments by Federal executive agencies that extends to reporting payments to corporations as well as individuals.[743]

However, these provisions discussed above do not cover payments for goods or certain enumerated types of payments that are subject to other specific reporting requirements, such as provisions covering dividends, interest, and royalties.[744] Treasury regulations generally provide further exceptions from the reporting of payments to corporations, exempt organizations, governmental entities, international organizations, and retirement plans.[745]

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[738] Secs. 6041 through 6050Y.

[739] See, *e.g.*, sec. 6041(d).

[740] Sec. 6041.

[741] Sec. 6041A.

[742] Sec. 6041(A)(d)(2).

[743] Sec. 6041A(d)(3)(A).

[744] Section 6041(a) generally excepts from its scope most interest, royalties, and dividends, which are instead covered by sections 6049, 6050N, and 6042, respectively.

[745] Treas. Reg. sec. 1.6041-3. Certain for-profit health care provider corporations are not covered by this general exception, including those organizations providing billing services for such companies.

A person who is required to file information returns but who fails to do so by the due date for the returns, includes on the returns incorrect information, or files incomplete returns generally is subject to a penalty of $250 for each return with respect to which such a failure occurs, up to a maximum of $3,000,000 in any calendar year, adjusted for inflation.[746] Similar penalties apply to failures to furnish correct written statements to recipients of payments for which information reporting is required.[747] The failure to file and failure to furnish penalties are reduced for small businesses[748] and increased for failures due to intentional disregard.[749]

Backup withholding

Generally, a payor is not required to withhold taxes from payments to the payee. However, a payor may be required to deduct and withhold income tax on certain "reportable payments" at a rate equal to 24 percent[750] if: (1) the payee fails to furnish his or her taxpayer identification number ("TIN") to the payor; (2) the IRS notifies the payor that the payee's TIN is incorrect; (3) a notified payee underreporting of reportable payments has occurred; or (4) a payee certification failure with respect to reportable payments has occurred.[751] The requirement to deduct and withhold in the case of a notified payee underreporting or a payee certification failure applies solely to reportable interest or dividend payments. These deduction and withholding requirements[752] are referred to as backup withholding.

Reportable payments are defined as any reportable interest or dividend payment and any other reportable payment.[753] A reportable interest or dividend payment means any payment of a kind, and to a payee, required to be shown on an information return required under any of the

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[746] Sec. 6721. These amounts are adjusted annually for inflation. For information returns required to be filed in calendar year 2023, the penalty amount is $290, up to a maximum of $3,532,500 per calendar year. For information returns required to be filed in calendar year 2024, the penalty amount is $310, up to a maximum of $3,783,000 per calendar year. The penalties are reduced if the failure is corrected within a specified amount of time. Sec. 6721(b). The penalties are waived if a person establishes that any failure was due to reasonable cause and not willful neglect. Sec. 6724(a).

[747] Sec. 6722. These amounts are also adjusted annually for inflation. For information statements required to be filed in calendar year 2023, the penalty amount is $290, up to a maximum of $3,532,500 per calendar year. For information statements required to be filed in calendar year 2024, the penalty amount is $310, up to a maximum of $3,783,000 per calendar year. The penalties are reduced if the failure is corrected within a specified amount of time. Sec. 6722(b). The penalties are waived if a person establishes that any failure was due to reasonable cause and not willful neglect. Sec. 6724(a).

[748] Secs. 6721(d) and 6722(d).

[749] Secs. 6721(e) and 6722(e).

[750] Sec. 3406(a)(1)(D). The backup withholding rate is the fourth lowest rate of tax applicable under section 1(c). In 2023, this rate is 24 percent.

[751] Sec. 3406(a)(1).

[752] Sec. 3406.

[753] Sec. 3406(b).

following sections: (i) 6049(a), relating to payments of interest, (ii) 6042(a), relating to payments of dividends, or (iii) 6044, relating to payments of patronage dividends, but only to the extent such payment is in money and only if 50 percent or more of such payment is in money. Any other reportable payment means any payment of a kind, and to a payee, required to be shown on a return required under any of the following sections: (i) 6041, relating to certain information at source, (ii) 6041A(a), relating to payments of remuneration for services, (iii) 6045, relating to returns of brokers, (iv) 6050A, relating to reporting requirements of certain fishing boat operators, but only to the extent such payment is in money and represents a share of the proceeds of the catch, (v) 6050N, relating to payments of royalties, or (vi) 6050W, relating to payments made in settlement of payment card and third party settlement transactions. Examples of payments that may be subject to backup withholding include interest, dividends, rents, royalties, commissions, non-employee compensation, and broker payments.

In general, a payment is determined to be a reportable payment, and therefore subject to backup withholding, without regard to any minimum amount which must be paid before an information return is required under the applicable information reporting statute.[754]

For payments required to be shown on a return under section 6041(a) or 6041A(a), relating to certain information at the source and payments of remuneration for services, a minimum amount generally must be paid before the payment is subject to backup withholding.[755] Such payments are treated as reportable payments, and therefore subject to backup withholding, only if (i) the aggregate amount of such payment and all previous payments described in section 6041(a) or 6041A(a) by the payor to the payee during such calendar year equals or exceeds $600, (ii) the payor was required under section 6041(a) or 6041A(a) to file an information return for the preceding calendar year with respect to payments to the payee, or (iii) during the preceding calendar year, the payor made reportable payments to the payee with respect to which amounts were required to be deducted and withheld under the backup withholding requirements. Backup withholding generally applies only to payments made to U.S. persons who have failed to provide the payor with a valid IRS Form W-9, *Request for Taxpayer Identification Number and Certification*; however, it may also apply to certain payments made to persons in the absence of valid documentation of foreign status. Backup withholding does not apply to payments made to exempt recipients, including tax-exempt organizations, government entities, and certain other entities.[756] Thus, a payor of reportable payments generally must request that a U.S. payee (other than certain exempt recipients) furnish a Form W-9 providing that person's name and TIN.[757]

[754] Sec. 3406(b)(4).

[755] Sec. 3406(b)(6).

[756] Sec. 3406(g); Treas. Reg. sec. 31.3406(g)-1.

[757] Treas. Reg. sec. 31.3406(h)-3.

Description of Proposal

The proposal changes the information reporting threshold for certain payments to persons engaged in a trade or business[758] and payments of remuneration for services[759] to $2,000 in a calendar year, with the threshold amount to be indexed annually for inflation in calendar years after 2026. No change is made to the information reporting threshold for direct sales.

The proposal also makes a conforming change to the backup withholding dollar threshold[760] to align with the new $2,000 reporting threshold. Under the proposal, both the information reporting thresholds and the backup withholding thresholds are for transactions that equal or exceed $2,000 (indexed for inflation for calendar years after 2026).

Effective Date

The proposal applies with respect to payments made after December 31, 2025.

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[758] Sec. 6041(a).

[759] Sec. 6041A(a).

[760] Sec. 3406(b)(6).

F. Repeal of Excise Tax on Indoor Tanning Services

Present Law

A retail sales tax is imposed on indoor tanning services.[761] The tax rate is 10 percent of the amount paid for such services, including any amount paid by insurance.[762] If a payment covers charges for indoor tanning services as well as other goods and services, the charges for other goods and services may be excluded in computing the tax payable on the amount paid.[763]

Consumers are liable for the tax, with service providers being responsible for collecting and remitting the tax to the Federal Government on a quarterly basis.

Indoor tanning services are services employing any electronic product designed to induce skin tanning and which incorporate one or more ultraviolet lamps with wavelengths in air between 200 and 400 nanometers.[764] Taxable services do not include phototherapy services[765] performed by a licensed medical professional. There is also an exemption for qualified physical fitness facilities that meet certain criteria and offer tanning as an incidental service to members without a separately identifiable fee.[766]

Description of Proposal

Under the proposal, the excise tax on indoor tanning services applies for services performed on or prior to the date of enactment. Thus, the tax does not apply to services performed after the date of enactment.

Effective Date

The proposal is effective for services performed after the date of enactment.

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[761] Sec. 5000B.

[762] The total amount paid is presumed to include the tax if the tax is not separately stated. Treas. Reg. sec. 48.5000B-1(d)(1)(i).

[763] Treas. Reg. sec. 48.5000B-1(c)(2), (d)(2), and (d)(3).

[764] Treas. Reg. sec. 48.5000B-1(c)(1).

[765] Phototherapy services are services that expose an individual to specific wavelengths of light for the treatment of (i) dermatological conditions, such as acne, psoriasis, and eczema; (ii) sleep disorders; (iii) seasonal affective disorder or other psychiatric disorder; (iv) neonatal jaundice; (v) wound healing; and (vi) other medical conditions determined by a licensed medical professional to be treatable by exposing the individual to specific wavelengths of light. Treas. Reg. sec. 48.5000B-1(c)(3).

[766] Treas. Reg. sec. 48.5000B-1(d)(4).

G. Exclusion of Interest on Loans Secured by Rural or Agricultural Real Property

Present Law

In general

Gross income broadly encompasses all income from whatever source derived and includes, among other items, interest.[767] While the Code does not provide an exhaustive list of gross income inclusions, the courts deem an item as gross income if it constitutes a clearly realized accession to wealth under the taxpayer's control unless that item is excepted .[768] Exceptions include certain types interest income such as interest on State and local bonds[769] and interest received from the Federal Government in connection with an action to recover property seized by the Internal Revenue Service.[770] Present law disallows a deduction for certain expenses and interest on indebtedness incurred to purchase or carry tax-exempt obligations.[771]

Description of Proposal

The proposal allows banks insured under the Federal Deposit Insurance Act,[772] domestic entities owned by a bank holding company,[773] State or Federally regulated insurance companies, domestic entities owned by a State law insurance holding company, and the Federal Agricultural Mortgage Corporation ("Farmer Mac")[774] to exclude from gross income 25 percent of interest income derived from qualified real estate loans.

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[767] Sec. 61(a)(4) and Treas. Reg. sec. 1.61-7. Interest income includes interest on savings or other bank deposits; interest on coupon bonds; interest on an open account, a promissory note, a mortgage, or a corporate bond or debenture; the interest portion of a condemnation award; usurious interest (unless by State law it is automatically converted to a payment on the principal); interest on legacies; interest on life insurance proceeds held under an agreement to pay interest thereon; and interest on refunds of Federal taxes. Treas. Reg. sec. 1.61-7(a).

[768] *Commissioner v. Glenshaw Glass Co.,* 348 U.S. 426, 432 (1955). Sec. 61(b) cross references statutory exclusions from gross income in sections 101 through 139I.

[769] Sec. 103.

[770] Sec. 139H.

[771] Sec. 265(a).

[772] As defined in 12 U.S.C. sec. 1811, *et seq*.

[773] As defined in section 8 of the International Banking Act (12 U.S.C. sec. 3106).

[774] As established under section 8.1(a) of the Farm Credit Act of 1971 (12 U.S.C. sec. 2279aa-1(a)).

Qualified real estate loans are the following types of original loans[775] made after the date of enactment and before January 1, 2029, to a person other than a specified foreign entity:[776]

- loans secured by domestic real property that is substantially used to produce agricultural products (*e.g*. farms and ranches) or a leasehold mortgage on such property;
- loans secured by domestic real property that is substantially used in the trade or business of fishing or seafood processing or a leasehold mortgage on such property; and
- loans secured by any domestic aquaculture facility[777] or a leasehold mortgage on such facility.[778]

The proposal treats qualified real estate loans as tax-exempt obligations for purposes of disallowing interest deductions on indebtedness incurred by qualified lenders to purchase or carry such loans.

Effective Date

The proposal applies to original debt incurred in taxable years ending after the date of enactment.

[775] Qualified real estate loans exclude refinancings of loans made on or before the date of enactment.

[776] As defined under section 7701(a)(51)(B), as added by the proposal.

[777] An aquaculture facility means any domestic land, structure, or other appurtenance that is used for aquaculture, including any hatchery, rearing pond, raceway, pen, or incubator that is in any State or any territory of the United States,

[778] Farmer Mac is not eligible to exclude from gross income any interest income received from loans secured by domestic real property that is substantially used in the trade or business of fishing or seafood processing, or loans secured by domestic aquaculture facilities. That is, it may only exclude from gross income 25 percent of the interest derived from loans secured by domestic real property that is substantially used to produce agricultural products or a leasehold mortgage on such property.

H. Treatment of Certain Qualified Sound Recording Productions

Present Law

Expensing of certain qualified film, television, and live theatrical productions

Under section 181, a taxpayer may elect[779] to deduct up to $15 million of the aggregate production costs of any qualified film, television or live theatrical production that commences before to January 1, 2026.[780] Instead of capitalizing and recovering those production costs through depreciation allowances once the production is placed in service, taxpayers deduct the costs when it pays or incurs them.[781] The dollar limit is increased to $20 million if a significant amount of the production costs are incurred in areas eligible for designation as a low-income community or eligible for designation by the Delta Regional Authority as a distressed county or isolated area of distress.[782]

A section 181 election may only be made by an owner of the production.[783] An owner of a production is any person that is required under section 263A to capitalize the costs of producing the production into the cost basis of the production, or that would be required to do so if section 263A applied to that person.[784] In addition, the aggregate production costs of a qualified production that is co-produced include all production costs, regardless of funding source, in determining if the applicable dollar limit is exceeded. Thus, the term "aggregate production costs" means all production costs paid or incurred by any person, whether paid or

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[779] See Treas. Reg. sec. 1.181-2 for rules on making (and revoking) an election under section 181.

[780] For purposes of determining whether a production is eligible for section 181 expensing, a qualified film or television production is treated as commencing on the first date of principal photography or in-between animation. Treas. Reg. sec. 1.181-6(a). The date on which a qualified live theatrical production commences is the date of the first public performance of such production for a paying audience. 2015 PATH Act, Pub. L. No. 114-113, Div. Q, sec. 169(d)(2)(B).

[781] Sec. 181(a)(2)(A). See Treas. Reg. sec. 1.181-1 for rules on determining eligible production costs. Eligible production costs under section 181 include participations and residuals, compensation for services, compensation for property rights, and financing costs. Treas. Reg. sec. 1.181-1(a)(3)(i). The special rule in section 167(g)(7) that allows taxpayers using the income forecast method of depreciation to include participations and residuals that have not satisfied the economic performance rules (*i.e.*, participations and residuals that have not been 'paid or incurred') in the adjusted basis of property placed in service does not apply for purposes of section 181. Treas. Reg. sec. 1.181-1(a)(8). Thus, under section 181, a taxpayer may only include participations and residuals that it pays or incurs for eligible production costs. Production costs exclude the cost of obtaining a production after its initial release or broadcast. See Treas. Reg. sec. 1.181-1(a)(3)(iii). For this purpose, "initial release or broadcast" means the first commercial exhibition or broadcast of a production to an audience. Treas. Reg. sec. 1.181-1(a)(7). Thus, *e.g.*, a taxpayer may not expense the purchase of an existing film library under section 181. See T.D. 9551, 76 Fed. Reg. 64816, October 19, 2011.

[782] Sec. 181(a)(2)(B).

[783] Treas. Reg. sec. 1.181-1(a).

[784] Treas. Reg. sec. 1.181-1(a)(2)(i).

incurred directly by an owner or indirectly on behalf of an owner.[785] Taxpayers must capitalize and recover production costs that exceed the applicable dollar limitation under their method of accounting (*e.g.*, under the income forecast method, or section 168(k) if eligible, as discussed below).[786]

A qualified film or television, or live theatrical production means any production of a motion picture (whether released theatrically or directly to video cassette or any other format), television program, or live staged play if at least 75 percent of the total compensation, excluding participations and residuals,[787] expended on the production is for services performed in the United States by actors, directors, producers, and other relevant production personnel.[788]

A qualified film or television production means any motion picture or video tape.[789] Each episode of a television series is treated as a separate production, and only the first 44 episodes of a particular series qualify under the provision.[790] Qualified film or television productions exclude sexually explicit productions.[791]

A qualified live theatrical production means a live staged production of a play (with or without music) which is derived from a written book or script and is produced or presented by a commercial entity in venues of a certain capacity. Generally, the audience capacity of the venue cannot exceed 3,000 people, or in the case of a series of venues, the majority of those venues cannot exceed 3,000 people.[792] There is a capacity exception for seasonal productions produced or presented by a taxpayer for no more than 10 weeks annually in any venue whose audience

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[785] Treas. Reg. sec. 1.181-1(a)(4). See Treas. Reg. sec. 1.181-2(c)(3) for the information required to be provided to the Internal Revenue Service when more than one person will claim deductions under section 181 for a production (to ensure that the applicable deduction limitation is not exceeded).

[786] See Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 110th Congress* (JCS-1-09), March 2009, p. 448; Treas. Reg. sec. 1.181-1(c)(2). A production is generally considered to be placed in service at the time of initial release, broadcast, or live staged performance (*i.e.*, at the time of the first commercial exhibition, broadcast, or live staged performance of a production to an audience). See, *e.g.*, Rev. Rul. 79-285, 1979-2 C.B. 91; and PLR 9010011, March 9, 1990. See also, Treas. Reg. sec. 1.181-1(a)(7). However, a production is not placed in service if it is only exhibited, broadcasted or performed for a limited test audience in advance of the commercial exhibition, broadcast, or performance to general audiences. See PLR 9010011; Treas. Reg. sec. 1.181-1(a)(7).

[787] Sec. 181(d)(3)(B). Participations and residuals are defined as, with respect to any property, costs the amount of which by contract varies with the amount of income earned in connection with such property. See also Treas. Reg. sec. 1.181-3(c).

[788] Sec. 181(d)(1) and (e)(1).

[789] Secs. 181(d)(2)(A) and 168(f)(3).

[790] Sec. 181(d)(2)(B).

[791] As referenced by 18 U.S.C. section 2257. Sec. 181(d)(2)(C).

[792] Sec. 181(e)(2)(A).

capacity does not exceed 6,500 people.[793] Each live-staged production is treated as a separate production. Like qualified film and television productions, qualified live theatrical productions exclude sexually explicit productions.[794]

Any deduction allowed under section 181 is treated as an allowable amortization deduction[795] subject to ordinary income recapture in the taxable year in which (1) the taxpayer revokes a section 181 election, (2) the production fails to meet the requirements of section 181, or (3) the taxpayer sells or otherwise disposes of the production.[796]

Depreciation of certain intangible property

A taxpayer generally must capitalize the cost of property used in a trade or business or held produce income and recover the cost over time through annual depreciation or amortization deductions.[797] Depreciation or amortization generally begins when the asset is placed in service by the taxpayer.[798] Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation for different types of property based on an assigned applicable depreciation method, recovery period, and placed in service convention.[799]

Films, videos, and sound recordings

MACRS does not apply to certain property, including any motion picture film, video tape, or sound recording, or to any other property if the taxpayer elects to exclude such property from MACRS and the taxpayer properly applies a unit-of-production method or other method of depreciation not expressed in a term of years.[800] Thus, the recovery of the cost of a film, video tape, sound recording, or similar property that is produced or acquired by the taxpayer may not be determined under either the MACRS depreciation provisions or under the section 197

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793 Sec. 181(e)(2)(D),

794 As referenced by 18 U.S.C. section 2257. Sec. 181(e)(2)(E).

795 Sec. 1245(a)(2)(C). For a discussion of the recapture rules applicable to depreciation and amortization deductions, see Joint Committee on Taxation, *Tax Incentives for Domestic Manufacturing* (JCX-8-24), March 8, 2024, pp. 14-17. This document can be found on the Joint Committee on Taxation website at www.jct.gov.

796 See Treas. Reg. sec. 1.181-4.

797 See secs. 263(a) and 167. In general, only the tax owner of property (*i.e.*, the taxpayer with the benefits and burdens of ownership) is entitled to claim tax benefits such as cost recovery deductions with respect to the property. In addition, where property is not used exclusively in a taxpayer's business, the amount eligible for a deduction must be reduced by the amount related to personal use. See, *e.g.*, sec. 280A.

798 See Treas. Reg. secs. 1.167(a)-10(b), -3, -14, and 1.197-2(f). See also Treas. Reg. sec. 1.167(a)-11(e)(1)(i).

799 Sec. 168.

800 Sec. 168(f)(1), (3) and (4).

amortization provisions.[801] The cost recovery of such property is determined under section 167, which allows a depreciation deduction for the reasonable allowance for the exhaustion, wear and tear, or obsolescence of property used in a trade or business or held to produce of income. In addition, the costs of motion picture films, video tapes, sound recordings, copyrights, books, and patents are eligible to be recovered using the income forecast method of depreciation.[802]

Under the income forecast method, a property's depreciation deduction for a taxable year is determined by multiplying the adjusted basis of the property by a fraction, the numerator of which is the gross income generated by the property during the year, and the denominator of which is the total forecasted or estimated gross income expected to be generated prior to the close of the tenth taxable year after the year the property is placed in service. Any costs that are not recovered by the end of the tenth taxable year after the property is placed in service may be depreciated in that year.[803]

Additional first-year depreciation deduction for certain productions

Under section 168(k), qualified property acquired and placed in service after September 27, 2017, and before January 1, 2023 (January 1, 2024, for longer production period property and certain aircraft), as well as specified plants planted or grafted after September 27, 2017, and before January 1, 2023, is eligible for an additional first-year depreciation deduction equal to 100 percent of the adjusted basis of the property. The 100 percent allowance is phased down by 20 percent per calendar year for qualified property acquired after September 27, 2017, and placed in service after December 31, 2022 (after December 31, 2023, for longer production period property and certain aircraft), as well as specified plants planted or grafted after December 31, 2022. This additional first-year depreciation is commonly referred to as "bonus depreciation."

Qualified property eligible for bonus depreciation under section 168(k) includes qualified film, television, and live theatrical productions placed in service after September 27, 2017, and before January 1, 2027, for which a deduction otherwise would have been allowable under

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[801] Under section 197, when a taxpayer acquires intangible assets held in connection with a trade or business, any value properly attributable to a "section 197 intangible" is amortizable on a straight-line basis over 15 years. No other depreciation or amortization deduction (such as bonus depreciation under section 168(k)) is allowable with respect to any section 197 intangible. Section 197 does not apply to certain intangible property, including certain property produced by the taxpayer or any interest in a film, sound recording, video tape, book or similar property not acquired in a transaction (or a series of related transactions) involving the acquisition of assets constituting a trade or business or substantial portion thereof. See sec. 197(c)(2) and (e)(4)(A).

[802] Sec. 167(g)(6).

[803] Sec. 167(g)(1). In general, the adjusted basis of property that may be taken into account under the income forecast method only includes amounts that have been incurred under the economic performance requirements of section 461(h). An exception to this rule applies to participations and residuals. Specifically, solely for purposes of computing the allowable deduction for property under the income forecast method of depreciation, participations and residuals may be included in the adjusted basis of the property beginning in the year such property is placed in service (even if economic performance has not yet occurred) if such participations and residuals relate to income to be derived from the property before the close of the tenth taxable year following the year the property is placed in service. For this purpose, participations and residuals are defined as costs the amount of which, by contract, varies with the amount of income earned in connection with such property. See sec. 167(g)(7).

section 181, without regard to the dollar limitation or termination of such section.[804] A qualified production is considered to be placed in service, and thus eligible for bonus depreciation, at the time of initial release, broadcast, or live staged performance.[805]

Description of Proposal

The proposal expands the special expensing rules for qualified film, television, and live theatrical productions under section 181 to include aggregate qualified sound recording production costs of up to $150,000 per taxable year. A qualified sound recording production is a sound recording (as defined in 17 U.S.C. sec. 101)[806] produced and recorded in the United States. Like qualified film and television productions or qualified live theatrical productions, the section 181 deduction only applies to qualified sound recordings that commence before January 1, 2026. The practical impact is that only sound recordings that commence in taxable years ending after the date of enactment and before January 1, 2026 will be eligible for the section 181 deduction.

The proposal also expands the definition of qualified property eligible for bonus depreciation to include qualified sound recording productions placed in service before January 1, 2029. A qualified sound recording production is placed in service at the time of initial release or broadcast.

Effective Date

The proposal applies to productions commencing in taxable years ending after the date of enactment.

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[804] See sec. 168(k)(2)(A)(i)(IV) and (V); Treas. Reg. sec. 1.168(k)-(2)(b)(E) and (F).

[805] See Treas. Reg. sec. 1.168(k)-2(b)(4)(iii).

[806] Sound recordings are works that result from the fixation of a series of musical, spoken, or other sounds, but not including the sounds accompanying a motion picture or other audiovisual work, regardless of the nature of the material objects, such as disks, tapes, or other phonorecords, in which they are embodied.

I. Modifications to Low-Income Housing Credit

Present Law

A taxpayer may claim the low-income housing credit annually over a 10-year period for the costs of building or rehabilitating rental housing occupied by low-income tenants. To be eligible for the credit, a low-income building must have received a credit allocation from the State or been financed with the proceeds of certain tax-exempt bonds that are subject to the private activity bond volume limit. For any calendar year, the total amount of housing credits available for allocation by a State is limited to the State housing credit ceiling. However, the amount of housing credit allocated to a low-income building reduces the State housing credit ceiling only once, in the year the housing credit is allocated.

State housing credit ceiling

The State housing credit ceiling is an amount equal to the sum of four components: (1) the unused State housing credit ceiling (if any) for the preceding calendar year (the "unused carryforward component"), (2) the population component, (3) the amount of State housing credit ceiling returned in the calendar year (the "returned credit component"), plus (4) the amount (if any) that the Secretary allocates to the State from the national pool of unused housing credits (the "national pool component").[807]

For calendar year 2025, the population component of the State housing credit ceiling is equal to the greater of (1) $3.00 multiplied by the State population or (2) $3,455,000.[808]

Credit calculations

Determination of applicable percentage

The applicable percentage for non-Federally subsidized newly constructed housing and non-Federally subsidized substantial rehabilitation is calculated such that the present value of the credit amounts is at least 70 percent of a building's qualified basis, depending on the prevailing interest rate.[809] These credits are sometimes referred to as "nine-percent credits."

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[807] Sec. 42(h)(3)(C); Treas. Reg. sec. 1.42-14(a)(1).

[808] Rev. Proc. 2024-40. A building does not require an allocation of credits from the credit ceiling if at least 50 percent of the aggregate basis of the building and the land on which the building is located is financed by certain tax-exempt bonds subject to the private activity bond volume limit. Sec. 42(h)(4)(B).

[809] See sec. 42(b) and (e). This credit is referred to as the 70-percent credit. See Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (JCS-10-87), May 4, 1987. This document can be found on the Joint Committee on Taxation website at www.jct.gov. However, under the Housing and Economic Recovery Act of 2008, the minimum applicable percentage for such credits was temporarily set at nine percent (the "nine-percent floor"). The Consolidated Appropriations Act, 2016 made the nine-percent floor permanent. The enactment of the nine-percent floor on the credit implies that, under the statutory formula, the present value is always 70 percent or greater.

The applicable percentage for Federally subsidized newly constructed housing, Federally subsidized substantial rehabilitation, and certain housing acquisition costs, is calculated such that the present value of the credit amounts is at least 30 percent of a building's qualified basis, depending on the prevailing interest rate.[810] These credits are sometimes referred to as "four-percent credits."

Calculation of eligible basis

The qualified basis for purposes of determining the amount of low-income housing credit to be claimed each year is an amount equal to the applicable fraction of eligible basis.[811] The eligible basis of a new building is its adjusted basis as of the close of the first taxable year of the credit period. The eligible basis of an existing building is zero unless the building meets the following requirements: the building is acquired by purchase; there is a period of at least 10 years between the date of its acquisition by the taxpayer and the date the building was last placed in service; the building was not previously placed in service by the taxpayer or a related person; and the building was rehabilitated and is eligible for the low income housing credit for rehabilitation expenditures treated as a separate new building.

Generally, buildings located in certain census tracts and difficult development areas, as designated by the Secretary of Housing and Urban Development, are eligible for increased housing credit.[812] The increase in housing credit is effected by increasing a building's eligible basis from 100 to 130 percent of the otherwise applicable eligible basis (in the case of a new building) or rehabilitation expenditures (in the case of an existing building). A building designated by a State housing credit agency as requiring an increase in credit to be financially feasible is treated as being located in a difficult development area.

Tax-exempt bond-financed buildings

If 50 percent or more of the aggregate basis of the building and the land on which the building is located is financed by the proceeds of tax-exempt bonds, a low-income housing tax credit is allowable with respect to the entire eligible basis of the project without an allocation from the State or local housing credit agency. If less than 50 percent of the aggregate basis is so financed, a low-income housing tax credit is allowable only with respect to the portion financed by the proceeds of tax-exempt bonds. The tax-exempt bonds must be subject to the volume cap

[810] This credit is referred to as the 30-percent credit. See Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (JCS-10-87), May 4, 1987. This document can be found on the Joint Committee on Taxation website at www.jct.gov. However, under the Consolidated Appropriations Act, 2020, the minimum applicable percentage for such credits was set at four percent (the "four-percent floor"). The enactment of the four-percent floor on the credit implies that, under the statutory formula, the present value is always 30 percent or greater.

[811] Sec. 42(c)(1)(A).

[812] Sec. 42(d)(5).

for private activity bonds and once bond proceeds are used to finance a project, principal payments on such financing must be applied within a reasonable period to redeem the bonds.[813]

Description of Proposal

Increase State housing credit ceiling amounts

The proposal provides an increase in the State housing credit ceiling for calendar years 2026, 2027, 2028, and 2029. In each of the calendar years, the population component of the State housing credit ceiling (after application of the cost-of-living adjustment) is increased by multiplying the dollar amounts for that year by 1.125.

Modify tax-exempt bond financing requirement

The proposal modifies the tax-exempt bond financing requirement to allow additional buildings financed with tax-exempt bonds to qualify for housing credits without receiving a credit allocation from the State housing credit ceiling. As under present law, a building may be allowed four-percent credits without receiving a credit allocation if 50 percent or more of the aggregate basis of the building and the land on which the building is located is financed by the proceeds of one or more tax-exempt bonds. In addition, under the proposal, a building may be allowed four-percent credits without receiving a credit allocation if at least 25 percent (rather than 50 percent) of the aggregate basis of the building is financed with one or more qualified obligations, and one or more of such obligations (1) are part of an issue the issue date of which is after December 31, 2025, and (2) provides the financing for at least five percent of the aggregate basis of the building and the land on which the building is located. A qualified obligation is a tax-exempt bond which is part of an issue the issue date of which is before January 1, 2030.

Temporary inclusion of Indian areas and rural areas as difficult development areas

The proposal provides a temporary increase in housing credit by expanding the definition of difficult development areas to include Indian areas and rural areas in the case of buildings place in service after December 31, 2025 and before January 1, 2030. Such buildings are eligible for increased housing credit to be calculated by increasing a building's eligible basis from 100 to 130 percent of the otherwise applicable eligible basis (in the case of a new building) or rehabilitation expenditures (in the case of an existing building).

An Indian area is defined as in section 4(11) of the Native American Housing Assistance and Self Determination Act of 1996 ("NAHASDA")[814] and any housing area as defined in section 801(5) of such Act[815]. A building in an Indian area is treated as being in a difficult development area only if it is assisted or financed under NAHASDA or the project sponsor is an

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[813] Sec. 42(h)(4)(A).

[814] 25 U.S.C. 4103(11).

[815] 25 U.S.C. 4221(5).

Indian tribe,[816] a tribally designated housing entity[817] or wholly owned or controlled by such an Indian tribe or tribally designated housing entity.

A rural area is defined to be any non-metropolitan area, or any open country, place, town, village, or city which is not part of or associated with an urban area and either has low population or is not contained within a standard metropolitan statistical area and has a serious lack of mortgage credit for lower and moderate-income families, as determined by the Secretary of Agriculture and the Secretary of Housing and Urban Development[818] and which is identified by the qualified allocation plan of the housing credit agency.

Effective Date

The increase in State housing ceiling amounts is effective for calendar years after 2025.

The modification of the tax-exempt bond financing requirement is effective for buildings placed in service in taxable years beginning after December 31, 2025. However, in the case of a building with respect to which any expenditures are treated as a separate new building under section 42(e), both the existing building and the separate new building are treated as having been placed in service on the date the expenditures are treated as placed in service under section 42(e)(4).

The temporary inclusion of Indian areas and rural areas as difficult development areas is effective for buildings placed in service after December 31, 2025.

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[816] As defined in sec. 45A(c)(6).

[817] As defined in 25 U.S.C. 4103(22).

[818] 42 U.S.C. 1490.

J. Increased Gross Receipts Threshold for Small Manufacturing Businesses

Present Law

General rule for methods of accounting

Section 446 generally allows a taxpayer to select the method of accounting to be used to compute taxable income, provided that such method clearly reflects the income of the taxpayer. The term "method of accounting" includes not only the overall method of accounting used by the taxpayer, but also the accounting treatment of any one item.[819] Permissible overall methods of accounting include the cash receipts and disbursements method ("cash method"), an accrual method, or any other method (including a hybrid method) permitted under regulations prescribed by the Secretary.[820] Examples of any one item for which an accounting method may be adopted include cost recovery,[821] revenue recognition,[822] and the timing of deductions.[823] For each separate trade or business, a taxpayer is entitled to adopt any permissible method, subject to certain restrictions.[824]

A taxpayer filing its first return may adopt any permissible method of accounting in computing taxable income for such year.[825] Except as otherwise provided, section 446(e) requires taxpayers to secure the consent of the Secretary before changing a method of accounting. The regulations under this section provide rules for determining: (1) what a method of accounting is, (2) how a method of accounting is adopted,[826] and (3) how a change in method of accounting is effectuated.[827]

Cash and accrual methods

Taxpayers using the cash method generally recognize items of income when actually or constructively received and items of expense when paid. The cash method is administratively easy and provides the taxpayer flexibility in the timing of income recognition. It is the method generally used by most individual taxpayers, including farm and nonfarm sole proprietorships.

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[819] Treas. Reg. sec. 1.446-1(a)(1).

[820] Sec. 446(c).

[821] See, *e.g.*, secs. 167 and 168.

[822] See, *e.g.*, secs. 451 and 460.

[823] See, *e.g.*, secs. 461 and 467.

[824] Sec. 446(d); Treas. Reg. sec. 1.446-1(d).

[825] Treas. Reg. sec. 1.446-1(e)(1).

[826] See also Rev. Rul. 90-38, 1990-1 C.B. 57 (holding that a taxpayer adopts a method of accounting (1) when it uses a permissible method of accounting on a single tax return, or (2) when it uses the same impermissible method of accounting on two or more consecutive tax returns).

[827] Treas. Reg. sec. 1.446-1(e).

In general, taxpayers using an accrual method generally accrue items of income when all the events have occurred that fix the right to receive the income and the amount of the income can be determined with reasonable accuracy.[828] For accrual method taxpayers with applicable financial statements,[829] the accrual of income generally occurs not later than when such amounts are taken into account as revenue in the taxpayer's applicable financial statements.[830] Taxpayers using an accrual method of accounting generally may not deduct items of expense prior to when all the events have occurred that fix the obligation to pay the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred.[831] Accrual methods of accounting generally result in a more accurate measure of economic income than the cash method. The accrual method is often used by businesses for financial accounting purposes.

A C corporation, a partnership that has a C corporation as a partner, or a tax-exempt trust or corporation with unrelated business income generally may not use the cash method. In addition, the cash method generally may not be used if the purchase, production, or sale of merchandise is an income producing factor.[832] Such taxpayers generally are required to keep inventories and use an accrual method with respect to inventory items.[833] Exceptions are made for farming businesses, qualified personal service corporations, and the aforementioned entities to the extent their average annual gross receipts[834] do not exceed $25 million for the three prior taxable-year period (the "$25 million gross receipts test") to use the cash method. Under the $25 million gross receipts test, the cash method of accounting may be used by taxpayers, other than tax shelters, that satisfy the gross receipts test, regardless of whether the purchase, production, or

[828] See, *e.g.*, sec. 451.

[829] See sec. 451(b)(3) and Treas. Reg. 1.451-3(a)(5).

[830] See sec. 451(b) and Treas. Reg. secs. 1.451-1 and 1.451-3.

[831] See, *e.g.*, sec. 461.

[832] Treas. Reg. secs. 1.446-1(c)(2) and 1.471-1.

[833] Sec. 471 and Treas. Reg. secs. 1.446-1(c)(2) and 1.471-1.

[834] For this purpose, gross receipts are taken into account in the taxable year in which they are properly recognized under the taxpayer's method of accounting used in that taxable year. Gross receipts include total sales (net of returns and allowances) and all amounts received for services. In addition, gross receipts include income from investments, income from incidental or outside sources, interest (including original issue discount and tax-exempt interest within the meaning of section 103), dividends, rents, royalties, and annuities, regardless of whether such amounts are derived in the ordinary course of the taxpayer's trade or business. Gross receipts are not reduced by cost of goods sold or by the cost of property sold if such property is described in section 1221(1), (3), (4), or (5). With respect to sales of capital assets as defined in section 1221, or sales of property described in section 1221(2) (relating to property used in a trade or business), gross receipts are reduced by the taxpayer's adjusted basis in such property. Gross receipts do not include the repayment of a loan or similar instrument (*e.g.*, a repayment of the principal amount of a loan held by a commercial lender). Finally, gross receipts do not include amounts received by the taxpayer with respect to sales tax or other similar State and local taxes if, under the applicable State or local law, the tax is legally imposed on the purchaser of the good or service, and the taxpayer merely collects and remits the tax to the taxing authority. If, in contrast, the tax is imposed on the taxpayer under the applicable law, then gross receipts include the amounts received that are allocable to the payment of such tax. See section 448(c)(3)(C) and Treas. Reg. sec. 1.448-1T(f)(2)(iv).

sale of merchandise is an income-producing factor. Aggregation rules apply to determine the amount of a taxpayer's gross receipts under the $25 million gross receipts test.[835] The cash method may not be used by any tax shelter.[836]

A farming business is defined as a trade or business of farming, including operating a nursery or sod farm, or the raising or harvesting of trees bearing fruit, nuts, or other crops, timber, or ornamental trees (other than evergreen trees that are more than six years old at the time they are severed from their roots).[837] Such farming businesses are not precluded from using the cash method regardless of whether they meet the gross receipts test. However, section 447 generally requires a farming C corporation (and any farming partnership if a corporation is a partner in such partnership) to use an accrual method of accounting. Section 447 does not apply to nursery or sod farms, to the raising or harvesting of trees (other than fruit and nut trees), nor to farming C corporations that meet the $25 million gross receipts test.

A qualified personal service corporation is a corporation: (1) substantially all of whose activities involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, and (2) substantially all of the stock of which (by value) is owned by current or former employees performing such services, their estates, or heirs.[838] Qualified personal service corporations are allowed to use the cash method without regard to whether they meet the $25 million gross receipts test.

<u>Accounting for inventories</u>

In general, for Federal income tax purposes, taxpayers must account for inventories if the production, purchase, or sale of merchandise is an income-producing factor to the taxpayer.[839] Treasury regulations also provide that in any case in which the use of inventories is necessary to clearly reflect income, the accrual method must be used with regard to purchases and sales.[840]

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[835] See sec. 448(c)(2).

[836] Secs. 448(a)(3) and (d)(3) and 461(i)(3) and (4). For this purpose, a tax shelter includes: (1) any enterprise (other than a C corporation) if at any time interests in such enterprise have been offered for sale in any offering required to be registered with any Federal or State agency having the authority to regulate the offering of securities for sale; (2) any syndicate (within the meaning of section 1256(e)(3)(B)); or (3) any tax shelter as defined in section 6662(d)(2)(C)(ii). In the case of a farming trade or business, a tax shelter includes any tax shelter as defined in section 6662(d)(2)(C)(ii) or any partnership or any other enterprise other than a corporation which is not an S corporation engaged in the trade or business of farming, (1) if at any time interests in such partnership or enterprise have been offered for sale in any offering required to be registered with any Federal or State agency having authority to regulate the offering of securities for sale, or (2) if more than 35 percent of the losses during any period are allocable to limited partners or limited entrepreneurs. For this purpose, certain holdings held directly by individuals that are attributable to active farm management activities are not treated as being held by a limited partner or a limited entrepreneur.

[837] Secs. 448(d)(1) and 263A(e)(4). See also Treas. Reg. sec. 1.263A-4(a)(5).

[838] Sec. 448(d)(2).

[839] Sec. 471(a) and Treas. Reg. sec. 1.471-1.

[840] Treas. Reg. sec. 1.446-1(c)(2).

However, an exception is provided for taxpayers that meet the $25 million gross receipts test.[841] Specifically, taxpayers that meet the $25 million gross receipts test are not required to account for inventories under section 471, but rather may use a method of accounting for inventories that either (1) treats inventories as non-incidental materials and supplies, or (2) conforms to the taxpayer's financial accounting treatment of inventories.[842]

In those circumstances in which a taxpayer is required to account for inventory, the taxpayer must maintain inventory records to determine the cost of goods sold during the taxable period. Cost of goods sold generally is determined by adding the taxpayer's inventory at the beginning of the period to the purchases made during the period and subtracting from that sum the taxpayer's inventory at the end of the period.

Because of the difficulty of accounting for inventories on an item-by-item basis, taxpayers often use conventions that assume certain item or cost flows. Among these conventions are the first-in, first-out ("FIFO") method, which assumes that the items in ending inventory are those most recently acquired by the taxpayer,[843] and the last-in, first-out ("LIFO") method, which assumes that the items in ending inventory are those earliest acquired by the taxpayer.[844]

Uniform capitalization

The uniform capitalization rules require certain direct and indirect costs allocable to real or tangible personal property produced by the taxpayer to be included in either inventory or capitalized into the basis of such property, as applicable.[845] For real or personal property acquired by the taxpayer for resale, section 263A generally requires certain direct and indirect costs allocable to such property to be included in inventory.

Section 263A provides several exceptions to the general uniform capitalization requirements. One such exception exists for any producer or reseller that meets the $25 million gross receipts test.[846] Another exception exists for taxpayers who raise, harvest, or grow trees.[847] Under this exception, section 263A does not apply to trees raised, harvested, or grown by the taxpayer (other than trees bearing fruit, nuts, or other crops, or ornamental trees) and any real property underlying such trees. Similarly, the uniform capitalization rules do not apply to any plant having a preproductive period of two years or less or to any animal, which is produced by a taxpayer in a farming business (unless the taxpayer is required to use an accrual method of

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[841] Sec. 471(c).

[842] See sec. 471(c) and Treas. Reg. sec. 1.471-1(b).

[843] See Treas. Reg. sec. 1.471-2(d).

[844] See sec. 472.

[845] Sec. 263A.

[846] Sec 263A(i).

[847] Sec. 263A(c)(5).

accounting under section 447 or 448(a)(3)).[848] Freelance authors, photographers, and artists also are exempt from section 263A for any qualified creative expenses.[849]

Interest limitation

In the case of any taxpayer for any taxable year, the deduction for business interest is limited to the sum of (1) business interest income of the taxpayer for the taxable year, (2) 30 percent of the adjusted taxable income of the taxpayer for the taxable year (not less than zero), and (3) the floor plan financing interest of the taxpayer for the taxable year. The limitation does not apply to any taxpayer (other than a tax shelter prohibited from using the cash method under section 448(a)(3)) that meets the $25 million gross receipts test.

Description of Proposal

The proposal increases the $25 million threshold of the gross receipts test[850] to $80 million (indexed for inflation)[851] for a manufacturing taxpayer (other than a tax shelter).

A "manufacturing taxpayer" means a corporation or partnership if, during the three taxable year period ending with the taxable year preceding such taxable year, substantially all of the gross receipts of the taxpayer are derived from the lease, rental, sale, license, exchange, or other disposition of "qualified products."

For purposes of the gross receipts test, a qualified product means a product that is (1) any tangible personal property, except any food or beverage prepared in the same building as a retail establishment in which substantially similar property is sold to the public, and (2) produced or manufactured by the taxpayer in a manner that results in a substantial transformation (within the meaning of proposed section 168(n)(2)(D)) of the property comprising the product.

Solely for purposes of determining whether a taxpayer qualifies as a manufacturing taxpayer, the aggregation rules[852] apply, except for purposes of applying rules related to common control under section 52(b), the term trade or business includes any activity involving research or

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[848] Sec. 263A(d).

[849] Sec. 263A(h). Qualified creative expenses are defined as amounts paid or incurred by an individual in the trade or business of being a writer, photographer, or artist (other than as an employee). However, such term does not include any expense related to printing, photographic plates, motion picture films, video tapes, or similar items.

[850] Sec. 448(c)(1).

[851] The gross receipts threshold for a manufacturing taxpayer is adjusted for inflation for taxable years beginning after December 31, 2018.

[852] See secs. 448(c)(2) and 448(c)(3).

experimentation,[853] any activity in connection with a trade or business, or any activity with respect to which expenses are allowable as a deduction under section 212.[854]

The proposal allows a manufacturing taxpayer to qualify for the cash method of accounting if it meets the $80 million gross receipts test. Such a taxpayer may also benefit from the exemptions from the limitation on business interest,[855] uniform capitalization,[856] and accounting for inventories under section 471.[857]

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

[853] See sec. 469(c)(5).

[854] See sec. 469(c)(6). The application of section 469(c)(6) is determined without regard to the phrase 'To the extent provided in regulations."

[855] See sec. 163(j)(3).

[856] See sec. 263A(i)(1).

[857] See sec. 471(c)(1).

K. Global Intangible Low-Taxed Income Determined Without Regard to Certain Income Derived from Services Performed in the Virgin Islands

Present Law

Global intangible low-taxed income ("GILTI")

A U.S. shareholder of a controlled foreign corporation ("CFC")[858] must include in gross income its GILTI. GILTI is the excess of the shareholder's net CFC tested income over the shareholder's net deemed tangible income return. The shareholder's net deemed tangible income return equals the excess of 10 percent of the aggregate of its pro rata share of the qualified business asset investment ("QBAI") of each CFC over certain interest expense.

The formula for GILTI is:

GILTI = Net CFC Tested Income - [(10% × QBAI) - Interest Expense]

Net CFC tested income means the excess of the aggregate of a U.S. shareholder's pro rata share of the tested income of each CFC over the aggregate of its pro rata share of the tested loss of each CFC.[859] In other words, GILTI is calculated on a worldwide basis.

The tested income of a CFC is the excess of the gross income of the CFC determined without regard to certain amounts that are exceptions to tested income (referred to in this document as "gross tested income") over deductions (including taxes) properly allocable to such gross tested income. The exceptions to tested income are: (1) any effectively connected income described in section 952(b); (2) any gross income taken into account in determining the CFC's subpart F income;[860] (3) any gross income excluded from foreign base company income or insurance income by reason of the high-tax exception under section 954(b)(4);[861] (4) any dividend received from a related person (as defined in section 954(d)(3)); and (5) any foreign oil and gas extraction income (as defined in section 907(c)(1)).

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[858] U.S. shareholders are U.S. persons that own at least 10 percent (measured by vote or value) of the stock of a foreign corporation. A CFC generally is any foreign corporation in which U.S. shareholders own (directly, indirectly, or constructively) more than 50 percent of the corporation's stock (measured by vote or value). See secs. 951(b), 957, 958.

[859] Sec. 951A(c)(1). Pro rata shares are determined under subpart F principles (*i.e.,* the rules of section 951(a)(2) and the regulations thereunder).

[860] Earnings of a CFC may constitute income to U.S. shareholders under the traditional anti-deferral regime of subpart F of the Code, which applies to certain passive income and certain other related-party income. Subpart F income is taxed at full rates with related foreign income taxes generally eligible for the foreign tax credit.

[861] In general, if a taxpayer so elects, subpart F income and tested income for purposes of determining GILTI inclusions exclude any item of income if the taxpayer establishes that the income was subject to an effective foreign income tax rate greater than 90 percent of the maximum U.S. corporate income tax rate (*i.e.,* currently greater than 90 percent of 21 percent, or 18.9 percent). See sec. 954(b)(4) and Treas. Reg. secs. 1.954-1(d) and 1.951A-2(c)(7).

The tested loss of a CFC means the excess of deductions (including taxes) properly allocable to the CFC's gross tested income over the amount of such gross tested income.[862]

Investment incentives in U.S. territories

Federal tax rules apply to the territories in a manner that is different from their application in relation to both the States and foreign countries. The application of the Federal tax rules to the territories varies from one possession to another. Three territories, Guam, the Northern Mariana Islands, and the U.S. Virgin Islands, are referred to as mirror Code possessions because the Code serves as the internal tax law of those territories (substituting the particular territory for the United States wherever the Code refers to the United States). A resident of one of those territories generally files a single tax return only with the territory of which the individual is a resident, and not with the United States. American Samoa and Puerto Rico, by contrast, are non-mirror Code possessions. These two territories have their own internal tax laws, and a resident of either American Samoa or Puerto Rico may be required to file income tax returns with both the territory of residence and the United States.

Broadly, an individual resident of a territory is exempt from U.S. tax on income that has a source in that territory but is subject to U.S. tax on U.S.-source and non-possession-source income. A corporation that is organized in a territory is generally treated as a foreign corporation for U.S. tax purposes. On the other hand, a number of Code provisions have effect in one or all of the territories as if the territories were States. For example, the tax credit for research and experimentation has been available for research conducted in a territory.

Historically, the Federal tax rules also have included preferences for territory activities. Until its expiration in 2006, the section 936 possession tax credit permitted qualifying U.S. corporations a credit against their U.S. tax liability in respect of possession-source income.[863]

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[862] For more information, see the description of *Section 111004, Extension of deduction for foreign-derived intangible income and global intangible low-taxed income*.

[863] For taxable years beginning before January 1, 2006, certain domestic corporations with business operations in the U.S. possessions were eligible for the possession tax credit. Secs. 27(b) and 936. This credit offset the U.S. tax imposed on certain income related to operations in the U.S. possessions. Subject to certain limitations, the amount of the possession tax credit allowed to any domestic corporation equaled the portion of that corporation's U.S. tax that was attributable to the corporate taxable income from (1) the active conduct of a trade or business within a U.S. possession, (2) the sale or exchange of substantially all of the assets that were used in such trade or business, or (3) certain possessions investment. No deduction or foreign tax credit was allowed for any possessions or foreign tax paid or accrued with respect to taxable income that was taken into account in computing the credit under section 936. Under the economic activity-based limit, the amount of the credit could not exceed an amount equal to the sum of (1) 60 percent of the taxpayer's qualified possession wages and allocable employee fringe benefit expenses, (2) 15 percent of depreciation allowances with respect to short-life qualified tangible property, plus 40 percent of depreciation allowances with respect to medium-life qualified tangible property, plus 65 percent of depreciation allowances with respect to long-life qualified tangible property, and (3) in certain cases, a portion of the taxpayer's possession income taxes. A taxpayer could elect, instead of the economic activity-based limit, a limit equal to the applicable percentage of the credit that otherwise would have been allowable with respect to possession business income. Beginning in 1998, the applicable percentage was 40 percent.

To qualify for the possession tax credit for a taxable year, a domestic corporation was required to satisfy two conditions. First, the corporation was required to derive at least 80 percent of its gross income for the three-year

After section 936 expired, a similar, temporary provision was enacted for American Samoa activities,[864] and the section 199 domestic production activities deduction was expanded temporarily to include production activities conducted in Puerto Rico. The latter has since expired.[865] At present, there is no economic development credit in the Code applicable only to activities in the U.S. possessions.

Description of Proposal

The proposal excludes from the definition of "tested income" in the case of any "specified United States shareholder" any "qualified Virgin Island services income." The provision defines "qualified Virgin Islands services income" as any gross income which is: (i) compensation for labor or personal services performed in the Virgin Islands by a corporation formed under the laws of the Virgin Islands; (ii) attributable to services performed from within the Virgin Islands by individuals for the benefit of such corporation; and (iii) effectively connected with the conduct of a trade or business within the Virgin Islands. A "specified United States shareholder" is a United States shareholder which is: (i) an individual, trust, or estate; or (ii) a closely held C corporation,[866] if such corporation acquired its direct or indirect equity interest in the foreign corporation which derived the qualified Virgin Islands services income before December 31, 2023. The proposal directs the Secretary to provide regulations to carry out the provision, including regulations to prevent its abuse.

Effective Date

The proposal is effective for taxable years of foreign corporations beginning after the date of enactment, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

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period immediately preceding the close of the taxable year from sources within a possession. Second, the corporation was required to derive at least 75 percent of its gross income for that same period from the active conduct of a possession business. Sec. 936(a)(2). The section 936 credit was phased out during the 10-year period starting in 1996. During this phase-out period, the Puerto Rico economic activity credit of section 30A was available for trade or business activity in Puerto Rico.

[864] Section 199 was repealed for taxable years beginning after December 31, 2017, by An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Pub. L. No. 115-97, section 13305, December 22, 2017.

[865] Sec. 199(d)(8).

[866] As defined in sec. 469(j)(1).

L. Extension and Modification of Clean Fuel Production Credit

Present Law

Clean fuel production credit

For transportation fuel, the Code provides a business credit, the "Clean Fuel Production Credit." "Transportation fuel" is a fuel suitable for use as a fuel in a highway vehicle or aircraft, that has a lifecycle greenhouse gas emissions rate which is not greater than 50 kilograms of CO_2e per 1 million British Thermal Units ("mmBTU"), and that is not derived from coprocessing an applicable material (or material derived from an applicable material) with a feedstock which is not biomass.[867]

The credit per gallon is the product of (1) the applicable amount per gallon (or gallon equivalent) of transportation fuel produced and sold by the taxpayer under specified circumstances and (2) the emissions factor for such fuel. To qualify for the credit, the transportation fuel must be produced at a qualified facility and sold by the taxpayer to an unrelated person (1) for use by such person in the production of a fuel mixture, (2) for use by such person in a trade or business, or (3) who sells such fuel at retail into the fuel tank of another person.

The "applicable amount" is either a "base amount" or an "alternative amount" depending on whether certain requirements are met. The base amount is 20 cents per gallon for transportation fuel produced at a qualified facility that does not satisfy certain prevailing wage and apprenticeship requirements. For transportation fuel produced at a qualified facility that does satisfy those requirements, the alternative amount is $1.00 per gallon. For transportation fuel that is sustainable aviation fuel, the base amount is 35 cents, and the alternative amount is $1.75. "Sustainable aviation fuel" means liquid fuel, the portion of which is not kerosene, which is sold for use in an aircraft, and which meets the requirements of either ASTM International Standard D7566, or the Fischer Tropsch provisions of ASTM International Standard D1655, Annex A1; and is not derived from palm fatty acid distillates or petroleum.

Fuel must be produced at a qualified facility

A "qualified facility" is a facility used for the production of transportation fuels and does not include any facility for which one of the following credits is allowed under section 38 for the taxable year: section 45V (the credit for production of clean hydrogen), section 46 to the extent that such credit is attributable to the energy credit determined under section 48 with respect to any specified clean hydrogen production facility for which an election has been made under section 48(a)(15), or section 45Q (the credit for carbon oxide sequestration).

[867] "Applicable material" means monoglycerides, diglycerides, and triglycerides, free fatty acids, and fatty acid esters. The term "biomass" has the same meaning given such term in section 45K(c)(3).

Emissions factor calculation and establishment by the Secretary

The emissions factor of a transportation fuel is an amount equal to the quotient of (1) 50 kilograms of CO_2e per mmBTU minus the emissions rate for such fuel, divided by (2) 50 kilograms of CO_2e per mmBTU.

The Secretary is required to publish a table that sets forth the emission rate for similar types and categories of transportation fuels based on the amount of lifecycle greenhouse gas emissions (as described in section 211(o)(1)(H) of the Clean Air Act (42 U.S.C. 7545(o)(1)(H)) as in effect on the date of enactment of this section) for such fuels, expressed as kilograms of CO_2e per mmBTU, which a taxpayer shall use for the purposes of this provision.

In the case of transportation fuel that is not sustainable aviation fuel, the lifecycle greenhouse gas emissions of such fuel shall be based on the most recent determinations under the Greenhouse Gases, Regulated Emissions, and Energy Use in Transportation model ("GREET") developed by Argonne National Laboratory, or a successor model (as determined by the Secretary).

In the case of transportation fuel that is sustainable aviation fuel, the lifecycle greenhouse gas emissions of such fuel shall be determined in accordance with (1) the most recent Carbon Offsetting and Reduction Scheme for International Aviation that has been adopted by the International Civil Aviation Organization ("ICAO") with the agreement of the United States, or (2) any similar methodology which satisfies the criteria under section 211(o)(1)(H) of the Clean Air Act (42 U.S.C. 7545(o)(1)(H)) as in effect on the date of enactment of this provision (August 22, 2022).

The Secretary may round the emissions rates for purposes of the table to the nearest five kilograms of CO_2e per mmBTU. However, in the case of an emissions rate that is between 2.5 kilograms of CO_2e per mmBTU and -2.5 kilograms CO_2e per mmBTU, the Secretary may round such rate to zero.

On January 22, 2025, the IRS published Notice 2025-11, providing initial guidance on emissions rates. The notice contains the initial table of emissions rates for purposes of the credit. The table covers several types of fuels (including pathways and primary feedstock), such as ethanol, biodiesel, renewable diesel, renewable natural gas, propane, naptha, hydrogen, and sustainable aviation fuel. The Argonne National Laboratory developed, and the Department of Energy published, the "45ZCF-GREET" model to determine emissions rates for purposes of the credit.

The determination of emissions rates is calculated using either (1) determinations under the most recent version of the 45ZCF-GREET model or (2) determinations from fuel pathways approved under the most recent CORSIA Default Life Cycle Emissions Values for CORSIA Eligible Fuels lifecycle approach ("CORSIA Default") or the most recent CORSIA Methodology for Calculating Actual Life Cycle Emissions Values lifecycle approach ("CORSIA Actual").

Notice 2025-11 notes that the pathways that use imported used cooking oil will not be available in the 45ZCF-GREET model until the Department of the Treasury and the IRS publish further guidance, such as substantiation and recordkeeping requirements. The Notice expresses concern about the improper identification of a substance that is not used cooking oil as used cooking oil, the uncertainty of market impacts caused by incentivizing used cooking oil and, with imported used cooking oil in particular, the lack of transparency regarding local sources.

Petition for provisional emissions rate

In the case of any transportation fuel for which an emissions rate has not been established by the Secretary, a taxpayer producing such fuel may file a petition with the Secretary for determination of the emissions rate with respect to such fuel. Notice 2025-11 indicates that the Department of the Treasury and IRS intend to provide guidance related to the petition process at a later date. Until guidance is issued, the IRS will not accept requests for provisional emissions rate determinations and the Department of Energy will not issues emissions values. However, the emissions rate for any new type or category of fuel established on the applicable table or determined through the provisional emissions rate process will apply on January 1, 2025, regardless of when guidance is published establishing such rate.

Inflation adjustment

In the case of calendar years beginning after 2024, the 20-cent amount, $1.00 amount, 35 cent amount and $1.75 amount are adjusted by multiplying such amount by the inflation adjustment factor for the calendar year in which the sale or use of the transportation fuel occurs. If any amount as increased is not a multiple of one cent, such amount is to be rounded to the nearest one cent. The inflation adjustment factor is the inflation adjustment factor determined and published by the Secretary under the clean electricity production credit (section 45Y), determined by substituting "calendar year 2022" for "calendar year 1992."

Special rules

To be entitled to the clean fuel production credit, the taxpayer must be registered with the IRS as a producer of clean fuel at the time of production.[868] Such fuel must be produced in the United States. In addition, in the case of any transportation that is sustainable aviation fuel, the taxpayer must provide certification (in such form and such manner as the Secretary prescribes) from an unrelated party demonstrating compliance with any general requirements, supply chain traceability requirements, and information transmission requirements established under the Carbon Offsetting and Reduction Scheme for International Aviation or similar methodology which satisfies the criteria under section 211(o)(1)(H) of the Clean Air Act as in effect on the date of enactment of this provision.

In the case of a facility in which more than one person has an ownership interest, except to the extent provided in Treasury regulations, production from such facility shall be allocated among such persons in proportion to their respective ownership interests in the gross sales from such facility.

Persons shall be treated as related to each other if such persons would be treated as a single employer under the regulations prescribed under section 52(b). In the case of a

[868] Notice 2024-49 provides guidance on the clean fuel production credit registration requirements.

corporation which is a member of an affiliated group of corporations filing a consolidated return, such corporation shall be treated as selling fuel to an unrelated person if such fuel is sold to such a person by another member of such group.

In the case of estates and trusts, under regulations prescribed by the Secretary, rules similar to the rules of section 52(d) shall apply. In the case of agricultural cooperatives, an election may be made to apportion the credit determined among the patrons of the cooperative on the basis of business done by the patrons during the taxable year.

Prevailing wage and apprenticeship requirements for purposes of the alternative amount

To obtain the alternative amount, the transportation fuel must be produced at a qualified facility that satisfies the prevailing wage and apprenticeship requirements. Rules similar to the rules of section 45(b)(7) (prevailing wage requirements) apply.

A special rule applies for facilities placed in service before January 1, 2025. For those facilities, section 45(b)(7)(A)(i) (related to the construction of such facility) does not apply. In addition, section 45(b)(7)(A)(ii) is to be applied to alteration and repairs of a qualified facility with respect to a taxable year beginning after December 31, 2024, for which a clean fuel production credit is allowed.

Rules similar to section 45(b)(8) (relating to apprenticeship requirements) apply for the purpose of the clean fuel production credit.

Termination

The provision does not apply to transportation fuel sold after December 31, 2027.

Description of Proposal

Prohibition on foreign feedstocks

The proposal requires that the fuel be derived exclusively from a feedstock produced or grown in the United States, Mexico, or Canada.

Determination of emissions rate

The proposal makes two changes with respect to the determination of emissions rate. The proposal requires that the lifecycle greenhouse gas emissions are to be adjusted as necessary to exclude any emissions attributed to indirect land use change. Any such adjustment is to be based on regulations or methodologies determined by the Secretary in consultation with the Administrator of the Environmental Protection Agency and the Secretary of Agriculture.

In addition, for transportation fuels that are derived from animal manure, the emission rates table prescribed by the Secretary is to provide a distinct emissions rate with respect to each specific feedstock used to produce such fuel, including dairy manure, swine manure, poultry manure and such other sources as are determined appropriate by the Secretary.

Extension of the clean fuel production credit

The proposal extends the clean fuel production credit through December 31, 2031.

Restrictions relating to prohibited foreign entities

If the taxpayer is a specified foreign entity (as defined in section 7701(a)(51)(B)), no clean fuel production credit is allowed under section 38 for any taxable year beginning after the date of enactment. If the taxpayer is a foreign-influenced entity (as defined in section 7701(a)(51)(D)), no clean fuel production credit is allowed under section 38 for any taxable year beginning two years after the date of enactment.

Effective Date

The prohibition on foreign feedstocks applies to transportation fuel sold after December 31, 2025. The changes with respect to the determination of emission rates applies to emission rates published for taxable years beginning after December 31, 2025. The extension of the clean fuel production credit is effective on the date of enactment. The restrictions relating to prohibited foreign entities apply to taxable years beginning after the date of enactment.

SUBTITLE C—MAKE AMERICA WIN AGAIN

PART I—WORKING FAMILIES OVER ELITES

A. Termination of Previously-Owned Clean Vehicle Credit

Present Law

In general

A credit is available for previously-owned clean vehicles (the "previously-owned CV credit") placed in service by a qualified buyer.[869] A "previously-owned clean vehicle" is a motor vehicle with a model year at least two years earlier than the calendar year in which the taxpayer acquires the vehicle, the original use of which commences with a person other than the taxpayer, which has a gross vehicle weight rating of less than 14,000 pounds,[870] which is acquired by the taxpayer in a qualified sale, and that meets certain emissions standards.[871]

A qualified sale is a sale by a dealer[872] that is the first transfer since the date of enactment of this section to a qualified buyer other than the person with whom the original use of such vehicle commenced.[873] A qualified sale does not include transfers to qualified buyers made after the vehicle has been used and owned by a person other than the person with whom the original use of such vehicle commenced, even if such use and ownership was not by a qualified buyer.[874]

Additionally, a previously-owned clean vehicle must be an electric vehicle or a fuel-cell vehicle that satisfies certain criteria. Specifically, a previously-owned clean vehicle must either (1) be propelled to a significant extent by an electric motor drawing electricity from a battery (a) with at least seven kilowatt-hours of capacity and (b) which is capable of being recharged from an external source of electricity, made by a qualified manufacturer, and with respect to which the person who sells the vehicle provides a report to the taxpayer and Secretary that includes the name and taxpayer identification number of the taxpayer, the vehicle identification number of the vehicle, the battery capacity of the vehicle, and the maximum credit allowable to the taxpayer with respect to the vehicle,[875] or (2) be propelled by power derived from one or more cells which

[869] Treasury has released final regulations on the previously-owned clean vehicle credit. T.D. 9995, 89 Fed. Reg. 37747, May 6, 2024.

[870] Sec. 25E(c)(1).

[871] Sec. 25E(e).

[872] A dealer is a person licensed by a State, territory of the United States, Indian tribal government, or Alaska Native Corporation to engage in the sale of vehicles. Sec. 30D(g)(8).

[873] Sec. 25E(c)(2).

[874] Treas. Reg. sec. 1.25E-1(b)(14).

[875] Sec. 25E(c)(1)(D)(i).

convert chemical energy directly into electricity by combining oxygen with hydrogen fuel stored on board the vehicle and have received certain emissions-standard certification.[876]

A taxpayer must include the vehicle identification number of the vehicle on a tax return to claim the credit.[877]

A qualified buyer is an individual who purchases a vehicle for use and not resale, who cannot be claimed as a dependent, and during the three-year period prior to such purchase, has not made any purchases for which a previously-owned CV credit was claimed.[878]

Previously-owned CV credit amount

The amount of the credit is the lesser of (1) $4,000 or (2) 30 percent of the sale price of the vehicle.[879]

The sale price of a previously-owned clean vehicle purchased by the taxpayer may not exceed $25,000.[880] That is, the credit amount is $0 if the sale price for the vehicle exceeds this amount.

Additionally, no credit is allowed if the taxpayer's income exceeds $150,000 in the case of a joint return or surviving spouse, $112,500 in the case of a head of household, or $75,000 in the case of any other taxpayer.[881] For purposes of this limitation, the taxpayer's income is the lesser of modified AGI of the current taxable year or modified AGI of the preceding taxable year.[882]

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[876] Sec. 25E(c)(1)(D)(ii). Fuel cell vehicles must satisfy the requirements of section 30B(b)(3)(A) and (B).

[877] Sec. 25E(d).

[878] Sec. 25E(c)(3).

[879] Sec. 25E(a).

[880] Sec. 25E(c)(2)(B).

[881] Sec. 25E(b).

[882] Modified AGI is AGI increased by any amount excluded from gross income under section 911, 931, or 933. Sec. 25E(b)(3).

Other rules

In general, the credit is available to the vehicle owner, including the lessor of a vehicle subject to lease. A vehicle must be used predominantly in the United States to qualify for the credit and the basis of any qualified vehicle is reduced by the amount of the credit.[883]

Transfer of credit

For vehicles acquired after December 31, 2023, a taxpayer may elect to transfer the credit to an eligible entity under rules similar to those for the transfer of the clean vehicle credit.[884] These rules are explained in the description of present law for the proposal "Termination of Clean Vehicle Credit" below.

Expiration

No credit is allowed for any vehicle acquired after December 31, 2032.[885]

Description of Proposal

The proposal repeals the previously-owned CV credit.

Effective Date

The proposal is effective for vehicles acquired after December 31, 2025.

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[883] Secs. 25E(e) and 30D(f).

[884] Sec. 25E(f).

[885] Sec. 25E(g).

B. Termination of Clean Vehicle Credit

Present Law

In general

Present law allows a credit for each new clean vehicle placed in service (the "CV credit").[886] A new clean vehicle is a motor vehicle the original use of which commences with the taxpayer, is acquired for use or lease and not for resale, is made by a qualified manufacturer,[887] has a gross vehicle weight rating of less than 14,000 pounds, is treated as a motor vehicle for purposes of title II of the Clean Air Act, and is propelled to a significant extent by an electric motor drawing electricity from a battery (1) with at least seven kilowatt-hours of capacity and (2) which is capable of being recharged from an external source of electricity.[888] The person who sells the vehicle must provide a report to the taxpayer and Secretary that includes the name and taxpayer identification number of the taxpayer, the vehicle identification number of the vehicle, the battery capacity of the vehicle, verification that original use of the vehicle commences with the taxpayer, and the maximum credit allowable to the taxpayer with respect to the vehicle.[889] A new clean vehicle must have final assembly occur within North America.[890]

New qualified fuel cell motor vehicles[891] which have final assembly within North America and for which sellers provide a report, as described above, are new clean vehicles for purposes of the credit.[892]

Vehicles with any applicable critical minerals in the battery that are extracted, processed, or recycled by a foreign entity of concern that are placed in service after December 31, 2024, or vehicles with any components contained in the battery of the vehicle that are manufactured or

[886] Treasury has released final regulations on the clean vehicle credit. T.D. 9995, 89 Fed. Reg. 37754, May 6, 2024.

[887] A qualified manufacturer must be a manufacturer as defined in regulations prescribed by the Administrator of the Environmental Protection Agency for purposes of the administration of title II of the Clean Air Act (42 U.S.C. sec. 7521 *et seq.*) and must provide periodic written reports to the Secretary which include vehicle identification numbers. Sec. 30D(d)(3).

[888] Sec. 30D(d)(1).

[889] Sec. 30D(d)(1)(H).

[890] Sec. 30D(d)(1)(G).

[891] As defined in sec. 30B(b)(3).

[892] Sec. 30D(d)(6).

assembled by a foreign entity of concern that are placed in service after December 31, 2023 do not qualify for the credit.[893]

CV credit amount

A new clean vehicle is eligible for a maximum credit of up to $7,500 if certain requirements are met. One $3,750 amount is allowed if a critical minerals requirement for the battery is met.[894] Another $3,750 amount is allowed if a battery components requirement is met.[895]

Critical minerals requirement

To satisfy the critical minerals requirement, a new clean vehicle's battery (from which the electric motor draws electricity) must have a percentage of the value of applicable critical minerals[896] that were (1) extracted or processed in the United States or a country that has a free trade agreement with the United States or (2) recycled in North America equal to or greater than an applicable percentage.[897]

For this purpose the applicable percentage is 40 percent for a vehicle placed in service before January 1, 2024. The applicable percentage is 50 percent for a vehicle placed in service during calendar year 2024, 60 percent for 2025, 70 percent for 2026, and 80 percent after 2026.[898]

Battery components requirement

To satisfy the battery components requirement, a new clean vehicle's battery (from which the electric motor draws electricity) must have a percentage of the value of components that were manufactured or assembled in North America equal to or greater than an applicable percentage.[899]

For this purpose the applicable percentage is 50 percent for a vehicle placed in service before January 1, 2024. The applicable percentage is 60 percent for a vehicle placed in service

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[893] Sec. 30D(d)(7). For a description of the meaning of foreign entity of concern for purposes of section 30D see the present law description for the proposal "Phase-out and Restrictions on Clean Electricity Production Credit below.

[894] Sec. 30D(b)(2).

[895] Sec. 30D(b)(3).

[896] Critical minerals as defined in sec. 45X(c)(6).

[897] Sec. 30D(e)(1)(A).

[898] Sec. 30D(e)(1)(B).

[899] Sec. 30D(e)(2)(A).

during calendar year 2024 or 2025, 70 percent for 2026, 80 percent for 2027, 90 percent for 2028, and 100 percent after 2028.[900]

Vehicle price and AGI limitations

The provision requires that the manufacturer's suggested retail price ("MSRP") of a new clean vehicle purchased by the taxpayer not exceed certain limitations. That is, the credit amount is $0 if the MSRP for the vehicle exceeds the applicable limitation. This limitation is $80,000 in the case of a van, sport utility vehicle, or pickup truck, and $55,000 in the case of any other vehicle. The Secretary is directed to release regulations or guidance to characterize vehicles into the appropriate category by applying rules similar to those employed by the Environmental Protection Agency ("EPA") and the Department of Energy to determine vehicle class and size.[901]

Additionally, no credit is allowed if the taxpayer's income exceeds $300,000 in the case of a joint return or surviving spouse, $225,000 in the case of a head of household, or $150,000 in the case of any other taxpayer.[902] For purposes of this limitation, the taxpayer's income is the lesser of modified AGI of the current taxable year or modified AGI of the preceding taxable year.[903]

Transfer of credit

A taxpayer who has purchased or leased a vehicle may elect to transfer the credit to an eligible entity, subject to regulations or guidance the Secretary deems necessary.[904] The eligible entity is then treated as the taxpayer with respect to the credit.[905] The Secretary is directed to establish a program to provide advance payments of these credit amounts to eligible entities.[906] An election to transfer the credit must be made on or before the date of vehicle purchase.[907]

An eligible entity is a dealer[908] which meets the following requirements: First, the dealer must be registered with the Secretary. Second, prior to the election of transfer, the dealer must disclose information to the buyer on the MSRP price of the vehicle, value of the credit or other

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[900] Sec. 30D(e)(2)(B).

[901] Sec. 30D(f)(11). Treas. Reg. sec. 1.30D-2(b)(56).

[902] Sec. 30D(f)(10).

[903] Modified AGI is AGI increased by any amount excluded from gross income under section 911, 931, or 933. Sec. 30D(f)(10)(C).

[904] Treas. Reg. sec. 1.30D-5.

[905] Sec. 30D(g)(1).

[906] Sec. 30D(g)(7). Treas. Reg. sec. 1.30D-5(f).

[907] Sec. 30D(g)(3).

[908] A dealer is a person licensed by a State, territory of the United States, Indian tribal government, or Alaska Native Corporation to engage in the sale of vehicles. Sec. 30D(g)(8).

incentives available, and the amount provided by the dealer as a condition of an election to transfer. Third, the dealer must pay the taxpayer for the amount of the credit allowable. Finally, the dealer must ensure that the availability or use of any other available manufacturer or dealer incentive does not limit the ability of the taxpayer to make an election and that the election will not limit the value or use of any such incentive.[909] The Secretary may revoke the registration of dealers that fail to comply with these requirements.[910]

The payment made by dealers to buyers in connection with a credit transfer election is not includable in the gross income of the taxpayer and is not deductible to the dealer.[911]

The tax liability of a taxpayer that does not meet the AGI requirements for the credit, that elects to transfer a credit, and that receives a payment in connection with such credit transfer, is increased by the amount of such payment.[912]

Other rules

A vehicle that is predominantly used outside the United States does not qualify for the credit.[913] A vehicle must meet certain emissions and safety standards in order to qualify for the credit.[914]

The basis of any qualified vehicle is reduced by the amount of the credit.[915] The portion of the credit attributable to vehicles of a character subject to an allowance for depreciation is treated as part of the general business credit; the nonbusiness portion of the credit is allowable to the extent of the excess of the regular tax and the alternative minimum tax (reduced by certain other credits) for the taxable year.[916]

Only one credit is allowed for each vehicle and a taxpayer must include the vehicle identification number of the vehicle on a tax return to claim the credit.[917]

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[909] Sec 30D(g)(2).

[910] Sec. 30D(g)(4).

[911] Sec. 30D(g)(5).

[912] Sec. 30D(g)(10).

[913] Sec. 30D(f)(4).

[914] Sec. 30D(f)(7).

[915] Sec. 30D(f)(1).

[916] Sec. 30D(c).

[917] Sec. 30D(f)(8) and (9).

Expiration

No credit is allowed for any vehicle placed in service after December 31, 2032.[918]

Description of Proposal

For vehicles sold after December 31, 2025, and before January 1, 2027, the proposal adds a manufacturer limitation for covered vehicles. For each manufacturer, if a total of 200,000 covered vehicles have been manufactured by such manufacturer and sold for use in the United States after December 31, 2009, and before January 1, 2026, no credit is available for any vehicle manufactured by such manufacturer. Covered vehicles are new qualified plug-in electric drive motor vehicles[919] placed in service before January 1, 2023, and new clean vehicles.

The proposal modifies the termination date of the new clean vehicle credit such that no credit is allowed for any vehicle placed in service after December 31, 2026.

Effective Date

The proposal is effective for vehicles placed in service after December 31, 2025.

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[918] Sec. 30D(h).

[919] New qualified plug-in electric drive motor vehicles are defined in section 30D(d)(1) as in effect on December 31, 2022. For a detailed description of prior law section 30D, see the description of the clean vehicle credit in Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 117th Congress* (JCS-1-23), December 21, 2023. This document can be found on the Joint Committee on Taxation website at www.jct.gov.

C. Termination of Qualified Commercial Clean Vehicles Credit

Present Law

Present law allows for a credit for qualified commercial clean vehicles placed in service by a taxpayer.[920] A qualified commercial clean vehicle is a vehicle made by a qualified manufacturer,[921] acquired for use or lease by the taxpayer and not for resale, that either (1) is manufactured primarily for use on public streets, roads, and highways,[922] or (2) is mobile machinery,[923] and of a character subject to the allowance of depreciation.[924]

Additionally, a qualified commercial clean vehicle must be an electric vehicle or a fuel-cell vehicle that satisfies certain criteria. Specifically, a qualified commercial clean vehicle must either (1) be propelled to a significant extent by an electric motor drawing electricity from a battery (a) with at least 15 kilowatt-hours of capacity (or seven kilowatt-hours for a vehicle with a gross vehicle weight rating of less than 14,000 pounds) and (b) which is capable of being recharged from an external source of electricity[925] or (2) be propelled by power derived from one or more cells which convert chemical energy directly into electricity by combining oxygen with hydrogen fuel stored on board the vehicle and have received certain emissions-standard certification.[926]

A taxpayer must include the vehicle identification number of the vehicle on a tax return to claim the credit.[927] Only one credit is allowed per vehicle, determined by such vehicle identification number.[928]

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[920] Treasury has released proposed regulations for section 45W. See Notice of Proposed Rulemaking, 90 Fed. Reg. 3506, January 14, 2025. No credit is allowed under section 45W with respect to any vehicle for which a section 45W or section 30D was previously allowed.

[921] Qualified manufacturer has the same meaning as in section 30D. For more detail see the present law description of the clean vehicle credit above.

[922] Vehicles operated exclusively on a rail or rails are excluded.

[923] This is mobile machinery as defined in section 4053(8) and includes vehicles not designed to perform a function of transporting a load over public highways.

[924] Sec. 45W(c).

[925] Sec. 45W(c)(3)(A).

[926] Sec. 45W(c)(3)(B). Fuel cell vehicles must satisfy the requirements of section 30B(b)(3)(A) and (B).

[927] Sec. 45W(e).

[928] Secs. 45W(d)(1) and 30D(f)(8).

A qualified commercial clean vehicle must also meet certain emissions standards to be eligible for a credit.[929]

Qualified commercial clean vehicle credit amount

A qualified commercial clean vehicle qualifies for a credit equal to the lesser of (1) 15 percent of the basis of such vehicle (30 percent if the vehicle is not powered by a gasoline or diesel internal combustion engine) or (2) the incremental cost of the vehicle.[930] The credit is limited to $40,000 ($7,500 for a vehicle with a gross vehicle weight rating of less than 14,000 pounds).[931]

The incremental cost of the vehicle is the amount by which the purchase price of the vehicle exceeds the purchase price of a comparable vehicle (one powered solely by gasoline or a diesel internal combustion engine which is comparable in size and use).[932]

Other rules

The basis of any qualified vehicle is reduced by the amount of the credit.[933] No credit is allowed for any vehicle for which a new clean vehicle credit is allowed.[934]

The requirement that a qualified clean commercial vehicle is of a character subject to the allowance of depreciation does not apply to vehicles that are not subject to a lease and which are placed in service by certain tax-exempt entities.[935]

A vehicle must be used predominantly in the United States to qualify for the credit.[936]

Regulations and guidance

The Secretary is directed to issue regulations or other guidance relating to determining the incremental cost of any qualified commercial clean vehicle in addition those necessary to carry out this provision.[937]

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[929] Sec. 45W(d)(1).

[930] Sec. 45W(b)(1).

[931] Sec. 45W(b)(4).

[932] Sec. 45W(b)(2) and (3).

[933] Secs. 45W(d)(1) and 30D(f)(1).

[934] Sec. 45W(d)(3).

[935] Sec. 45W(d)(2).

[936] Secs. 45W(d)(1) and 30D(f)(4).

[937] Sec. 45W(f). Treasury has released proposed regulations on determining the incremental cost of a qualified commercial clean vehicle. See Notice of Proposed Rulemaking, 90 Fed. Reg. 3506, January 14, 2025.

Expiration

No credit is allowed for any vehicle placed in service after December 31, 2032.[938]

Description of Proposal

The proposal repeals the commercial clean vehicle credit. An exception is provided for vehicles placed in service before January 1, 2033, which are acquired pursuant to a written binding contract entered into before May 12, 2025.

Effective Date

The proposal is effective for vehicles acquired after December 31, 2025.

Notice 2025-9 provides a safe harbor for determining the incremental cost of certain qualified commercial clean vehicles. Notice 2025-9, 2025-6 I.R.B. 681, January 15, 2025.

[938] Sec. 45W(g).

D. Termination of Alternative Fuel Vehicle Refueling Property Credit

Present Law

In general

Present law allows a credit of 30 percent of the cost of any qualified alternative fuel vehicle refueling property placed in service that is not depreciable.[939] The credit rate is six percent for any qualified alternative fuel refueling property that is depreciable.

Qualified alternative fuel refueling property is property (not including a building and its structural components) of a character subject to an allowance of depreciation (unless installed on property used as the principal residence of the taxpayer) the original use of which begins with the taxpayer. Additionally, qualified alternative fuel refueling property is property (1) for the storage or dispensing of a clean-burning fuel into the fuel tank of a motor vehicle propelled by such fuel but only if the storage or dispensing of fuel is at the point where such fuel is delivered into the fuel tank of the motor vehicle or (2) for the recharging of motor vehicles propelled by electricity, but only if the property is located at the point where the motor vehicles are recharged.[940]

For this purpose a clean-burning fuel is (1) any fuel which is at least 85 percent by volume of one or more of ethanol, natural gas, compressed natural gas, liquified natural gas, liquified petroleum gas, or hydrogen, (2) any mixture consisting of two or more of biodiesel, diesel fuel, or kerosene and with at least 20 percent volume of biodiesel determined without regard to any kerosene in such mixture, or (3) electricity.[941]

Qualified alternative fuel vehicle refueling property includes property that can charge the battery of a motor vehicle propelled by electricity and allows discharging electricity from such battery to an electric load external to the motor vehicle.[942]

Qualified alternative fuel vehicle refueling property includes depreciable property designed to charge two- and three-wheeled motor vehicles manufactured for primary use on public streets, roads, or highways that are propelled by electricity.[943]

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[939] Sec. 30C(a).

[940] Secs. 30C(c)(1) and 179A(d), as in effect immediately before repeal by Pub. L. No. 113-295, December 19, 2024.

[941] Sec. 30C(c)(1)(B).

[942] Sec. 30C(c)(2).

[943] Sec. 30C(f).

The credit amount per item is limited to $100,000 in the case of depreciable property and $1,000 in any other case.[944]

Location requirements

Qualified alternative fuel vehicle refueling property must not be located in an urban area or must be located in a low-income community.[945] An urban area is a census tract which has been designated as an urban area by the Secretary of Commerce, according to the most recent decennial census.[946] A low-income community is a census tract with either (1) a poverty rate of at least 20 percent or (2) median family income which does not exceed 80 percent of the greater of metropolitan area median family income or statewide median family income (for a nonmetropolitan census tract, generally does not exceed 80 percent of statewide median family income).[947]

Enhanced credit rate where certain prevailing wage and apprenticeship requirements are met

The credit rate is increased to 30 percent for any depreciable qualified alternative fuel refueling property that is part of a qualified alternative fuel vehicle refueling project.[948] A qualified alternative fuel vehicle refueling project is a project (1) that meets certain prevailing wage and apprenticeship requirements or (2) for which the construction begins prior to the date that is 60 days after the Secretary publishes guidance on such requirements.[949] The Secretary is directed to issue regulations or other guidance deemed necessary to administer these requirements.[950]

The prevailing wage requirements are that the taxpayer must ensure that any laborers and mechanics employed by the taxpayer or any contractors or subcontractors in the construction of any qualified alternative fuel vehicle refueling property which is part of a project are paid wages at a rate not less than the prevailing wage rates for construction, alteration, or repair of a similar character in the locality where the project is located as determined by the Secretary of Labor, in accordance with subchapter IV of chapter 31, of title 40, United States Code.[951] Additionally,

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[944] Sec. 30C(b).

[945] Sec. 30C(c)(3).

[946] Sec. 30C(c)(3)(B)(ii). Treasury has released proposed regulations on section 30C. Under these proposed rules, a "non-urban census tract" means any population census tract in which at least 10 percent of the census blocks are not designated as urban areas by the Census Bureau. See Notice of Proposed Rulemaking, 89 Fed. Reg. 76759, September 19, 2024.

[947] Sec. 30C(c)(3)(B)(i). Low-income community has the same meaning as in section 45D(e).

[948] Sec. 30C(g)(1)(A). A project consists of one or more properties.

[949] Sec. 30C(g)(1)(C).

[950] Sec. 30C(g)(4).

[951] Sec. 30C(g)(2)(A).

correction and penalty procedures for failure to satisfy wage requirements, similar to the rules in section 45(b)(7)(B), apply.[952]

The apprenticeship requirements are that generally not less than a certain percentage of total labor hours of the construction, alteration, or repair work (including work performed by any contractor or subcontractor) on a project must be performed by qualified apprentices, similar to the rules of section 45(b)(8).[953]

Other rules

The basis of any qualified alternative fuel refueling property is reduced by the amount of the credit.[954] The portion of the credit attributable to property of a character subject to an allowance for depreciation is treated as part of the general business credit; the nonbusiness portion of the credit is allowable to the extent of the excess of the regular tax and the alternative minimum tax (reduced by certain other credits) for the taxable year.[955]

For qualified property used by certain tax-exempt organizations, governments, or foreign persons and that is not subject to a lease, the seller of the property may claim the credit so long as the seller clearly discloses to the user in a document the amount that is allowable as a credit.[956] Property that is predominantly used outside the United States does not qualify for the credit.[957]

Termination

The credit does not apply to property placed in service after December 31, 2032.

Description of Proposal

The proposal repeals the alternative fuel vehicle refueling property credit.

Effective Date

The proposal is effective for property placed in service after December 31, 2025.

[952] Sec. 30C(g)(2)(B). For more detail explaining such correction and penalties related to the failure to satisfy wage requirements, see the present law description of the clean electricity production credit, below.

[953] Sec. 30C(g)(3). For more detail on apprenticeship requirements, see the present law description of the clean electricity production credit, below.

[954] Sec. 30C(e)(1).

[955] Sec. 30C(d).

[956] Sec. 30C(e)(2).

[957] Sec. 30C(e)(3).

E. Termination of Energy Efficient Home Improvement Credit

Present Law

A 30-percent credit is available to individuals for amounts paid or incurred for qualified energy efficiency improvements, residential energy property expenditures, and home energy audits.[958]

Qualified energy efficiency improvements

A qualified energy efficiency improvement is any energy efficient building envelope component (1) that is installed in or on a dwelling located in the United States and owned and used by the taxpayer as the taxpayer's principal residence; (2) the original use of which commences with the taxpayer; and (3) that reasonably can be expected to remain in use for at least five years.[959]

Energy efficient building envelope components are building envelope components that meet (1) in the case of an exterior window, a skylight, or an exterior door, the applicable Energy Star program requirements, and (2) in the case of any other component, the prescriptive criteria for such component established by the International Energy Conservation Code ("IECC") standard in effect as of the beginning of the calendar year which is two years prior to the calendar year in which such component is placed in service.[960]

Building envelope components are (1) insulation materials or systems which are specifically and primarily designed to reduce the heat loss or gain for a dwelling when installed in or on such dwelling unit, (2) exterior windows (including skylights); and (3) exterior doors.[961]

Residential energy property expenditures

Residential energy property expenditures are expenditures made by the taxpayer for qualified energy property (1) that is installed on or in connection with a dwelling unit located in the United States that is used as a residence by the taxpayer; and (2) that is originally placed in service by the taxpayer. Residential energy efficiency improvements include both qualified energy property and expenditures for labor costs properly allocable to the onsite preparation, assembly, or original installation of the qualified energy property.[962]

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[958] Sec. 25C. Treasury has released proposed regulations on the energy efficient home improvement credit as modified by Pub. L. No. 117-169, august 16, 2022. See Notice of Proposed Rulemaking, 89 Fed. Reg. 85099, October 25, 2024.

[959] Sec. 25C(c)(1).

[960] Sec. 25C(c)(2).

[961] Sec. 25C(c)(3).

[962] Sec. 25C(d)(1).

Qualified energy property includes any of the following which meet or exceed the highest efficiency tier (not including any advanced tier) established by the Consortium for Energy Efficiency which is in effect as of the beginning of the calendar year in which the property is placed in service:

- An electric heat pump water heater;
- An electric heat pump;
- A central air conditioner;
- A natural gas, propane, or oil water heater; or
- A natural gas, propane, or oil furnace or hot water boiler.[963]

Qualified energy property also includes a biomass stove or boiler which (i) uses the burning of biomass fuel to heat a dwelling unit located in the United States and used as a residence by the taxpayer, or to heat water for use in such a dwelling unit, and (ii) has a thermal efficiency rating of at least 75 percent (measured by the higher heating value of the fuel).[964]

Additionally, qualified energy property includes oil furnaces and hot water boilers to be qualified energy property.[965] For property placed in service after 2022 and before 2027, an oil furnace or hot water boiler can qualify if it meets or exceeds 2021 Energy Star efficiency criteria, and is rated by the manufacturer for use with fuel blends at least 20 percent of the volume of which consists of an eligible fuel. For such property placed in service after 2026, it can qualify if it achieves an annual fuel utilization efficiency rate of not less than 90, and is rated by the manufacturer for use with fuel blends at least 50 percent of the volume of which consists of an eligible fuel. For this purpose, an eligible fuel means biodiesel and renewable diesel (within the meaning of section 40A) and second generation biofuel (within the meaning of section 40).[966]

Finally, qualified energy property includes any improvement to, or replacement of, a panelboard, sub-panelboard, branch circuits, or feeders that is installed in a manner consistent with the National Electric Code, has a load capacity of at least 200 amps, and is installed in conjunction with (and is necessary for the installation and use of) any qualified energy efficiency improvements or any qualified energy property.[967]

Home energy audits

A home energy audit means an inspection and written report with respect to a dwelling unit located in the United States owned or used by the taxpayer as the taxpayer's principal

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[963] Sec. 25C(d)(2)(A).

[964] Sec. 25C(d)(2)(B).

[965] Sec. 25C(d)(2)(C).

[966] Sec. 25C(d)(3).

[967] Sec. 25C(d)(2)(D).

residence that (1) identifies the most significant and cost-effective energy efficiency improvements with respect to such dwelling unit, including an estimate of the energy and cost savings with respect to each such improvement, and (2) is conducted and prepared by a home energy auditor that meets the certification or other requirements specified by the Secretary.[968]

Limitations

Generally, the credit is available for property placed in service prior to January 1, 2033. The credit has an annual limitation of $1,200.[969] The credit limit with respect to any item of energy property is generally limited to $600. For windows, the limit is $600 for all exterior windows and skylights combined. In the case of doors, the limit is $250 for any exterior door and $500 for all exterior doors combined. In the case of heat pumps, heat pump water heaters, biomass stoves, and boilers, the annual limit is $2,000 for all such property combined, applied separately from the $1,200 limit described above.[970] The effect of these limits is thus that the maximum possible credit for a taxpayer in a given year is $3,200.

Other rules

The taxpayer's basis in the property is reduced by the amount of the credit.[971] Special proration rules apply in the case of jointly owned property, condominiums, and tenant-stockholders in cooperative housing corporations.[972] If less than 80 percent of the property is used for nonbusiness purposes, only the portion of expenditures that is used for nonbusiness purposes is taken into account.[973]

For purposes of determining the amount of expenditures made by any individual with respect to any dwelling unit, expenditures which are made from subsidized energy financing are not taken into account. The term "subsidized energy financing" means financing provided under a Federal, State, or local program a principal purpose of which is to provide subsidized financing for projects designed to conserve or produce energy.[974]

A credit is not allowed with respect to any qualified energy property or exterior window, skylight, or door, unless a unique qualified product identification number, assigned by the

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[968] Sec. 25C(e). Treasury has released guidance on home energy audits. See Notice 2023-59, 2023-34 I.R.B. 564, August 21, 2023.

[969] Sec. 25C(b).

[970] Sec. 25C(b)(5).

[971] Sec. 25C(g).

[972] Sec. 25C(f).

[973] *Ibid.*

[974] Sec. 25C(f)(3).

product's manufacturer, is included on the return.[975] Omission of such a number is treated as a mathematical or clerical error.[976]

Description of Proposal

The proposal repeals the energy efficient home improvement credit.

Effective Date

The proposal is effective for property placed in service after December 31, 2025.

[975] Sec. 25C(h).

[976] Sec. 6213(g)(2)(S).

F. Termination of Residential Clean Energy Credit

Present Law

In general

An income tax credit is available to individuals for the purchase of qualified solar electric property, qualified solar water heating property, qualified fuel cell property, qualified small wind energy property, qualified geothermal heat pump property, and qualified battery storage technology.[977]

For property placed in service before January 1, 2033, the credit rate is 30 percent of qualifying expenditures. For property placed in service in calendar year 2033, the credit rate is reduced to 26 percent, and for property placed in service in calendar year 2034, the credit rate is reduced to 22 percent. The credit expires for property placed in service after December 31, 2034.

Expenditures for labor costs allocable to onsite preparation, assembly, or original installation of property eligible for the credit, and for piping and wiring to interconnect such property to the dwelling unit, are eligible expenditures.[978]

The credit is nonrefundable, but unused tax credits may be carried forward to future tax years.[979] The credit with respect to all qualifying property may be claimed against the alternative minimum tax.

Qualified property

Qualified solar electric property is property that uses solar energy to generate electricity for use in a dwelling unit located in the United States and used as a residence by the taxpayer.[980] Qualifying solar water heating property is property used to heat water for use in a dwelling unit located in the United States and used as a residence by the taxpayer if at least half of the energy used by such property for such purpose is derived from the sun.[981]

Qualified fuel cell property is a fuel cell power plant which is an integrated system comprised of a fuel cell stack assembly and associated balance of plant components that (1) converts a fuel into electricity using electrochemical means, (2) has an electricity-only generation efficiency of greater than 30 percent, and (3) has a nameplate capacity of at least 0.5

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[977] Sec. 25D.

[978] Sec. 25D(e)(1).

[979] Sec. 25D(c).

[980] Sec. 25D(d)(2).

[981] Sec. 25D(d)(1).

kilowatt of electricity using an electrochemical process.[982] The qualified fuel cell property must be installed on or in connection with a dwelling unit located in the United States and used by the taxpayer as a principal residence. In general, the credit for any fuel cell property may not exceed $500 for each 0.5 kilowatt of capacity.[983]

Qualified small wind energy property is property that uses a wind turbine to generate electricity for use in connection with a dwelling unit located in the United States and used as a residence by the taxpayer.[984]

Qualified geothermal heat pump property means any equipment which (1) uses the ground or ground water as a thermal energy source to heat the dwelling unit or as a thermal energy sink to cool such dwelling unit, (2) meets the requirements of the Energy Star program which are in effect at the time that the expenditure for such equipment is made, and (3) is installed on or in connection with a dwelling unit located in the United States and used as a residence by the taxpayer.[985]

Qualified battery storage technology is battery storage technology having a capacity of at least three kilowatts that is installed in connection with a dwelling unit located in the United States and used as a residence by the taxpayer.[986]

Additional rules

The depreciable basis of the property is reduced by the amount of the credit.[987] Special proration rules apply in the case of jointly owned property, condominiums, and tenant-stockholders in cooperative housing corporations. If less than 80 percent of the property is used for nonbusiness purposes, only that portion of expenditures that is used for nonbusiness purposes is taken into account.[988]

Description of Proposal

The proposal repeals the residential clean energy credit.

Effective Date

The proposal is effective for property placed in service after December 31, 2025.

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[982] Secs. 25D(d)(3) and 48(c)(1).

[983] Sec. 25D(b)(1).

[984] Sec. 25D(d)(4).

[985] Sec. 25D(d)(5).

[986] Sec. 25D(d)(6).

[987] Sec. 25D(f).

[988] Sec. 25D(e).

G. Termination of New Energy Efficient Home Credit

Present Law

The section 45L credit is available to an eligible contractor for each qualified new energy efficient home that is constructed by the eligible contractor and acquired by a person from such eligible contractor for use as a residence during the taxable year.[989] To qualify as a new energy efficient home, the home must be: (1) a dwelling located in the United States, (2) substantially completed after August 8, 2005, and (3) certified to meet certain energy saving requirements.[990] As described below, the provision provides for a $2,500 credit for new homes that meet certain energy efficiency standards, but which are not certified zero-energy ready, and a $5,000 credit for new homes that are certified as zero-energy ready homes.[991] For multifamily dwelling units that are part of a building eligible to participate in the Energy Star Multi-family New Construction Program the credit is $500 for new units that meet certain energy efficiency standards, but which are not certified as zero-energy ready, and $1,000 for dwelling units that are certified as zero-energy ready.[992]

For single-family homes, to be eligible for the $2,500 credit, a dwelling unit must meet the following standards, as applicable: (1) in the case of a dwelling unit acquired before January 1, 2025, the Energy Star Single-Family New Homes National Program Requirements 3.1, and (2) in the case of a dwelling unit acquired after December 31, 2024, the Energy Star Single-Family New Homes National Program Requirements 3.2.[993] In addition, such dwelling unit must meet the most recent Energy Star Single-Family New Homes Program Requirements applicable to the location of such dwelling unit (as in effect on the latter of January 1, 2023, or January 1 of two calendar years prior to the date such dwelling unit is acquired). In the case of a manufactured home, a dwelling unit is eligible for the $2,500 credit if it meets the most recent Energy Star Manufactured Home National program requirements as in effect on the latter of January 1, 2023, or January 1 of two calendar years prior to the date such dwelling unit is acquired.

A multifamily dwelling unit is eligible for the $500 credit if such unit (1) meets the most recent Energy Star Multifamily New Construction National Program Requirements (as in effect on the latter of January 1, 2023, or January 1 of three calendar years prior to the date such dwelling unit was acquired), and (2) meets the most recent Energy Star Multifamily New Construction Regional Program Requirements applicable to the location of such dwelling unit (as

[989] Sec. 45L(a).

[990] Sec. 45L(b)(2).

[991] Sec. 45L(a)(2)(A).

[992] Sec. 45L(a)(2)(B).

[993] Sec. 45L(c)(2).

in effect on the latter of January 1, 2023, or January 1 of three calendar years prior to the date such dwelling unit is acquired).[994]

For the $5,000 credit ($1,000 in the case of multifamily housing), a dwelling unit must be certified as a zero-energy ready home under the zero-energy ready home program of the Department of Energy as in effect on January 1, 2023 (or any successor program determined by the Secretary of the Treasury).[995]

If certain prevailing wage requirements are met, the credit for qualifying multifamily dwelling units is increased to $2,500 per unit for those that are not zero-energy ready and to $5,000 per unit for those that are zero-energy ready.[996] In general, to satisfy the prevailing wage requirements, the taxpayer must ensure that any laborers and mechanics employed by the taxpayer or any contractor or subcontractor in the construction of such residence shall be paid wages at a rate not less than the prevailing wage rates for construction, alteration, or repair of a similar character in the locality as determined by the Secretary of Labor, in accordance with subchapter IV of chapter 31, of title 40, United States Code. Rules similar to the rules set forth in section 45(b)(7)(B) of the renewable electricity production credit apply regarding penalties for failing to satisfy the prevailing wage requirements.

The basis of any property associated with the new energy efficient homes credit is reduced by the amount of any such credit allowed under section 45L. The basis reduction is not taken into account for purposes of determining the amount of the section 42 low-income housing tax credit.

The credit is part of the general business credit. The credit applies to homes that are purchased prior to January 1, 2033.

Description of Proposal

The proposal generally repeals the new energy efficient home credit for any qualified new energy efficient home acquired after December 31, 2025. In the case of any home for which construction began before May 12, 2025, the proposal repeals the credit for homes acquired after December 31, 2026.

Effective Date

The proposal is effective for any qualified new energy efficient home acquired after December 31, 2025.

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[994] Sec. 45L(c)(3).

[995] Sec. 45L(c)(1)(B).

[996] Sec. 45L(g).

H. Phase-out and Restrictions on Clean Electricity Production Credit

Present Law

The clean electricity production credit is available with respect to electricity produced by the taxpayer at a qualified facility and sold to an unrelated person during the taxable year.[997] The credit is also available where such electricity is consumed or stored by the taxpayer during the taxable year and there is no third-party sale, but only if the qualified facility is equipped with a metering device owned and operated by an unrelated person.[998] The credit is available for electricity produced during the 10-year period beginning when the qualified facility is originally placed in service.[999] Consumption, sales, or storage are only taken into account with respect to electricity produced within the United States or a possession of the United States.[1000]

The base credit rate is 0.3 cents per kilowatt-hour.[1001] This amount is increased to 1.5 cents per kilowatt-hour for facilities with a maximum output of less than one megawatt of electricity (as measured in alternating current) and for facilities that meet certain prevailing wage and apprenticeship requirements (or for which construction began before January 29, 2023).[1002] These amounts are adjusted for inflation using 1992 as the base year and increased in increments of one-twentieth of a cent for the base credit and one-tenth of a cent for the enhanced credit. The inflation adjustments must be published annually be the Secretary no later than April 1 of each calendar year.

A qualified facility is an electricity generation facility owned by the taxpayer that is placed in service after December 31, 2024, and for which the greenhouse gas emissions rate is not greater than zero.[1003] With respect to a facility placed in service before January 1, 2025, a qualified facility includes new units and additions to capacity placed in service after December 31, 2024.[1004] A qualified facility does not include any facility for which a credit is allowed

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[997] Sec. 45Y(a)(1).

[998] *Ibid.*

[999] Sec. 45Y(b)(1)(B).

[1000] Sec. 45Y(g)(1).

[1001] Sec. 45Y(a)(2)(A).

[1002] Section 45Y(a)(2)(B)(ii) specifies that a qualified facility that begins construction "prior to the date that is 60 days after the Secretary publishes guidance" with respect to the prevailing wage and apprenticeship requirements receives the increased credit rate. Treasury published such guidance on November 30, 2022, therefore a facility that began construction before January 29, 2023, is treated as satisfying the prevailing wage and apprenticeship requirements. T.D. 9998, 89 Fed. Reg. 53184, June 25, 2024.

[1003] Sec. 45Y(b)(1)(A). This inflation adjustment is calculated using the gross domestic product ("GDP") implicit price deflator for the preceding calendar year compared to the GDP implicit price deflator for the base year.

[1004] Sec. 45Y(b)(1)(C).

under sections 45, 45J, 45Q, 45U, 48, 48A, or 48E for the taxable year or any prior taxable year.[1005]

The greenhouse gas emissions rate means the amount of greenhouse gases emitted into the atmosphere by a facility in the production of electricity, expressed as grams of carbon dioxide equivalents per kilowatt-hour (“CO_2e per KWh”; see definitions below for how this is measured).[1006] In the case of a facility which produces electricity through combustion or gasification, the greenhouse gas emissions rate for such facility shall be equal to the net rate of greenhouse gases emitted into the atmosphere by such facility (taking into account lifecycle greenhouse gas emissions, as described in section 211(o)(1)(H) of the Clean Air Act) in the production of electricity, expressed as grams of CO_2e per KWh.[1007]

The provision directs the Secretary to annually publish greenhouse gas emissions rates for types or categories of facilities, for use by taxpayers to determine whether a facility qualifies.[1008] In the case of any facility for which an emissions rate has not been established by the Secretary, a taxpayer which owns such a facility may file a petition with the Secretary for a determination of the emissions rate with respect to such facility.

The amount of greenhouse gases emitted into the atmosphere by a facility in the production of electricity does not include any qualified carbon dioxide that is captured by the taxpayer and sequestered in secure geological storage under rules similar to the rules applicable under section 45Q(f) or utilized by the taxpayer in a manner described in section 45Q(f)(5).[1009]

The credit is part of the general business credit.

Phaseout of credit

The credit begins to phase out in the “applicable year,” which is defined as the later of 2032 or the calendar year in which the Secretary determines that the annual greenhouse gas emissions from the production of electricity in the United States are equal to or less than 25 percent of the annual greenhouse gas emissions from the production of electricity in the United States for calendar year 2022.[1010] The credit is reduced by 25 percent for a facility the construction of which begins during the second calendar year following the applicable year, by 50 percent for a facility the construction of which begins during the third calendar year following the applicable year, and by 100 percent for a facility the construction of which begins during any subsequent calendar year.

[1005] Sec. 45Y(b)(1)(D).

[1006] Sec. 45Y(b)(2)(A).

[1007] Sec. 45Y(b)(2)(B).

[1008] Sec. 45Y(b)(2)(C).

[1009] Sec. 45Y(b)(2)(D).

[1010] Sec. 45Y(d).

Wage and apprenticeship requirements

The prevailing wage and apprenticeship requirements follow a structure similar to that set forth in section 45(b)(7) and 45(b)(8).[1011]

A taxpayer can meet the prevailing wage requirements if it ensures that prevailing wages are paid to any laborers and mechanics employed by the taxpayer or any contractor or subcontractor in the construction of a qualified facility, and for the alteration or repair of such facility during the 10-year credit-eligible production period.[1012] Prevailing wages are wages paid at rates not less than the prevailing wage rates for construction, alteration, or repair of a similar character in the locality as determined by the Secretary of Labor, in accordance with subchapter IV of chapter 31, of title 40, United States Code.[1013]

A taxpayer that fails to pay prevailing wages may bring a facility into compliance with the prevailing wage requirement, and thus remain eligible for the increased credit rate, by paying any affected workers the difference between the actual compensation paid to such workers and the wages required to be paid to those workers to meet prevailing wage requirements, plus any applicable interest.[1014] This amount is multiplied by three in the case of intentional disregard of the requirements. In addition, such taxpayer must pay a penalty to the IRS equal to $5,000 per affected worker. The penalty is increased to $10,000 per affected worker in the case of intentional disregard of the requirements. The deficiency procedures do not apply with respect to the assessment or collection of these penalties, and payment must be made within 180 days of the penalty's determination.

To be eligible for the enhanced credit, a taxpayer must also ensure that certain qualified apprenticeship requirements are satisfied by ensuring that not less than 15 percent of the total labor hours of construction, alteration, or repair work on any qualified facility that begins construction after December 31, 2023 are performed by qualified apprentices (including such work performed by any contractor or subcontractor).[1015] Labor hours are the total number of hours devoted to construction, alteration, or repair work by employees of the contractor or subcontractor and excludes certain hours worked by managers, owners, or certain other bona fide executives, administrators, or professionals.[1016] A qualified apprentice is an employee of the contractor or subcontractor who is participating in a registered apprenticeship program.[1017] In

[1011] Sec. 45Y(g)(8)-(9).

[1012] Sec. 45(b)(7)(A).

[1013] *Ibid.*

[1014] Sec. 45(b)(7)(B).

[1015] Sec. 45(b)(8)(A).

[1016] Sec. 45(b)(8)(E)(i).

[1017] Sec. 45(b)(8)(E)(ii).

addition, the ratio of apprentice-to-journeyworker must meet the standard set by the Department of Labor or applicable State apprenticeship agency.[1018]

Each taxpayer, contractor, or subcontractor who employs four or more individuals to perform construction, alteration, or repair work with respect to the construction of a qualified facility must employ one or more qualified apprentices to perform such work.[1019] Exceptions from these requirements are provided for taxpayers that make a good faith effort to comply with the requirements of the provision by requesting qualified apprentices from a registered apprenticeship program but where such request is denied or where the registered apprenticeship program fails to respond to a request within five business days.[1020]

A taxpayer that fails to satisfy the apprenticeship requirements can come into compliance and thus remain eligible for the increased rate by paying a penalty in the amount of $50 per missing apprenticeship labor hour.[1021] In the case of intentional disregard of the apprenticeship rules, this amount is increased to $500 per labor hour.[1022]

Definitions and guidance

CO_2e per KWh means, with respect to any greenhouse gas, the equivalent carbon dioxide (as determined based on global warming potential) per kilowatt hour of electricity produced.[1023] The term greenhouse gas has the same meaning given such term under section 211(o)(1)(G) of the Clean Air Act, as in effect on the date of the provision's enactment.[1024] Qualified carbon dioxide means carbon dioxide captured from an industrial source which (1) would otherwise be released into the atmosphere as industrial emission of greenhouse gas, (2) is measured at the source of capture and verified at the point of disposal or utilization, and (3) is captured and disposed or utilized within the United States or a possession of the United States.[1025]

The Secretary is required to issue guidance regarding implementation of the provision no later than January 1, 2025, including guidance on the calculation of greenhouse gas emission rates for qualified facilities and the determination of clean electricity production credits.[1026]

[1018] Sec. 45(b)(8)(B).

[1019] Sec. 45(b)(8)(C).

[1020] Sec. 45(b)(8)(D)(ii).

[1021] Sec. 45(b)(8)(D)(i).

[1022] Sec. 45(b)(8)(D)(iii).

[1023] Sec. 45Y(e)(1).

[1024] Sec. 45Y(e)(2).

[1025] Sec. 45Y(e)(3).

[1026] See T.D. 10024, 90 Fed. Reg. 4006, January 15, 2025.

Combined heat and power system property

For purposes of determining the clean electricity production credit, the kilowatt hours of electricity produced by a taxpayer at a qualified facility include any production in the form of useful thermal energy by any combined heat and power system property within such facility, and the amount of greenhouse gases emitted into the atmosphere by such facility in the production of such useful thermal energy is included for purposes of determining the greenhouse gas emissions rate for such facility.[1027] For this purpose the term combined heat and power system property has the same meaning given such term for purposes of the section 48 energy credit, without regard to the sunset date, capacity limitations, or special biomass rule.[1028] The amount of kilowatt-hours of electricity produced in the form of useful thermal energy equals the total useful thermal energy produced by the combined heat and power system property within the qualified facility divided by the heat rate for such facility.[1029] For this purpose, the heat rate means the amount of energy used by the qualified facility to generate one kilowatt-hour of electricity, expressed as British thermal units per net kilowatt-hour generated.[1030]

Energy communities bonus

In the case of any qualified facility which is located in an energy community (as defined in section 45(b)(11)(B)), the credit amount is increased by 10 percent. An energy community is defined as: (1) a brownfield site; (2) a metropolitan statistical area or non-metropolitan area with an unemployment rate at or above the national average for the previous year which has (or had after 2009) 0.17 percent or greater direct employment or 25 percent or greater local tax revenues related to the extraction, processing, transport, or storage of coal, oil, or natural gas; or (3) a census tract (or directly adjoining tract) in which, in the period since 1999, a coal mine has closed, or, in the period since 2009, a coal-fueled power plant has been retired.[1031]

Credit reduced for tax-exempt bonds

The credit is reduced for tax-exempt bonds under rules similar to the rules of section 45(b)(3).[1032] With respect to such bond-financed facilities, the credit is reduced by the lesser of 15 percent or a percentage calculated using as the numerator that amount of tax-exempt financing with respect to a facility (for the taxable year and all prior years) and as the denominator the aggregate amount of additions to the capitol account for such facility (for the taxable year and all prior years).[1033] For purposes of this calculation, the numerator includes

[1027] Sec. 45Y(g)(2)(A).

[1028] Sec. 45Y(g)(2)(B).

[1029] Sec. 45Y(e)(2)(C)(i).

[1030] Sec. 45Y(e)(2)(C)(ii).

[1031] Sec. 45(b)(11)(B).

[1032] Sec. 45Y(g)(8).

[1033] Sec. 45(b)(3).

bond proceeds that are used for capital expenditures of qualified facilities but does not include proceeds that are used for other purposes, such as reserve funds.

Domestic content bonus

The credit is increased by 10 percent (calculated without regard to the energy communities bonus) if certain domestic content requirements are met.[1034] To meet these requirements, a taxpayer must certify to the Secretary that any steel, iron, or manufactured product which is a component of a qualified facility (upon completion of construction) was produced in the United States.[1035]

For purposes of steel and iron, this requirement shall be applied consistent with section 661.5 of title 49, Code of Federal Regulations.[1036]

Manufactured products which are components of qualified facilities are deemed to have been produced in the United States if not less than the adjusted percentage of the total costs of all manufactured products of such facility are attributable to manufactured products (including components) which are mined, produced, or manufactured in the United States.[1037] Except with respect to offshore wind facilities, the percentage is 40 percent for a facility the construction of which begins before January 1, 2025, 45 percent for a facility the construction of which begins in calendar year 2025, 50 percent for a facility the construction of which begins in calendar year 2026, and 55 percent for a facility the construction of which begins after December 31, 2026.[1038] For offshore wind facilities, the percentage is 20 percent for a facility the construction of which begins before January 1, 2025, 27.5 percent for a facility the construction of which begins in calendar year 2025, 35 percent for a facility the construction of which begins in calendar year 2026, 45 percent for a facility the construction of which begins in calendar year 2027, and 55 percent for a facility the construction of which begins after December 31, 2027.[1039]

Reduction of elective payment if domestic content rules are not satisfied

Under section 6417, certain taxpayers may elect to have the credit paid directly to the extent there is insufficient tax liability to absorb the credit (see "Elective payment for applicable credits" below). The amount of this direct payment is reduced if the domestic content requirements described above for the bonus credit are not satisfied.[1040] This reduction applies only to facilities having a maximum net output of at least one megawatt (as measured in

[1034] Sec. 45Y(g)(11)(A).

[1035] Sec. 45Y(g)(11)(B)(i); see Notice 2025-8, 2025-8 I.R.B. 800, February 18, 2025.

[1036] Sec. 45Y(g)(11)(B)(ii).

[1037] Sec. 45Y(g)(11)(B)(iii).

[1038] Sec. 45Y(g)(11)(C)(i).

[1039] Sec. 45Y(g)(11)(C)(ii).

[1040] Sec. 45Y(g)(12)(B)(i).

alternating current).[1041] The payment is reduced by 10 percent if construction of the facility begins in calendar year 2024, by 15 percent if construction the facility begins in calendar year 2025, and by 100 percent if the construction of the facility begins after December 31, 2025.[1042]

An exception applies if the Secretary determines that the inclusion of steel, iron, or manufactured products which are produced in the United States increases the overall costs of construction of qualified facilities by more than 25 percent, or if the relevant steel, iron, or manufactured products are not produced in the United States in sufficient and reasonably available quantities or of a satisfactory quality.[1043]

Special rules

In the case of a qualified facility in which more than one person has an ownership interest, except to the extent provided in regulations prescribed by the Secretary, production from the facility shall be allocated among such persons in proportion to their respective ownership interests in the gross sales from such facility.[1044]

Persons shall be treated as related to each other if such persons would be treated as a single employer under the regulations prescribed under section 52(b).[1045] In the case of a corporation which is a member of an affiliated group of corporations filing a consolidated return, such corporation shall be treated as selling electricity to an unrelated person if such electricity is sold to such a person by another member of such group.[1046]

Elective payment of applicable credits

In general

In the case of an applicable entity making an election (at such time and in such manner as the Secretary may provide[1047]) with respect to any applicable credit determined with respect to such entity, such entity is treated as making a payment against the tax imposed by subtitle A of the Code (for the taxable year with respect to which such credit was determined) equal to the entire amount of such credit (a "direct payment").[1048]

[1041] Sec. 45Y(g)(12)(B)(ii).

[1042] Sec. 45Y(g)(12)(C).

[1043] Sec. 45Y(g)(12)(D).

[1044] Sec. 45Y(g)(3) and Treas. Reg. sec. 1.45Y-4(b).

[1045] Sec. 45Y(g)(2).

[1046] Sec. 45Y(g)(4).

[1047] Treas. Reg. 1.6417-2.

[1048] Sec. 6417(a). Because the payment is treated as a payment against tax, it is not income for income tax purposes.

The applicable credits are: (1) the business credit portion of the alternative fuel vehicle refueling property credit,[1049] (2) the renewable electricity production credit (to the extent attributable to qualified facilities originally placed in service after December 31, 2022),[1050] (3) the carbon oxide sequestration credit (to the extent attributable to carbon capture equipment which is originally placed in service after December 31, 2022),[1051] (4) the zero-emission nuclear power production credit,[1052] (5) the clean hydrogen production credit (to the extent attributable to qualified clean hydrogen production facilities that are originally placed in service after December 31, 2012),[1053] (6) in the case of a tax-exempt entity described in clause (i), (ii), or (iv) of section 168(h)(2)(A), the credit for qualified commercial vehicles determined under section 45W by reason of subsection (d)(2) thereof, (7) the credit for advanced manufacturing production,[1054] (8) the clean electricity production credit,[1055] (9) the clean fuel production credit,[1056] (10) the energy credit,[1057] (11) the qualifying advanced energy project credit,[1058] and (12) the clean electricity investment credit.[1059]

In general, an applicable entity is (1) any tax-exempt organization, (2) any State or political subdivision thereof,[1060] (3) the Tennessee Valley Authority, (4) any Indian tribal government,[1061] (5) any Alaska Native Corporation, or (6) any corporation operating on a cooperative basis which is engaged in furnishing electric energy to persons in rural areas.[1062] With certain limitations, entities not included in this list ("nonlist entities") may make an election and be treated as an applicable entity with respect to the section 45V qualified clean hydrogen production credit, the section 45Q carbon oxide sequestration credit, and the section 45X advanced manufacturing production credit. No election by a taxpayer that is a nonlist entity may be made with respect to any taxable year beginning after December 31, 2032.

[1049] Sec. 30C.

[1050] Sec. 45.

[1051] Sec. 45Q.

[1052] Sec. 45U.

[1053] Sec. 45V.

[1054] Sec. 45X.

[1055] Sec. 45Y.

[1056] Sec. 45Z.

[1057] Sec. 48.

[1058] Sec. 48C.

[1059] Sec. 48E.

[1060] Eligible entities include State agencies and instrumentalities. Treas. Reg. sec. 1.6417-1(c)(7).

[1061] As defined in sec. 30D(g)(9).

[1062] Sec. 6417(d)(1).

An election with respect to sections 45V, 45Q, and 45X by a taxpayer that is a nonlist entity generally remains in effect for the election year and for each of the four succeeding taxable years ending before January 1, 2033.[1063] A taxpayer may prospectively revoke this election one time during that period but may not subsequently re-elect.

Special rules

In the case of an applicable credit determined with respect to any facility or property held directly by a partnership or S corporation, the election is made at the partnership level or by the S corporation, in such manner as the Secretary may provide.[1064] In the event of such an election, any amount received by a partnership or S corporation as an elective payment is treated as tax-exempt income for purposes of sections 705 and 1366, and a partner's distributive share of such tax-exempt income is based on such partner's distributive share of the otherwise applicable credit for each taxable year.

Limitations in section 50(b)(3) and (4)(A)(i), relating to property used by tax-exempt and government entities, do not apply with respect to any applicable credit for which an election for a direct payment has been made. In addition, any such property is treated as used in a trade or business of the applicable entity.[1065]

An election by a taxpayer must generally be made by the due date (including extensions of time) for the tax return for the taxable year for which the election is made, but in no event earlier than 180 days after the date of enactment of the provision.[1066] In the case of any government or political subdivision for which no return is required, the Secretary has determined that the appropriate date is the 15th day of the fifth month after the end of the taxable year.[1067]

For the section 45 renewable electricity production credit, the section 45Q credit for carbon oxide sequestration, the section 45V credit for clean hydrogen production, and the section 45Y clean electricity production credit, any election for a direct payment is applied separately with respect to each qualified facility.

As a condition of, and prior to, any amount being treated as a payment which is made by an applicable entity under the provision, the Secretary may require such information or

[1063] Sec. 6417(d)(1)(B), (C), and (D) and Treas. Reg. sec. 1.6417-2.

[1064] Sec. 6417(c) and Treas. Reg. sec. 1.6417-4.

[1065] Sec. 6417(d)(2).

[1066] Sec. 6417(d)(3)(A)(i)(II). The Joint Committee on Taxation's refund review function only applies with respect to income taxes that have been assessed. For this reason, direct payments with respect to elections made on originally filed returns are not subject to review by the Joint Committee under section 6405.

[1067] Sec. 6417(d)(3)(A)(i)(I) and Treas. Reg. sec. 1.6417-2(b)(3)(i).

registration as the Secretary deems necessary for purposes of preventing duplication, fraud, improper payments, or excessive payments under this section.[1068]

Excessive payments are subject to recapture and penalty, in the absence of reasonable cause. An excessive payment is, generally, the excess of the amount of the direct payment over the amount of the credit which would otherwise be allowable for the taxable year.[1069] In the case of an excessive payment, the tax is increased in the year in which the Secretary makes a determination that an excessive payment exists.[1070]

In general, if a nonlist entity makes an election for a direct payment no election may be made to transfer the credits under the rules described below.

If an election is made for a direct payment, the underlying applicable credit for which an election is made is reduced to zero and, for any other Code purposes, is deemed allowed to such entity for the taxable year.[1071] In other words, the credit determined with respect to the applicable entity is treated as a credit for all purposes, but after it is applied against income tax liability, it is reduced to zero to prevent any double benefit (such as claiming the credit twice).

The direct payment rules do not apply to any possession of the United States with a mirror code tax system unless the possession elects to have them apply.[1072]

Rules similar to the rules of section 50 apply, without regard to certain limitations applicable to government and tax-exempt entities.[1073]

Beginning in fiscal year 2023 and each fiscal year thereafter, the portion of any payment for which a direct payment election has been made, or any amount treated as a such a payment and that is direct spending is increased by 6.0445 percent.[1074] This is intended to offset any reduction due to Federal budget sequestration.

Transfer of certain credits

In general

An eligible taxpayer may elect to transfer all or a portion of an eligible credit determined with respect to such taxpayer for any taxable year to an unrelated taxpayer (the "transferee

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[1068] For such requirements see Treas. Reg. sec. 1.6417-5.

[1069] Sec. 6417(d)(6).

[1070] Treas. Reg. sec. 1.6417-6(a).

[1071] Sec. 6417(e).

[1072] Sec. 6417(f).

[1073] Sec. 6417(g).

[1074] Pub. L. No. 117-169, sec. 13801(f), August 16, 2022.

taxpayer").[1075] Payments to the taxpayer by the transferee taxpayer must be made in cash. Such payments are not includible in the gross income of the taxpayer nor are they deductible by the transferee taxpayer.[1076] The transferee taxpayer has no basis in any transferred credit, and the fact that the credit amount may exceed the transfer payment does not give rise to any income to the transferee. Such payments are similarly ignored when determining the existence or character of income for other tax purposes. Taxpayers may only transfer credits to which they are entitled, after the application of any limitations (such as the limitation on projects financed by tax-exempt bonds).

The list of eligible credits is the same as the list of applicable credits under the direct payment rules described above, except for the credit for qualified commercial vehicles determined under section 45W by reason of subsection (d)(2) thereof.[1077] An eligible credit does not include any business credit carryforward or business credit carryback.[1078] In the case of an eligible credit under sections 45, 45Q, 45V, and 45Y, an election may be made separately with respect to each facility for which such credit is determined and for each taxable year during the 10-year period beginning on the date such facility was originally placed in service (or in the case of a credit under section 45Q, the 12-year period beginning on the date the carbon capture equipment was originally placed in service at such facility).[1079]

An eligible taxpayer is any taxpayer other than a tax-exempt organization, a State or political subdivision thereof, the Tennessee Valley Authority, an Indian tribal government, an Alaska Native Corporation, or a corporation operating on a cooperative basis which is engaged in furnishing electric energy to persons in rural areas.[1080]

In the case of any facility or property held directly by a partnership or S corporation, a credit transfer election must be made at the partnership or S corporation level. If a partnership or S corporation makes an election to transfer credits under the provision, any amount received as consideration for a transfer described is treated as tax-exempt income for purposes of sections 705 and 1366, and a partner's distributive share of such tax-exempt income is based on such partner's distributive share of the otherwise eligible credit for each taxable year.[1081]

[1075] Sec. 6418(a).

[1076] Sec. 6418(b).

[1077] Sec. 6418(f)(1)(A).

[1078] Sec. 6418(f)(1)(C).

[1079] Sec. 6418(f)(1)(B).

[1080] Sec. 6418(f)(2); see also sec. 6417(d)(1)(A).

[1081] Sec. 6418(c).

Transferred credits must be taken into account in the first taxable year of the transferee taxpayer ending with, or after, the taxable year of the eligible taxpayer with respect to which the credit was determined.[1082]

An election to transfer any portion of an eligible credit must made not later than the due date (including extensions of time) for the tax return for the taxable year for which the credit is determined, but in no event earlier than 180 days after the date of the enactment of the provision. Any such election, once made, is irrevocable and no additional election may be made by a transferee taxpayer with respect to any credits received under the provision.[1083]

Special rules

As a condition of, and prior to, any transfer of any portion of an eligible credit, the Secretary may require such information (including, in such form or manner as is determined appropriate by the Secretary, such information returns) or registration as the Secretary deems necessary for purposes of preventing duplication, fraud, improper payments, or excessive payments under this section.[1084]

Absent reasonable cause, in the event of an excessive credit transfer, the transferee taxpayer is liable for tax in the amount of the excessive credit transfer plus 20-percent penalty. For this purpose, an excessive credit transfer is, generally, the excess of the amount of the credit claimed by the transferee taxpayer over the amount of the credit which would otherwise be allowable for the taxable year without the application of section 6418 (in other words, the amount of the credit properly determined with respect to such facility or property for such taxable year in the hands of the eligible taxpayer).[1085]

In the case of transferred credits associated with investment credit property, the basis of such property must be reduced under the rules of section 50. In addition, if, during any taxable year, the underlying property that gave rise to a transferred credit is disposed of or otherwise ceases to be investment credit property with respect to the eligible taxpayer before the close of the section 50 recapture period, such eligible taxpayer must notify the transferee taxpayer of the recapture event and the transferee taxpayer must notify the eligible taxpayer of the recapture amount. The transferee, filling in as the taxpayer once the transfer is complete, is responsible for any amounts subject to recapture.[1086]

No transfer election may be made with respect to progress expenditures.[1087]

[1082] Sec. 6418(d).

[1083] Sec. 6418(e).

[1084] Sec. 6418(g)(1) and Treas. Reg. sec. 1.6418-4.

[1085] Sec. 6418(g)(2) and Treas. Reg. sec. 16418-5.

[1086] Sec. 6418(g)(3).

[1087] Sec. 6418(g)(4).

Foreign Entity of Concern

In general

There are two credits in the Code that have restrictions related to foreign entities of concern, the clean vehicle credit (section 30D) and the advanced manufacturing investment credit (section 48D).

Under section 30D, vehicles with any applicable critical minerals in the battery that are extracted, processed, or recycled by a foreign entity of concern[1088] that are placed in service after December 31, 2024, or vehicles with any components contained in the battery of the vehicle that are manufactured or assembled by a foreign entity of concern that are placed in service after December 31, 2023, do not qualify for the clean vehicle credit.[1089]

Under section 48D a taxpayer that is a foreign entity of concern[1090] is not allowed to claim the advanced manufacturing investment credit.[1091]

For both purposes a foreign entity of concern is defined as a foreign entity that is (1) designated as a foreign terrorist organization by the Secretary of State, (2) included on the list of specially designated nationals and blocked persons maintained by the Office of Foreign Assets Control of the Department of the Treasury ("SDN list"), (3) owned by, controlled by, or subject to the jurisdiction or direction of the government of a foreign country that is a covered nation,[1092] (4) alleged by the Attorney General to have been involved in activities for which a conviction was obtained under certain laws, or (5) determined by the Secretary,[1093] in consultation with the Secretary of Defense and the Director of National Intelligence, to be engaged in unauthorized conduct that is detrimental to the national security or foreign policy of the United States.

[1088] Foreign entity of concern as defined in 42 U.S.C. sec. 18741(a)(5).

[1089] Sec. 30D(d)(7). For a description of 30D see the description of the clean vehicle credit above.

[1090] Foreign entity of concern as defined in section 9901(8) of the William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021.

[1091] Sec. 48D(c)(1). For a detailed description of section 48D see the description of the advanced manufacturing investment credit in Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 117th Congress* (JCS-1-23), December 21, 2023.

[1092] 10 U.S.C. sec. 4872(f)(2). Covered nation means the Democratic People's Republic of North Korea, the People's Republic of China, the Russian Federation, and the Islamic Republic of Iran.

[1093] For the purposes of the foreign entity of concern definition used in section 48D, "the Secretary" refers to the "Secretary of Commerce." William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283, sec. 9901(12), January 1, 2021. For the purposes of the foreign entity of concern definition used in section 30D, "the Secretary" refers to the "Secretary of Energy." 42 U.S.C. sec. 18701(3).

Clean Vehicle Credit

Treasury regulations provide that guidance promulgated by the Department of Energy on foreign entity of concern applies for purposes of the clean vehicle credit.[1094] This guidance includes interpretations of the terms "foreign entity," "government of a foreign country," "subject to the jurisdiction," and "owned by, controlled by, or subject to the direction," used in the definition of foreign entity of concern described above.

A foreign entity is: (1) a government of a foreign country; (2) a natural person who is not a lawful permanent resident or citizen of the U.S. or any other protected individual; (3) a partnership, association, corporation, organization, or other combination of persons organized under the laws of or having its principal place of business in a foreign country; or (4) an entity organized under the laws of the U.S. that is owned by, controlled by, or subject to the direction of an entity described in (1)-(3).

A government of a foreign country is: (1) a national of subnational government of a foreign country; (2) an agency or instrumentality of a national or subnational government of a foreign country; (3) a dominant or ruling political party of a foreign country; or (4) a current or former senior foreign political figure.

A foreign entity is subject to the jurisdiction of a covered nation government if (1) the foreign entity is incorporated or domiciled in, or has its principal place of business in a covered nation or (2) the foreign entity engages in the extraction, processing, or recycling of critical minerals, the manufacturing or assembly of components, or the processing of materials for batteries used to power the electric motor of new clean vehicles.

An entity is considered to be owned by, controlled by, or subject to the direction of another entity if (1) 25% or more of the entity's board seats, voting rights, or equity interests are cumulatively held by that other entity, whether directly or indirectly or (2) the entity has entered into a licensing agreement or other contract with another entity that entitles the entity to exercise

[1094] Treas. Reg. sec. 1.30D-2(b)(24) and 89 Fed. Reg. 37079, May 6, 2024.

effective control over the extraction, processing, recycling, manufacturing, or assembly of the critical minerals, battery components, or battery materials attributed to the entity.[1095]

For the definition of foreign entity of concern, the Secretary of Energy makes the determination of engagement in unauthorized conduct detrimental to the national security or foreign policy of the United States for the clean vehicle credit.

Advanced manufacturing investment credit

Treasury regulations provide that foreign entity of concern has the same meaning as under regulations issued for Title 15 of the U.S. Code for purposes of the advanced manufacturing investment credit.[1096]

A person is considered to be owned by, controlled by, or subject to the jurisdiction or direction of a government of a covered nation if (1) the person is a citizen, national, or resident of a covered nation and located in a covered nation, (2) the person is organized under the laws or has its principal place of business in a covered nation, (3) 25 percent of more of the person's outstanding voting interest, board seats, or equity interests is directly or indirectly held by a covered nation, or (4) 25 percent or more of the person's outstanding voting interest, board seats, or equity interests is held directly or indirectly by any combinations of persons described in (1)-(3).[1097]

Description of Proposal

Clean Electricity Production Credit

Phase-out percentage

The proposal modifies the phaseout of the clean electricity production credit. The credit is reduced by 20 percent for facilities placed in service during calendar year 2029, by 40 percent for facilities placed in service during calendar year 2030, by 60 percent for facilities placed in service during calendar year 2031, and by 100 percent for a facility placed in service after December 31, 2031.

Restrictions related to prohibited foreign entities

Under the proposal, a "qualified facility" does not include any facility that begins construction after the date that is one year after the date of enactment if the construction of the facility includes any material assistance from a prohibited foreign entity (as defined in section 7701(a)(52).

[1095] 89 Fed. Reg. 37079, May 6, 2024.

[1096] Treas. Reg. sec. 1.48D-2(f)(2) and 15 C.F.R. sec. 231.104.

[1097] 15 C.F.R. sec. 231.104(c)(1).

The proposal disallows any credit for any taxable year beginning after the date of enactment if the taxpayer is a specified foreign entity (as defined in section 7701(a)(51)(B)).

The proposal disallows any credit for any taxable year beginning after the date that is two years after the date of enactment if the taxpayer is a foreign-influenced entity (as defined in section 7701(a)(51)(D)).

No credit is allowed for any taxable year beginning after the date that is two years after the date of enactment if the taxpayer makes a payment of dividends, interest, compensation for services, rentals or royalties, guarantees or any other fixed, determinable, annual, or periodic amount (1) to a prohibited foreign entity in an amount equal to or greater than five percent of such total payments made by the taxpayer related to the production of electricity during the taxable year or (2) to more than one prohibited foreign entity in an amount that, in aggregate, is equal to or greater than 15 percent of such payments related to the production of electricity made by the taxpayer during the taxable year.

Repeal of transferability

The proposal terminates transferability of the credit for facilities that begin construction after the date that is two years after the date of enactment.

Prohibited Foreign Entity

In general

The proposal expands upon the concept of foreign entity of concern and defines several new categories of entities, which are used for new requirements for certain energy-related tax benefits.[1098]

A prohibited foreign entity[1099] is an entity that is a specified foreign entity[1100] or a foreign-influenced entity.[1101]

Specified foreign entity

A specified foreign entity is: (1) a foreign entity that is designated as a foreign terrorist organization by the Secretary of State;[1102] (2) a foreign entity that is included on the list of

[1098] See the descriptions of restrictions on sections 45X, 45Y, and 48E for details on how the restrictions on prohibited foreign entities are applied.

[1099] New sec. 7701(a)(51)(A).

[1100] New sec. 7701(a)(51)(B).

[1101] New sec. 7701(a)(51)(D).

[1102] See 15 U.S.C. sec. 4651; William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021 ("NDAA"), Pub. L. No. 116-283, sec. 9901(8)(A), January 1, 2021. Note that the CHIPS and Science Act modified the NDAA. See Pub. L. No. 117-167, sec. 103, August 9, 2022.

specially designated nationals and blocked persons maintained by the Office of Foreign Assets Control of the Department of the Treasury ("SDN list");[1103] (3) a foreign entity that is alleged by the Attorney General to have been involved in activities for which a conviction was obtained under certain laws;[1104] (4) a foreign entity that is determined by the Secretary of Commerce, in consultation with the Secretary of Defense and the Director of National Intelligence, to be engaged in unauthorized conduct that is detrimental to the national security or foreign policy of the United States;[1105] (5) an entity identified as a Chinese military company operating in the United States;[1106] (6) a certain entity associated with the Xinjian Uyghur Autonomous Region;[1107] (7) a certain battery producing entity;[1108] or (8) a foreign-controlled entity.

For this purpose a foreign-controlled entity means: (1) the government of a covered nation (as defined in 10 U.S.C. section 4872(f)(2)); (2) a person who is a citizen, national, or resident of a covered nation and not a citizen or lawful permanent resident of the United States; (3) an entity or qualified business unit (as defined in section 989(a)) incorporated or organized under the laws of, or has its principal place of business in, a covered nation; or (4) an entity (including subsidiaries) controlled by an entity described in (1) through (3).[1109]

Control in the case of an entity, in (4) above, means ownership (by vote or value) of more than 50 percent of the stock in the case of a corporation, ownership of more than 50 percent of the profits interests or capital interests in the case of a partnership, and ownership of more than 50 percent of the beneficial interest in the case of any other entity.

Foreign-influenced entity

A foreign-influenced entity means an entity with respect to which, during the taxable year: (1) a specified foreign entity has the direct or indirect authority to appoint a covered officer; (2) a single specified foreign entity owns at least 10 percent; (3) one or more specified foreign entities own in aggregate at least 25 percent; (4) one or more specified foreign entities holds in aggregate at least 25 percent of the debt; or (5) payments of dividends, interest, compensation for services, rentals or royalties, guarantees or any other fixed, determinable, annual, or periodic amount (a) to a specified foreign entity equal to or exceed 10 percent of such total payments for the previous taxable year, or (b) to one or more specified foreign entities equal

[1103] See 15 U.S.C. sec. 4651; NDAA, Pub. L. No. 116-283, sec. 9901(8)(B), January 1, 2021.

[1104] See 15 U.S.C. sec. 4651; NDAA, Pub. L. No. 116-283, sec. 9901(8)(D), January 1, 2021.

[1105] See 15 U.S.C. sec. 4651; NDAA, Pub. L. No. 116-283, sec. 9901(8)(E), January 1, 2021.

[1106] In accordance with section 1260H of Public Law 116-283.

[1107] An entity included on a list required by sec. 2(d)(2)(B)(i), (ii), (iv), or (v) of Pub. L. No. 117-78.

[1108] An entity specified under section 154(b) of Public Law 118-31.

[1109] New sec. 7701(a)(51)(C).

to or exceed 25 percent of such total payments for the previous taxable year, are knowingly made.

A covered officer with respect to an entity is: (1) a member of the board of directors, board of supervisors, or equivalent governing body; (2) an executive-level officer, including the president, chief executive officer, chief operating officer, chief financial officer, general counsel, or senior vice president; or (3) an individual having powers or responsibilities similar to those described in (1) and (2).

Material assistance

Material assistance from a prohibited foreign entity means with respect to any property (1) any component, subcomponent, or applicable critical mineral (as defined in section 45X(c)(6)) included in such property that is extracted, processed, recycled, manufactured, or assembled by a prohibited foreign entity and (2) any design of such property which is based on any copyright or patent held by a prohibited foreign entity or any know-how or trade secret provided by a prohibited foreign entity.[1110]

Material assistance from a prohibited foreign entity does not include any assembly part or constituent material if such part or material is not directly acquired from a prohibited foreign entity. For this purpose, assembly parts are subcomponents or collections of subcomponents that (1) are not uniquely designed for use in the construction of a qualified facility described in section 45Y or 48E or an eligible component described in 45X and (2) are not exclusively or predominately produced by prohibited foreign entities. For this purpose, constituent materials are materials which (1) are not uniquely formulated for use in a qualified facility described in section 45Y or 48E or an eligible component described in 45X and (2) are not exclusively or predominately produced, processed, or extracted by prohibited foreign entities.

Effective Date

In general, the proposal is effective for taxable years beginning after the date of enactment. The repeal of transferability is effective for facilities that begin construction after the date that is two years after the date of enactment.

[1110] New sec. 7701(a)(52).

I. Phase-out and Restrictions on Clean Electricity Investment Credit

Present Law

In general

A business energy credit is allowed equal to the applicable percentage of qualified investment for any taxable year with respect to any qualified facility and any energy storage technology.[1111] The base rate is 6 percent.[1112] This base rate is increased to 30 percent (the "alternative rate") for facilities with a maximum output of less than one megawatt of electricity (as measured in alternating current) and for facilities that meet certain prevailing wage and apprenticeship requirements (or for which construction began more than 60 days before the Secretary publishes guidance with respect to such prevailing wage and apprenticeship requirements).[1113]

Qualified investment with respect to a qualified facility

For purposes of determining the amount of the credit, a qualified investment with respect to any qualified facility for the taxable year is the sum of the basis of any qualified property placed in service by the taxpayer during such taxable year which is part of a qualified facility, plus the amount of any expenditures that are paid or incurred by the taxpayer for qualified interconnection property.[1114] The qualified interconnection property must be properly chargeable to a capital account of the taxpayer and placed in service during the taxpayer's taxable year in connection with a qualified facility that has a maximum net output of no more than five megawatts (as measured in alternating current).[1115]

Qualified property is tangible personal property or other tangible property (not including a building or its structural components), but only if such property is used as an integral part of a qualified facility.[1116] In addition, such property must consist of depreciable or amortizable property that is either built by the taxpayer or the original use of which begins with the taxpayer.

A qualified facility is an electricity generation facility owned by the taxpayer that is placed in service after December 31, 2024, and for which the greenhouse gas emissions rate is

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[1111] Sec. 48E.

[1112] Sec. 48E(a)(2)(A)(i).

[1113] Sec. 48E(a)(2)(A)(ii). Section 48E(a)(2)(A)(ii)(II) and (a)(2)(B)(ii)(II) specify that a qualified facility or energy storage technology, respectively, that begins construction "prior to the date that is 60 days after the Secretary publishes guidance" with respect to the prevailing wage and apprenticeship requirements receives the increased credit rate. Treasury published such guidance on November 30, 2022, therefore a facility that began construction before January 29, 2023, is treated as satisfying the prevailing wage and apprenticeship requirements. T.D. 9998, 89 Fed. Reg. 53184, June 25, 2024.

[1114] Sec. 48E(b)(1).

[1115] Sec. 48E(b)(1)(B).

[1116] Sec. 48E(b)(2).

not greater than zero.[1117] With respect to a facility placed in service before January 1, 2025, a qualified facility includes new units and additions to capacity placed in service after December 31, 2024.[1118] The greenhouse gas emissions rate is determined using rules similar to the rules set forth in section 45Y(b)(2) and the terms "greenhouse gas," "greenhouse gas emissions rate," and "CO_2e per KWh" have the same meaning given such terms under section 45Y.[1119]

A qualified facility does not include any facility for which a credit is allowed under sections 45, 45J, 45Q, 45U, 45Y, 48, or 48A for the taxable year or any prior taxable year.[1120] The qualified investment with respect to any qualified facility for any taxable year does not include that portion of the basis of any property which is attributable to qualified rehabilitation expenditures (as defined in section 47(c)(2)).

Qualified interconnection property has the meaning given such term in section 48(a)(8)(B).[1121] Qualified interconnection property is tangible property that is part of an addition, modification, or upgrade to a transmission or distribution system, and which is required at or beyond the point where the energy project interconnects to such transmission or distribution system in order to accommodate such interconnection.[1122] Qualified interconnection property must be built or funded by the taxpayer and the original use of such property, pursuant to an interconnection agreement, must commence with a utility.

Qualified investment with respect to energy storage technology

The qualified investment with respect to energy storage technology for any taxable year is the basis of any energy storage technology placed in service by the taxpayer during such taxable year.[1123] The term "energy storage technology" has the meaning given such term in section 48(c)(6) (except that subparagraph (D) of such section shall not apply).[1124]

Energy storage technology consists of either (1) property (other than property primarily used in the transportation of goods or individuals and not for the production of electricity) which receives, stores, and delivers energy for conversion to electricity (or, in the case of hydrogen, which stores energy), and has a nameplate capacity of not less than five kilowatt-hours, and (2)

[1117] Sec. 48E(b)(3)(A).

[1118] Sec. 48E(b)(3)(B)(i).

[1119] See the present law description for the proposal "Phase-out and Restrictions on Clean Electricity Production Credit" above.

[1120] Sec. 48E(b)(3)(C).

[1121] Sec. 48E(b)(4).

[1122] Sec. 48(a)(8)(B).

[1123] Sec. 48E(c)(1).

[1124] Sec. 48E(c)(2).

thermal energy storage property.[1125] Property placed in service before the date of enactment of section 48 that is modified to increase its capacity to at least five kilowatts (or if already having a capacity of at least five kilowatts, increases its capacity by at least an additional five kilowatts), is treated as qualifying property except that the basis of any existing property prior to such modification is not taken into account.[1126]

Thermal energy storage property is property comprising a system which (1) is directly connected to a heating, ventilation, or air conditioning system, (2) removes heat from, or adds heat to, a storage medium for subsequent use, and (3) provides energy for the heating or cooling of the interior of a residential or commercial building. Thermal energy property does not include a swimming pool, combined heat and power system property, or a building or its structural components.[1127]

Wage and apprenticeship requirements

The prevailing wage and apprenticeship requirements follow a structure similar to that set forth in section 48(a)(10) and section 45(b)(8), respectively.[1128] A taxpayer can meet the prevailing wage requirements if it ensures that prevailing wages are paid to any laborers and mechanics employed by the taxpayer or any contractor or subcontractor in the construction of an energy project, and for the alteration or repair of such project during the 5-year period beginning on the date the energy project is originally placed in service.[1129] Prevailing wages are wages paid at rates not less than the prevailing wage rates for construction, alteration, or repair of a similar character in the locality as determined by the Secretary of Labor, in accordance with subchapter IV of chapter 31, of title 40, United States Code. Rules for correction and penalties related to failure to satisfy wage requirements similar to those in section 45(b)(7)(B) apply.[1130]

The apprenticeship requirements in section 45(b)(8) require that, generally, not less than a certain percentage of total labor hours of the construction, alteration, or repair work (including work performed by any contractor or subcontractor) on a project must be performed by qualified apprentices.[1131]

[1125] Sec. 48(c)(6)(A).

[1126] Sec. 48(c)(6)(B).

[1127] Sec. 48(c)(6)(C).

[1128] Sec. 48E(d)(2)-(3).

[1129] Sec. 48(a)(10)(A).

[1130] See the present law description for the proposal “Phase-out and Restrictions on Clean Electricity Production Credit” above for more detail.

[1131] *Ibid.*

Certain progress expenditure rules made applicable

Rules similar to the rules of subsections (c)(4) and (d) of section 46 (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990) apply.

Credit reduced for tax-exempt bonds

The credit is reduced for tax-exempt bonds under rules similar to the rules of section 45(b)(3).[1132]

Phaseout of credit

The credit phases out under rules similar to the rules set forth in section 45Y(d)(3).[1133]

Recapture of the credit

If the Secretary determines that the greenhouse gas emissions rate for a qualified facility is greater than 10 grams of CO_2e per KWh, any property for which a credit was allowed under this section with respect to such facility ceases to be investment credit property in the taxable year in which the determination is made and such credit is subject to recapture under the rules of section 50.[1134]

Energy communities bonus

If energy property is placed in service in an "energy community," the provision increases the base rate by two percentage points and the alternative rate by ten percentage points.[1135] The definition of energy community is that same that set forth in section 45(b)(11)(B).[1136]

Domestic content bonus

An additional credit amount is available for property that meets certain domestic content requirements similar to those used in section 48.[1137] To meet these requirements, a taxpayer must certify to the Secretary that any steel, iron, or manufactured product which is a component of a qualified facility or energy storage technology (upon completion of construction) was produced in the United States.[1138] For purposes of steel and iron, this requirement shall be

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1132 *Ibid.*

1133 See sec. 48E(e).

1134 Sec. 48E(g).

1135 Sec. 48E(a)(3)(A).

1136 See the present law description for the proposal "Phase-out and Restrictions on Clean Electricity Production Credit" above for more detail.

1137 Sec. 48E(a)(3)(B).

1138 See Notice 2025-8, 2025-8 I.R.B. 800, February 18, 2025.

applied consistent with section 661.5 of title 49, Code of Federal Regulations. Manufactured products which are components of a qualified facility or energy storage technology are deemed to have been produced in the United States if not less than 40 percent (20 percent in the case of offshore wind facilities) of the total costs of all manufactured products of such facility are attributable to manufactured products (including components) which are mined, produced, or manufactured in the United States.

Special rules for certain facilities placed in service in connection with low-income communities

A bonus credit amount is allowed for applicable facilities placed in service in connection with low-income communities.[1139] Applicable facilities are qualified facilities that do not produce electricity through combustion or gasification, have a maximum net output of less than five megawatts (as measured in alternating current), and are either (1) located in a low-income community (as defined in section 45D(e)) or on Indian land (as defined in section 2601(2) of the Energy Policy Act of 1992 (25 U.S.C. sec. 3501(2))) or (2) part of a qualified low-income residential building project or a qualified low-income economic benefit project.[1140] In the case of facilities located in a low-income community or on Indian land, the bonus credit rate is 10 percentage points.[1141] In the case of facilities that are part of a qualified low-income residential building project or a qualified low-income economic benefit project, the bonus credit rate is 20 percentage points.[1142]

A facility is treated as part of a qualified low-income residential building project if the facility is installed on a residential rental building[1143] which participates in a covered housing program (as defined in section 41411(a) of the Violence Against Women Act of 1994 (34 U.S.C. 12491(a)(3)), a housing assistance program administered by the Department of Agriculture under title V of the Housing Act of 1949, a housing program administered by a tribally designated housing entity (as defined in section 4(22) of the Native American Housing Assistance and Self-Determination Act of 1996 (25 U.S.C. 4103(22)) or such other affordable housing programs as the Secretary may provide, and the financial benefits of the electricity produced by such facility are allocated equitably among the occupants of the dwelling units of such building.[1144]

A facility is treated as part of a qualified low-income economic benefit project if at least 50 percent of the financial benefits of the electricity produced by such facility are provided to households with income of (1) less than 200 percent of the poverty line (as defined in section 36B(d)(3)(A)) applicable to a family of the size involved or (2) less than 80 percent of area

[1139] Sec. 48E(h).

[1140] Sec. 48E(h)(2).

[1141] Sec. 48E(h)(1)(A)(i).

[1142] Sec. 48E(h)(1)(A)(ii).

[1143] For this purpose, a facility installed next to a building or in a building complex's common area may be treated as installed on a residential building.

[1144] Sec. 48E(h)(2)(B).

median gross income (as determined under section 142(d)(2)(B)).[1145] For purposes of determining whether a facility is part of a qualified low-income residential building project or a qualified low-income economic benefit project, electricity acquired at a below-market rate shall be taken into account as a financial benefit.[1146]

The bonus is subject to an annual capacity limitation is 1.8 gigawatts of direct current capacity for each calendar year beginning on January 1, 2025, and ending on December 31 of the applicable year (as defined by section 45Y(d)(3)),[1147] and zero thereafter.[1148] The Secretary is required to establish (within 180 days after the date of the provision's enactment) a program to allocate the capacity limitation to qualified solar and wind facilities.[1149] In establishing such program, the Secretary must provide procedures to allow for an efficient allocation process, including, when appropriate, consideration of multiple projects in a single application if such projects will be placed in service by a single taxpayer.

Facilities that have been awarded credits must be placed in service within four years of the date such facilities have been allocated electricity generation capacity by the Secretary.[1150] If a facility is not placed in service within this four-year period, the electric generation capacity allocated to such facility may be reallocated by the Secretary.[1151] In addition, if the annual capacity limitation for 2023 is not fully allocated, the unallocated portion is added to the amount available in calendar year 2024.[1152]

The bonus credit is subject to recapture if the property to which it relates ceases to meet the applicable requirements, notwithstanding the fact such property still qualifies for the energy credit under section 50(a).

<u>Reduction of elective payment if domestic content rules are not satisfied</u>

Under section 6417, applicable entities may elect to have the credit paid directly to the extent there is insufficient tax liability to absorb the credit.[1153] The amount of this direct

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[1145] Sec. 48E(h)(2)(C).

[1146] Sec. 48E(h)(2)(D).

[1147] See the present law description for the proposal "Phase-out and Restrictions on Clean Electricity Production Credit" above.

[1148] Sec. 48E(h)(4)(C).

[1149] Sec. 48E(h)(4)(A) and Treas. Reg. sec 1.48E(h)-1.

[1150] Sec. 48E(h)(4)(E).

[1151] Sec. 48E(h)(4)(E)(ii).

[1152] Sec. 48E(h)(4)(D).

[1153] See the present law description for the proposal "Phase-out and Restrictions on Clean Electricity Production Credit" above for more detail.

payment is reduced if the domestic content requirements described above for the bonus credit are not satisfied under rules similar to the rules in section 45Y(g)(12).[1154]

Transferability

Under section 6418, an eligible taxpayer may elect to transfer all or a portion of a clean electricity investment credit determined with respect to such taxpayer for any taxable year to an unrelated taxpayer.[1155]

Description of Proposal

Modification of phase-out

The proposal modifies the phaseout of the clean electricity investment credit. The credit is reduced by 20 percent for any qualified investment with respect to any qualified facility or energy storage technology placed in service during calendar year 2029, by 40 percent for any qualified investment with respect to any qualified facility or energy storage technology placed in service during calendar year 2030, by 60 percent for any qualified investment with respect to any qualified facility or energy storage technology placed in service during calendar year 2031, and by 100 percent for any qualified investment with respect to any qualified facility or energy storage technology placed in service after December 31, 2031.

Restrictions related to prohibited foreign entities

Under the proposal, a "qualified facility" does not include any facility that begins construction after the date that is one year after the date of enactment if the construction of the facility includes any material assistance from a prohibited foreign entity (as defined in section 7701(a)(52)). "Energy storage technology" does not include any property that begins construction after the date that is one year after the date of enactment if the construction of the property includes any material assistance from a prohibited foreign entity (as defined in section 7701(a)(52)).

The proposal disallows any credit for any taxable year beginning after the date of enactment if the taxpayer is a specified foreign entity (as defined in section 7701(a)(51)(B)).

The proposal disallows any credit for any taxable year beginning after the date that is two years after the date of enactment if the taxpayer is a foreign-influenced entity (as defined in section 7701(a)(51)(D)).

No credit is allowed for any taxable year beginning after the date that is two years after the date of enactment if the taxpayer makes a payment of dividends, interest, compensation for services, rentals or royalties, guarantees or any other fixed, determinable, annual, or periodic amount related to the production of electricity or storage of energy (1) to a prohibited foreign

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[1154] Sec. 48E(d)(5); *ibid.*

[1155] See the present law description for the proposal "Phase-out and Restrictions on Clean Electricity Production Credit" above for more detail.

entity in an amount equal to or greater than five percent of such total payments made by the taxpayer during the taxable year or (2) to more than one prohibited foreign entity in an amount that, in aggregate, is equal to or greater than 15 percent of such payments made by the taxpayer during the taxable year.

The proposal modifies section 50 to provide that if a specified taxpayer makes an applicable payment during the 10-year period beginning on the date that the taxpayer placed in service investment credit property eligible for the section 48E credit, 100 percent of the section 48E credit for that property is recaptured during the taxable year in which the applicable payment occurs. A specified taxpayer is a taxpayer who has been allowed a credit under section 48E(a) for any taxable year beginning after the date which is two years after the date of enactment.

Under the proposal, an applicable payment is (1) a payment of dividends, interest, compensation for services, rentals or royalties, guarantees or any other fixed, determinable, annual, or periodic amount related to the production of electricity or storage of energy to a prohibited foreign entity in an amount equal to or greater than five percent of such total payments made by the taxpayer during the taxable year or (2) payments of dividends, interest, compensation for services, rentals or royalties, guarantees or any other fixed, determinable, annual, or periodic amount related to the production of electricity or storage of energy to more than one prohibited foreign entity in an amount that, in aggregate, is equal to or greater than 15 percent of such total payments made by the taxpayer during the taxable year.

Repeal of transferability

The proposal terminates transferability of the credit for facilities and energy storage technology that begin construction after the date that is two years after the date of enactment.

Modification of Low-Income Communities Bonus Credit

Under the proposal, the term "annual capacity limitation" means 1.8 gigawatts of direct current capacity for each calendar year during the period beginning on January 1, 2025, and ending on December 31, 2031, and zero thereafter. The proposal bars any excess capacity limitation from carrying over to any calendar year after December 31, 2031. The proposal requires facilities that have been awarded bonus credits to be placed in service by the earlier of the date that is four years after the date such facilities have been allocated electricity generation capacity by the Secretary and December 31, 2031.

Effective Date

In general, the proposal is effective for taxable years beginning after the date of enactment. The repeal of transferability is effective facilities and energy storage technology that begin construction after the date that is two years after the date of enactment.

J. Repeal of Transferability of Clean Fuel Production Credit

Present Law

Clean fuel production credit

For transportation fuel, the Code provides a business credit, the "Clean Fuel Production Credit." "Transportation fuel" is a fuel suitable for use as a fuel in a highway vehicle or aircraft, that has a lifecycle greenhouse gas emissions rate which is not greater than 50 kilograms of CO_2e per 1 million British Thermal Units ("mmBTU"), and that is not derived from coprocessing an applicable material (or material derived from an applicable material) with a feedstock which is not biomass.[1156]

The credit per gallon is the product of (1) the applicable amount per gallon (or gallon equivalent) of transportation fuel produced and sold by the taxpayer under specified circumstances and (2) the emissions factor for such fuel. To qualify for the credit, the transportation fuel must be produced at a qualified facility and sold by the taxpayer to an unrelated person (1) for use by such person in the production of a fuel mixture, (2) for use by such person in a trade or business, or (3) who sells such fuel at retail into the fuel tank of another person.

The "applicable amount" is either a "base amount" or an "alternative amount" depending on whether certain requirements are met. The base amount is 20 cents per gallon for transportation fuel produced at a qualified facility that does not satisfy certain prevailing wage and apprenticeship requirements. For transportation fuel produced at a qualified facility that does satisfy those requirements, the alternative amount is $1.00 per gallon. For transportation fuel that is sustainable aviation fuel, the base amount is 35 cents, and the alternative amount is $1.75. "Sustainable aviation fuel" means liquid fuel, the portion of which is not kerosene, which is sold for use in an aircraft, and which meets the requirements of either ASTM International Standard D7566, or the Fischer Tropsch provisions of ASTM International Standard D1655, Annex A1; and is not derived from palm fatty acid distillates or petroleum.

Fuel must be produced at a qualified facility

A "qualified facility" is a facility used for the production of transportation fuels and does not include any facility for which one of the following credits is allowed under section 38 for the taxable year: section 45V (the credit for production of clean hydrogen), section 46 to the extent that such credit is attributable to the energy credit determined under section 48 with respect to any specified clean hydrogen production facility for which an election has been made under section 48(a)(15), or section 45Q (the credit for carbon oxide sequestration).

[1156] "Applicable material" means monoglycerides, diglycerides, and triglycerides, free fatty acids, and fatty acid esters. The term "biomass" has the same meaning given such term in section 45K(c)(3).

Emissions factor calculation and establishment by the Secretary

The emissions factor of a transportation fuel is an amount equal to the quotient of (1) 50 kilograms of CO_2e per mmBTU minus the emissions rate for such fuel, divided by (2) 50 kilograms of CO_2e per mmBTU.

The Secretary is required to publish a table that sets forth the emission rate for similar types and categories of transportation fuels based on the amount of lifecycle greenhouse gas emissions (as described in section 211(o)(1)(H) of the Clean Air Act (42 U.S.C. 7545(o)(1)(H)) as in effect on the date of enactment of this section) for such fuels, expressed as kilograms of CO_2e per mmBTU, which a taxpayer shall use for the purposes of this provision.

In the case of transportation fuel that is not sustainable aviation fuel, the lifecycle greenhouse gas emissions of such fuel shall be based on the most recent determinations under the Greenhouse Gases, Regulated Emissions, and Energy Use in Transportation model ("GREET") developed by Argonne National Laboratory, or a successor model (as determined by the Secretary).

In the case of transportation fuel that is sustainable aviation fuel, the lifecycle greenhouse gas emissions of such fuel shall be determined in accordance with (1) the most recent Carbon Offsetting and Reduction Scheme for International Aviation that has been adopted by the International Civil Aviation Organization ("ICAO") with the agreement of the United States, or (2) any similar methodology which satisfies the criteria under section 211(o)(1)(H) of the Clean Air Act (42 U.S.C. 7545(o)(1)(H)) as in effect on the date of enactment of this provision (August 22, 2022).

The Secretary may round the emissions rates for purposes of the table to the nearest five kilograms of CO_2e per mmBTU. However, in the case of an emissions rate that is between 2.5 kilograms of CO_2e per mmBTU and -2.5 kilograms CO_2e per mmBTU, the Secretary may round such rate to zero.

On January 22, 2025, the IRS published Notice 2025-11, providing initial guidance on emissions rates. The notice contains the initial table of emissions rates for purposes of the credit. The table covers several types of fuels (including pathways and primary feedstock), such as ethanol, biodiesel, renewable diesel, renewable natural gas, propane, naptha, hydrogen, and sustainable aviation fuel. The Argonne National Laboratory developed, and the Department of Energy published, the "45ZCF-GREET" model to determine emissions rates for purposes of the credit.

The determination of emissions rates is calculated using either (1) determinations under the most recent version of the 45ZCF-GREET model or (2) determinations from fuel pathways approved under the most recent CORSIA Default Life Cycle Emissions Values for CORSIA Eligible Fuels lifecycle approach ("CORSIA Default") or the most recent CORSIA Methodology for Calculating Actual Life Cycle Emissions Values lifecycle approach ("CORSIA Actual").

Notice 2025-11 notes that the pathways that use imported used cooking oil will not be available in the 45ZCF-GREET model until the Department of the Treasury and the IRS publish further guidance, such as substantiation and recordkeeping requirements. The Notice expresses concern about the improper identification of a substance that is not used cooking oil as used cooking oil, the uncertainty of market impacts caused by incentivizing used cooking oil and, with imported used cooking oil in particular, the lack of transparency regarding local sources.

Petition for provisional emissions rate

In the case of any transportation fuel for which an emissions rate has not been established by the Secretary, a taxpayer producing such fuel may file a petition with the Secretary for determination of the emissions rate with respect to such fuel. Notice 2025-11 indicates that the Department of the Treasury and IRS intend to provide guidance related to the petition process at a later date. Until guidance is issued, the IRS will not accept requests for provisional emissions rate determinations and the Department of Energy will not issues emissions values. However, the emissions rate for any new type or category of fuel established on the applicable table or determined through the provisional emissions rate process will apply on January 1, 2025, regardless of when guidance is published establishing such rate.

Inflation adjustment

In the case of calendar years beginning after 2024, the 20-cent amount, $1.00 amount, 35 cent amount and $1.75 amount are adjusted by multiplying such amount by the inflation adjustment factor for the calendar year in which the sale or use of the transportation fuel occurs. If any amount as increased is not a multiple of one cent, such amount is to be rounded to the nearest one cent. The inflation adjustment factor is the inflation adjustment factor determined and published by the Secretary under the clean electricity production credit (section 45Y), determined by substituting "calendar year 2022" for "calendar year 1992."

Special rules

To be entitled to the clean fuel production credit, the taxpayer must be registered with the IRS as a producer of clean fuel at the time of production.[1157] Such fuel must be produced in the United States. In addition, in the case of any transportation that is sustainable aviation fuel, the taxpayer must provide certification (in such form and such manner as the Secretary prescribes) from an unrelated party demonstrating compliance with any general requirements, supply chain traceability requirements, and information transmission requirements established under the Carbon Offsetting and Reduction Scheme for International Aviation or similar methodology which satisfies the criteria under section 211(o)(1)(H) of the Clean Air Act as in effect on the date of enactment of this provision.

In the case of a facility in which more than one person has an ownership interest, except to the extent provided in Treasury regulations, production from such facility shall be allocated among such persons in proportion to their respective ownership interests in the gross sales from such facility.

Persons shall be treated as related to each other if such persons would be treated as a single employer under the regulations prescribed under section 52(b). In the case of a

[1157] Notice 2024-49 provides guidance on the clean fuel production credit registration requirements.

corporation which is a member of an affiliated group of corporations filing a consolidated return, such corporation shall be treated as selling fuel to an unrelated person if such fuel is sold to such a person by another member of such group.

In the case of estates and trusts, under regulations prescribed by the Secretary, rules similar to the rules of section 52(d) shall apply. In the case of agricultural cooperatives, an election may be made to apportion the credit determined among the patrons of the cooperative on the basis of business done by the patrons during the taxable year.

Prevailing wage and apprenticeship requirements for purposes of the alternative amount

To obtain the alternative amount, the transportation fuel must be produced at a qualified facility that satisfies the prevailing wage and apprenticeship requirements. Rules similar to the rules of section 45(b)(7) (prevailing wage requirements) apply.

A special rule applies for facilities placed in service before January 1, 2025. For those facilities, section 45(b)(7)(A)(i) (related to the construction of such facility) does not apply. In addition, section 45(b)(7)(A)(ii) is to be applied to alteration and repairs of a qualified facility with respect to a taxable year beginning after December 31, 2024, for which a clean fuel production credit is allowed.

Rules similar to section 45(b)(8) (relating to apprenticeship requirements) apply for the purpose of the clean fuel production credit.

Termination

The provision does not apply to transportation fuel sold after December 31, 2027.

Transferability

Under section 6418, an eligible taxpay may elect to transfer all or a portion of the clean fuel production credit determined with respect to such taxpayer for any taxable year to an unrelated taxpayer.

Description of Proposal

Repeal of transferability

The proposal terminates transferability of the clean fuel production credit[1158] attributable to fuel produced after December 31, 2027.

Effective Date

The repeal of transferability applies to fuel produced after December 31, 2027.

[1158] The proposal extends and modifies the credit in section 111112, "Extension and Modification of Clean Fuel Production Credit," described above.

K. Restrictions on Carbon Oxide Sequestration Credit

Present Law

In general

A general business credit is available for the capture and sequestration of carbon oxide. Taxpayers may claim the credit during the 12-year period beginning on the date the carbon capture equipment is originally placed in service.

Credits are generally attributable to the person that captures and physically or contractually ensures the disposal, utilization, or use as a tertiary injectant, of the qualified carbon oxide.[1159] Such persons may elect to transfer the credit to the taxpayer that disposes of, utilizes, or uses (as a tertiary injectant) the qualified carbon oxide.

Credits are subject to recapture with respect to any qualified carbon oxide that ceases to be captured, disposed of, or used as a tertiary injectant in a manner consistent with the credit rules.[1160]

Significant changes to the credit rate and structure were made in 2018 by the Bipartisan Budget Act of 2018 ("BBA") and in 2022 by the Inflation Reduction Act ("IRA").[1161] BBA was enacted on February 9, 2018. The BBA changes were effective for taxable years beginning after December 31, 2017.[1162] The IRA changes were generally effective for facilities or equipment placed in service after December 31, 2022, with exceptions noted below.

Credit amount

Equipment placed in service at a qualified facility on or after February 9, 2018, and before January 1, 2023

For carbon oxide captured using equipment placed in service on or after February 9, 2018, and before January 1, 2023, a credit rate of $12.83 per metric ton in 2017, increasing linearly each calendar year to $35 per metric ton by December 31, 2026, is available for qualified carbon oxide that is captured by the taxpayer at a qualified facility and used by such taxpayer either as a tertiary injectant in a qualified enhanced oil or natural gas recovery project ("EOR uses") and disposed of by such taxpayer in secure geological storage or for qualified carbon

[1159] Sec. 45Q(f)(3).

[1160] Sec. 45Q(f)(4).

[1161] Pub. L. No. 115-123, sec. 41119.

[1162] Pub. L. No. 117-169, sec. 13104.

oxide utilization by the taxpayer.[1163] The credit rate is adjusted for inflation after December 31, 2026. For 2025, the credit rate is $32.54. [1164]

For qualified carbon oxide captured using equipment placed in service on or after February 9, 2018, and before January 1, 2023, and disposed of in secure geological storage, the credit rate is $22.66 per metric ton in 2017, increasing linearly each calendar year to $50 per metric ton by December 31, 2026, and adjusted for inflation thereafter.[1165] For 2025, the credit rate is $46.96.[1166]

<u>Equipment placed in service at a qualified facility after December 31, 2022</u>

In the case of facilities and equipment originally placed in service after December 31, 2022, or with respect to additional carbon capture equipment installed after such date at a facility placed in service before such date, the base credit rate is $17 (adjusted for inflation after 2026) per metric ton for qualified carbon oxide captured by the taxpayer using carbon capture equipment which is disposed of by the taxpayer in secure geological storage without being first used for EOR uses.[1167] The base credit is $12 (adjusted for inflation after 2026) per metric ton where the captured carbon oxide is first used for EOR uses or utilized in a manner prescribed by section 45Q.[1168]

In the case of carbon oxide captured at direct air capture facilities placed in service after December 31, 2022, or with respect to additional carbon capture equipment installed after such date at such facilities placed in service before such date, the credit amounts described above are $36 and $26 per ton, respectively.

The total amount of credit is multiplied by five for qualified facilities or carbon capture equipment that meet certain prevailing wage and apprenticeship requirements.[1169]

<u>Election for equipment placed in service at a qualified facility on or after February 9, 2018</u>

The credit for carbon captured by facilities placed in service before February 9, 2018, ended on January 1, 2023.[1170] However, taxpayers may elect to apply the credit rate for these

[1163] Sec. 45Q(b)(1)(A)(i)(II) in effect prior to the date of enactment of the IRA, August 16, 2022.

[1164] Treas. Reg. sec. 1.45Q-1(d).

[1165] Sec. 45Q(b)(1)(A)(i)(I) in effect prior to the date of enactment of the IRA, August 16, 2022.

[1166] Treas. Reg. sec. 1.45Q-1(d).

[1167] 45Q(b)(1)(A).

[1168] *Ibid.*

[1169] Sec. 45Q(h).

[1170] Sec. 45Q(g); Notice 2022-38, 2022-39 IRB 239, September 26, 2022.

facilities to facilities that are placed in service on or after February 9, 2018.[1171] A taxpayer that makes this election would receive a credit of $10 per metric ton ($13.88 per metric ton, adjusted for inflation[1172]) for qualified carbon oxide that is captured by the taxpayer at a qualified facility and used by such taxpayer for EOR uses and disposed of by such taxpayer in secure geological storage or for qualified carbon oxide utilization.[1173] Such taxpayer would receive a credit of $20 per metric ton ($27.75 per metric ton, adjusted for inflation[1174]) for carbon oxide that is captured by the taxpayer at a qualified facility and disposed of in secure geological storage.[1175]

Definitions

Qualified carbon oxide is defined as any carbon dioxide or other carbon oxide captured from an industrial source by carbon capture equipment placed in service after February 9, 2018, that (1) would otherwise be released into the atmosphere as an industrial emission of greenhouse gas, and (2) is measured at the source of capture and verified at the point or points of injection.[1176] Qualified carbon oxide includes the initial deposit of captured carbon oxide used as a tertiary injectant but does not include carbon oxide that is recaptured, recycled, and re-injected as part of an enhanced oil or natural gas recovery project process.[1177] Only qualified carbon oxide captured and disposed of, used, or utilized within the United States or a possession of the United States is taken into account.[1178]

A qualified enhanced oil or natural gas recovery project is a project that would otherwise meet the definition of an enhanced oil recovery project under section 43, if natural gas projects were included within that definition.[1179]

Utilization of qualified carbon oxide means: (1) the fixation of such carbon oxide through photosynthesis or chemosynthesis, such as through the growing of algae or bacteria, (2) the chemical conversion of such qualified carbon oxide to a material or compound which results in secure storage, or (3) the use of such carbon oxide for any other purpose for which a commercial market exists (except for EOR uses), as determined by the Secretary.[1180]

1171 Sec. 45Q(b)(3).

1172 Notice 2024-39, 2024-24 I.R.B. 1611, June 10, 2024.

1173 Sec. 45Q(a)(2).

1174 Notice 2024-39, 2024-24 I.R.B. 1611, June 10, 2024.

1175 Sec. 45Q(a)(1).

1176 Sec. 45Q(c)(1)(B).

1177 Sec. 45Q(c)(2).

1178 Sec. 45Q(f)(1).

1179 Sec. 45Q(e)(4).

1180 Sec. 45Q(f)(5).

Secure geological storage includes storage at deep saline formations, oil and gas reservoirs, and unminable coal seams.[1181] The Secretary, in consultation with the Administrator of the Environmental Protection Agency, the Secretary of Energy, and the Secretary of the Interior, is required to establish regulations for determining adequate security measures for the secure geological storage of carbon oxide such that the carbon oxide does not escape into the atmosphere.[1182]

For facilities or equipment the construction of which begins before August 16, 2022 (pre-IRA), a qualified facility is any industrial facility or direct air capture facility located in the United States or a possession of the United States the construction of which begins before January 1, 2026, and the construction of carbon capture equipment begins before such date or is integrated into the original planning and design of the facility.[1183] Qualified facilities also must capture a minimum amount of carbon oxide.[1184] For electricity generation facilities that emit 500,000 metric tons or more of carbon oxide in a taxable year, the facility must capture at least 500,000 metric tons of carbon oxide. For facilities that emit less than 500,000 metric tons of carbon oxide or non-power facilities that emit at least 500,000 metric tons of carbon oxide, the facility must generally capture at least 100,000 metric tons of carbon oxide per taxable year. However, where the carbon oxide is captured at a facility that emits less than 500,000 metric tons of carbon oxide and is being utilized for commercial purposes, this minimum amount is reduced to 25,000 metric tons of carbon oxide. Direct air capture facilities (described below) must also capture at least 100,000 metric tons of carbon oxide per taxable year to be qualified facilities.

The IRA modified the definition of qualified facility for facilities or equipment the construction of which begins after the date of enactment of the IRA.[1185] A qualified facility must begin construction before January 1, 2033. In the case of a direct air capture facility, the minimum amount of carbon oxide that must be captured for a facility to qualify is 1,000 metric tons per taxable year. In the case of an electricity generating facility, the minimum amount is 18,750 metric tons per taxable year; any carbon capture equipment associated with the applicable electric generating unit at such facility must have a capture design capacity of not less than 75 percent of the baseline carbon oxide production of such unit. For this purpose, an applicable electric generating unit means the principal electric generating unit for which the carbon capture equipment is originally planned and designed.[1186]

In the case of an applicable electric generating unit originally placed in service more than one year prior to the date on which construction of the carbon capture equipment begins, the

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[1181] Sec. 45Q(f)(2).

[1182] Final Treasury regulations for section 45Q were published in the Federal Register on January 15, 2021. T.D. 9944, 86 Fed. Reg. 4728, January 15, 2021.

[1183] Sec. 45Q(d)(1) in effect prior to the date of enactment of the IRA, August 16, 2022.

[1184] Sec. 45Q(d)(2) in effect prior to the date of enactment of the IRA, August 16, 2022.

[1185] See sec. 45Q(d).

[1186] Sec. 45Q(e)(1).

baseline carbon oxide production is generally the average annual carbon oxide production, by mass, from such unit during the three years with the highest annual carbon oxide production during the 12-year period preceding the date on which construction of such carbon capture equipment began. In the case of an applicable generating unit that was originally placed in service more than one year but not more than three years prior to the date on which construction of the carbon capture equipment begins, the baseline is measured using the period beginning on the date such unit was placed in service and ending on the date on which construction of such carbon capture equipment began. Where construction of the carbon capture equipment begins either before or not more than one year after the applicable electric generating unit is placed in service, the baseline carbon oxide production is the designed annual carbon oxide production, by mass, as determined based on an assumed capacity factor of 60 percent.[1187]

Prevailing wage and apprenticeship

The prevailing wage and apprenticeship requirements generally follow the structure established in section 45(b)(7) and (b)(8). Generally, the prevailing wage rules require that the taxpayer ensure that any laborers and mechanics employed by the taxpayer or any contractor or subcontractor in the construction, alteration, or repair of a project are paid wages at a rate not less than the prevailing wage rates for construction, alteration, or repair of a similar character in the locality where the project is located as determined by the Secretary of Labor, in accordance with subchapter IV of chapter 31, of title 40, United States Code. The apprenticeship requirements require that, generally, not less than a certain percentage of total labor hours of the construction, alteration, or repair work (including work performed by any contractor or subcontractor) on a project must be performed by qualified apprentices, similar to the rules of section 45(b)(8).[1188]

Election for certain facilities located in an area affected by a Federally declared disaster

In the case of qualified carbon oxide captured using carbon capture equipment which is originally placed in service at a qualified facility on or after the date of enactment of the Bipartisan Budget Act of 2018 (February 9, 2018), the taxpayer may elect, at such time and in such manner as the Secretary may prescribe, to have the 12-year period begin on the first day of the first taxable year in which a credit is claimed so long as (1) no taxpayer claimed a credit with respect to such carbon capture equipment for any prior taxable year, (2) the qualified facility at which such carbon capture equipment is placed in service is located in an area affected by a Federally declared disaster (as defined by section 165(i)(5)(A)) after the carbon capture equipment is originally placed in service, and (3) such Federally declared disaster results in a cessation of the operation of the qualified facility or the carbon capture equipment after such equipment is originally placed in service.

[1187] Sec. 45Q(e)(2).

[1188] See the present law description for the proposal "Phase-out and Restrictions on Clean Electricity Production Credit" above for more detail.

Tax-exempt bonds

The credit is reduced for tax-exempt bonds for facilities or equipment that begin construction after December 31, 2022, under rules similar to the rules of section 45(b)(3).[1189]

Elective pay

Under section 6417, applicable entities may elect to have the credit paid directly to the extent there is insufficient tax liability to absorb the credit.[1190] In general, an applicable entity is (1) any tax-exempt organization, (2) any State or political subdivision thereof,[1191] (3) the Tennessee Valley Authority, (4) any Indian tribal government,[1192] (5) any Alaska Native Corporation, or (6) any corporation operating on a cooperative basis which is engaged in furnishing electric energy to persons in rural areas.[1193] With certain limitations, entities not included in this list ("nonlist entities") may make an election and be treated as an applicable entity with respect to the section 45Q carbon oxide sequestration credit.[1194] The election generally remains in effect for the election year and for each of the four succeeding taxable years ending before January 1, 2033.[1195]

Transferability

Under section 6418, an eligible taxpayer may elect to transfer all or a portion of a carbon oxide sequestration credit determined with respect to such taxpayer for any taxable year to an unrelated taxpayer.[1196]

Description of Proposal

The proposal disallows any credit for any taxable year beginning after the date of enactment if the taxpayer is a specified foreign entity (as defined in section 7701(a)(51)(B)).

The proposal disallows any credit for any taxable year beginning after the date that is two years after the date of enactment if the taxpayer is a foreign-influenced entity (as defined in section 7701(a)(51)(D)).

[1189] Sec. 45Q(f)(8).

[1190] See the present law description for the proposal "Phase-out and Restrictions on Clean Electricity Production Credit" above for more detail.

[1191] Eligible entities include State agencies and instrumentalities. Treas. Reg. sec. 1.6417-1(c)(7).

[1192] As defined in sec. 30D(g)(9).

[1193] Sec. 6417(d)(1)(A).

[1194] Sec. 6417(d)(1)(C).

[1195] Sec. 6417(d)(3)(C).

[1196] See the present law description for the proposal "Phase-out and Restrictions on Clean Electricity Production Credit" above for more detail.

The proposal terminates transferability of the credit for carbon capture equipment that begins construction after the date that is two years after the date of enactment.

Effective Date

In general, the proposal is effective for taxable years beginning after the date of enactment. The repeal of transferability is effective for carbon capture equipment that begins construction after the date that is two years after the date of enactment.

L. Phase-Out and Restrictions on Zero-Emission Nuclear Power Production Credit

Present Law

In general

A section 45U credit is available for the production of nuclear power produced in the United States by the taxpayer at a qualified nuclear power facility and sold by the taxpayer to an unrelated person. A qualified nuclear power facility is any nuclear facility which (1) is owned by the taxpayer (including successor owner-taxpayers) and uses nuclear energy to produce electricity, (2) is not an advanced nuclear power facility under section 45J, and (3) is placed in service before August 16, 2022.

The credit rate is 0.3 cents per kilowatt-hour of nuclear power production.[1197] The total credit for the taxable year is reduced (but not below zero) by a "reduction amount" equal to the lesser of: (1) the product of 0.3 cents multiplied by the kilowatt hours of electricity produced by the taxpayer at a qualified nuclear power facility and sold by the taxpayer to an unrelated person during the taxable year, or (2) 16 percent of the excess of the gross receipts from any electricity produced by such facility (including any electricity services or products provided in conjunction with the electricity produced by such facility) and sold to an unrelated person during the taxable year, over the number of kilowatts sold to unrelated persons times 2.5 cents.[1198] In calculating the reduction amount, gross receipts generally include payments with respect to a qualified nuclear power facility as a result of any Federal, State or local government program for, in whole or in part, the zero-emission, zero-carbon, or air quality attributes of any portion of the electricity produced by such facility.[1199] However, such payments are excluded from gross receipts for purposes of the reduction amount calculation if the full amount of the credit is used to reduce such payments.[1200] The 0.3 cent and 2.5 cent amounts are adjusted for inflation using calendar year 2023 as the base year.[1201]

The credit is part of the general business credit. The credit expires for taxable years beginning after December 31, 2032.

[1197] Sec. 45U(a).

[1198] Sec. 45U(b)(2)(A).

[1199] Sec. 45U(b)(2)(B)(i).

[1200] Section 45U(b)(2)(B)(iii).

[1201] Secs. 45U(c)(1) and 45(e)(2). This inflation adjustment is calculated using the gross domestic product ("GDP") implicit price deflator for the preceding calendar year compared to the GDP implicit price deflator for the base year.

Elective payment

Under section 6417, applicable entities may elect to have the credit paid directly to the extent there is insufficient tax liability to absorb the credit.[1202]

Transferability

Under section 6418, an eligible taxpayer may elect to transfer all or a portion of a zero-emission nuclear power production credit determined with respect to such taxpayer for any taxable year to an unrelated taxpayer.[1203]

Increased credit amount for qualified nuclear power facilities

If certain prevailing wage requirements are met, the total amount of the credit is multiplied by five for qualified nuclear power facilities. Generally, the prevailing wage rules require that the taxpayer ensure that any laborers and mechanics employed by the taxpayer or any contractor or subcontractor in the alteration or repair of a facility are paid wages at a rate not less than the prevailing wage rates for alteration or repair of a similar character in the locality where the project is located as determined by the Secretary of Labor, in accordance with subchapter IV of chapter 31, of title 40, United States Code. Rules similar to the rules set forth in section 45(b)(7)(B) of the renewable electricity production credit apply regarding penalties for failing to satisfy the prevailing wage requirements.[1204]

Description of Proposal

For taxable years beginning after December 31, 2028, the proposal phases down the amount of the zero-emission nuclear power production credit applicable for electricity produced and sold by the taxpayer. The otherwise allowable amount of the credit is multiplied by the applicable phase out percentage provided as follows.

Taxable year beginning in calendar year	Phase out percentage
2029	80 percent
2030	60 percent
2031	40 percent
2032	None

[1202] See the present law description for the proposal "Phase-out and Restrictions on Clean Electricity Production Credit" above for more detail.

[1203] *Ibid.*

[1204] *Ibid.*

No section 45U credit is allowed under section 38 for any taxable year beginning after the date of enactment if the taxpayer is a specified foreign entity as defined in section 7701(a)(51)(B). No foreign-influenced entity (as defined in section 7701(a)(51)(D)) is allowed a section 45U credit under section 38 for any taxable year beginning two years after the date of enactment.

Repeal of transferability

The proposal terminates transferability of the credit for electricity produced and sold after December 31, 2027.

Effective Date

The proposal is generally effective for taxable years beginning after the date of enactment. The repeal of transferability is effective for electricity produced and sold after December 31, 2027.

M. Termination of Clean Hydrogen Production Credit

Present Law

In general

The Code provides an income tax credit for the production of qualified clean hydrogen, the clean hydrogen production credit. The clean hydrogen production credit is part of the general business credit under section 38. For any taxable year, the clean hydrogen production credit is an amount equal to the product of (1) the kilograms of qualified clean hydrogen produced in that year by the taxpayer at a qualified clean hydrogen production facility during the ten-year period beginning on the date such facility was originally placed in service by (2) the applicable amount.

The "applicable amount" is equal to the applicable percentage of $0.60 (or of $3.00 if certain prevailing wage and apprenticeship requirements are met), rounded to the nearest 0.1 cent.[1205] The "applicable percentage" consists of four tiers, with the applicable percentage increasing as the lifecycle greenhouse gas emissions rate of the hydrogen decreases:

- 20 percent in the case of qualified clean hydrogen which is produced through a process that results in a lifecycle greenhouse gas emissions rate of not greater than four kilograms of CO_2e[1206] per kilogram of hydrogen and not less than 2.5 kilograms of CO_2e per kilogram of hydrogen
- 25 percent in the case of qualified clean hydrogen which is produced through a process that results in a lifecycle greenhouse gas emissions rate of less than 2.5 kilograms of CO_2e per kilogram of hydrogen and not less than 1.5 kilograms of CO_2e per kilogram of hydrogen
- 33.4 percent in the case of qualified clean hydrogen which is produced through a process that results in a lifecycle greenhouse gas emissions rate of less than 1.5 kilograms of CO_2e per kilogram of hydrogen and not less than 0.45 kilograms of CO_2e per kilogram of hydrogen
- 100 percent in the case of qualified clean hydrogen which is produced through a process that results in a lifecycle greenhouse gas emissions rate of less than 0.45 kilograms of CO_2e per kilogram of hydrogen

[1205] The $0.60 amount (or the $3.00 in the case of the enhanced credit) is indexed for inflation by multiplying such amount by the inflation adjustment factor (as determined under section 45(e)(2) by substituting 2022 for 1992 in subparagraph (B) thereof) for the calendar year in which the qualified hydrogen is produced. If any amount as adjusted is not a multiple of 0.1 cent, such amount is rounded to the nearest multiple of 0.1 cent.

[1206] "CO_2e" or "CO_2 equivalent" is the measure of greenhouse gas emissions "where the mass values of for all greenhouse gases are adjusted to account for their relative global warming potential." 42 U.S.C. sec. 7545(o)(1)(H).

Definitions

"Qualified clean hydrogen" means hydrogen that is produced through a process that results in a lifecycle greenhouse gas emissions rate of not greater than four kilograms of CO_2e per kilogram of hydrogen. The hydrogen must be produced in the United States or a possession of the United States in the ordinary course of a trade or business of the taxpayer for sale or use. The production and sale or use of such hydrogen must be verified by an unrelated party. In the case of any hydrogen for which a lifecycle greenhouse gas emissions rate has not been determined, a taxpayer producing such hydrogen may file a petition with the Secretary for determination of the lifecycle greenhouse gas emissions rate with respect to such hydrogen.

A "qualified clean hydrogen production facility" is a facility (1) owned by the taxpayer (2) that produces qualified clean hydrogen and (3) the construction of which begins before January 1, 2033.

The term "lifecycle greenhouse gas emissions" has the same meaning given such term under subparagraph (H) of section 211(o)(1) of the Clean Air Act as in effect on the date of enactment of the Act. However, such term only includes emissions through the point of production (well-to-gate) as determined under the most recent Greenhouse Gases, Regulated Emissions, and Energy Use in Transportation model ("GREET") developed by the Argonne National Laboratory or a successor model (as determined by the Secretary). The Secretary has identified a successor model for this purpose, "45VH2-GREET."

Increased credit amount for qualified clean hydrogen production facilities meeting certain prevailing wage and apprenticeship requirements

In the case of a qualified clean hydrogen production facility that satisfies certain prevailing wage and apprenticeship requirements, the amount of credit determined with respect to qualified clean hydrogen is multiplied by five.[1207]

Special rules

For facilities owned by more than one taxpayer, rules similar to the rules of section 45(e)(3) apply for purposes of the provision. Rules similar to the rule under section 45(b)(3) (credit reduced for tax-exempt bonds) apply for purposes of the provision. No credit is allowed with respect to qualified clean hydrogen produced at a facility which includes carbon capture equipment for which a credit is allowed to any taxpayer under section 45Q for the taxable year or any prior taxable year. Thus, a facility is disqualified for purposes of section 45V, if a section

[1207] Sec. 45V(e)(1). Under the Treasury regulations, a qualified clean hydrogen production facility satisfies the requirements it is one of the following: (1) a facility the construction of which began prior to January 29, 2023, and that meets the prevailing wage requirements of section 45(b)(7) and Treasury regulation section 1.45-7 with respect to alterations or repairs of a qualified facility that occur after January 29, 2023 (to the extent applicable), and that meets the recordkeeping and reporting requirements of Treasury regulation section 1.45-12; or (2) a facility that meets the prevailing wage requirements of section 45(b)(7) and Treasury regulation section 1.45-7, the apprenticeship requirements of section 45(b)(8) and Treasury regulation section 1.45-8, and the recordkeeping and reporting requirements of Treasury regulation section 1.45-7 with respect to the construction, alteration, or repair of a qualified facility. Treas. Reg. sec. 1.45V-3(b).

45Q credit is claimed for the taxable year or any prior taxable year with respect to such facility containing carbon capture equipment.

Modification of existing facilities

A special placed-in-service rule applies for existing facilities modified to produce qualified clean hydrogen. In the case of any facility that was originally placed in service before January 1, 2023, and prior to the modification, did not produce qualified clean hydrogen, and after the date such facility was originally placed in service is (1) modified to produce clean hydrogen, and (2) the amounts paid or incurred with respect to such modification are properly chargeable to the capital account of the taxpayer, such facility is deemed to have been originally placed in service as of the date that the property required to complete the modification is placed in service.

Election to treat clean hydrogen production facilities as energy property

In lieu of the clean hydrogen production credit, the provision permits a taxpayer to elect to treat specified clean hydrogen facilities (or any portion of such facility) as energy property. The energy percentage with respect to such property ranges from 1.2 percent to six percent depending on the type of qualified clean hydrogen that the facility is designed and reasonably expected to produce. No credit is allowed under section 45V or section 45Q for any taxable year with respect to any specified clean hydrogen production facility or any carbon capture equipment included at such facility. A "specified clean hydrogen production facility" is a qualified clean hydrogen production facility (as defined in 45V(c)(3) described above) (1) that is placed in service after December 31, 2022, (2) with respect to which no credit has been allowed under sections 45V or 45Q, and the taxpayer makes an irrevocable election to have this provision apply, and (3) for which an unrelated third party has verified (in such form or manner as the Secretary may prescribe) that such facility produces hydrogen through a process which results in lifecycle greenhouse gas emissions that are consistent with the hydrogen that such facility was designed and expected to produce.

Credit monetization

In lieu of the clean hydrogen production credit, certain taxpayers may elect a direct payment or transfer credits.

Regulations and guidance

On January 10, 2025, the Department of Treasury and the IRS published final regulations regarding the clean hydrogen production credit and the election under section 48(a)(15) relating to the investment tax credit for specified clean hydrogen production facilities.[1208] The regulations provide rules for: (1) determining lifecycle greenhouse gas emissions rates resulting from hydrogen production processes; (2) petitioning for provisional emissions rates; (3) verifying production and sale or use of clean hydrogen; (4) modifying or retrofitting existing qualified clean hydrogen production facilities; (5) using electricity from certain renewable or

[1208] T.D. 10023, 90 Fed. Reg. 2224, January 10, 2025.

zero-emissions sources to produce qualified clean hydrogen; and (6) electing to treat part of a specified clean hydrogen production facility as property eligible for the energy credit in lieu of the clean hydrogen production credit.

Description of Proposal

The proposal terminates the clean hydrogen production credit for facilities that begin construction after December 31, 2025. The proposal similarly terminates the election to treat clean hydrogen production facilities as energy property for purposes of section 48.

Effective Date

The proposal is effective for facilities that begin construction after the date of enactment.

N. Phase-out and Restrictions on Advanced Manufacturing Production Credit

Present Law

In general

A credit is provided for eligible components that are produced by the taxpayer and sold to an unrelated person during the taxable year.[1209] Eligible components include any solar energy component (solar modules, photovoltaic cells, photovoltaic wafers, solar grade polysilicon, torque tubes or structural fasteners, and polymeric backsheets), any wind energy component (blades, nacelles, towers, offshore wind foundations, and related offshore wind vessels), certain inverters (central, commercial, distributed wind, microinverter, residential, and utility), any qualifying battery component (electrode active materials, battery cells, and battery modules), and any applicable critical mineral.[1210] The production and sale of eligible components must be in the trade of business of the taxpayer.[1211]

An eligible component that is integrated, incorporated, or assembled into another eligible component which is then sold to an unrelated person is treated having been sold to an unrelated person for purposes of this credit.[1212]

A taxpayer can sell components to a related person and still qualify for the credit if the related person sells such components to an unrelated person or the taxpayer makes an election and meets certain requirements the Secretary deems necessary to prevent duplication, fraud, or any improper or excessive amount of credit.[1213] Likewise, a vertically integrated manufacturer that produces eligible components and integrates, incorporates, or assembles them as part of a product that is sold to an unrelated person may qualify for the credit.[1214]

Credit amounts

Table 1 shows the credit amount for certain eligible components.

[1209] Sec. 45X(a)(1).

[1210] Sec. 45X(c)(1)(A).

Any property produced by a facility that has received a credit under section 48C after the date of enactment (August 16, 2022) is not an eligible component. Sec. 45X(c)(1)(B).

Any property produced by a facility that is co-located with a facility that has received a credit under section 48C may be an eligible component if such facilities are separable. Treas. Reg. 1.45X-1(g).

[1211] Sec. 45X(a)(2).

[1212] Sec. 45X(d)(4).

[1213] Sec. 45X(a)(3) and Treas. Reg. 1.45X-2(d).

[1214] Treas. Reg. 1.45X-2(e).

Table 1–Credit Amount for Certain Eligible Components[1215]

Eligible Component	Credit Amount
Thin film photovoltaic cell or crystalline photovoltaic cell	4 cents times the capacity of the cell (per direct current watt basis)
Photovoltaic wafer	$12 per square meter
Solar grade polysilicon	$3 per kilogram
Polymeric backsheet	40 cents per square meter
Solar module	7 cents times the capacity of the module (per direct current watt basis)
Torque tube	87 cents per kilogram
Structural fastener	$2.28 per kilogram
Central inverter	.25 cents times the capacity of the inverter (per alternating current watt basis)
Utility inverter	1.5 cents times the capacity of the inverter (per alternating current watt basis)
Commercial inverter	2 cents times the capacity of the inverter (per alternating current watt basis)
Residential inverter	6.5 cents times the capacity of the inverter (per alternating current watt basis)
Microinverter or distributed wind inverter	11 cents times the capacity of the inverter (per alternating current watt basis)

The credit for a related offshore wind vessel is 10 percent of the sales price of the vessel.[1216] Table 2 presents the rates for other wind energy components. For this purpose, total rated capacity relates to the completed wind turbine for which the component is designed.[1217]

[1215] Sec. 45X(b)(1).

[1216] Sec. 45X(b)(1)(F)(i).

[1217] Sec. 45X(b)(1)(F)(ii)(II).

Table 2–Credit Amount for Certain Wind Energy Components[1218]

Wind Energy Component	Credit Amount
Blade	2 cents times the total rated capacity (per watt basis)
Nacelle	5 cents times the total rated capacity (per watt basis)
Tower	3 cents times the total rated capacity (per watt basis)
Offshore wind foundation using a fixed platform	2 cents times the total rated capacity (per watt basis)
Offshore wind foundation using a floating platform	4 cents times the total rated capacity (per watt basis)

The credit for electrode active minerals and applicable critical minerals is 10 percent of the costs incurred by the taxpayer with respect to production of the minerals.[1219]

The credit for a battery cell is $35 times the capacity of the cell (kilowatt-hour basis). The credit for a battery module is $10 ($45 if the battery module does not use battery cells) times the capacity of the battery module (kilowatt-hour basis).[1220] For both battery cells and modules, the capacity taken into account for the credit cannot exceed a ratio of such capacity to maximum discharge of 100 to 1.[1221]

<u>Applicable critical minerals</u>

Generally, applicable critical minerals are certain minerals converted to other forms or purified to a certain minimum purity by mass.[1222] These minerals are listed in table 3.

[1218] Sec. 45X(b)(1)(F)(ii) and (b)(2)(A).

[1219] Sec. 45X(b)(1)(J) and (M).

[1220] Sec. 45X(b)(1)(K) and (L).

[1221] Sec. 45X(b)(4).

[1222] Sec. 45X(c)(6).

Table 3–Certain Minerals[1223]

Aluminum	Antimony	Barite	Beryllium	Cerium
Cesium	Chromium	Cobalt	Dysprosium	Europium
Fluorspar	Gadolinium	Germanium	Graphite	Indium
Lithium	Manganese	Neodymium	Nickel	Niobium
Tellurium	Tin	Tungsten	Vanadium	Yttrium
Arsenic	Bismuth	Erbium	Gallium	Hafnium
Holmium	Iridium	Lanthanum	Lutetium	Magnesium
Palladium	Platinum	Praseodymium	Rhodium	Rubidium
Ruthenium	Samarium	Scandium	Tantalum	Terbium
Thulium	Titanium	Ytterbium	Zinc	Zirconium

Credit phaseout

The credit begins to phase out in 2030.[1224] Specifically, for eligible components sold during calendar years 2030, 2031, and 2032, the otherwise allowable amount of credit is reduced by 25 percent, 50 percent, and 75 percent, respectively. This phasedown does not apply to applicable critical minerals.[1225] The credit is fully phased out for eligible components except for applicable critical minerals after 2032.[1226]

Special rules

The credit only applies to sales where the eligible components are produced within the United States or U.S. territories.[1227] This requirement does not to apply to subcomponents or materials used to produce eligible components.[1228]

[1223] *Ibid.*

[1224] Sec. 45X(b)(3).

[1225] Sec. 45X(b)(3)(C).

[1226] Treas. Reg. sec. 1.45X-3(f).

[1227] Sec. 45X(d)(2).

[1228] Treas. Reg. sec. 1.45X-1(d)(2).

Rules for common control and estates and trusts similar to those of section 52(b) and (d) apply.[1229]

Description of Proposal

The proposal adds several restrictions to and accelerates the termination of the advanced manufacturing production credit.

No credit is allowed for taxpayers that are specified foreign entities (as defined in section 7701(a)(51)(B)) for taxable years beginning after the date of enactment. No credit is allowed for taxpayers that are foreign-influenced entities (as defined in section 7701(a)(51)(D)) for taxable years beginning two years after the date of enactment.

For taxable years beginning two years after the date of enactment, an eligible component for purposes of the credit does not include any property that includes material assistance from a prohibited foreign entity (as defined in section 7701(a)(52)) or is produced subject to a licensing agreement, valued in excess of $1,000,000, with a prohibited foreign entity (as defined in section 7701(a)(51)).

No credit is allowed for any taxable year beginning after the date that is two years after the date of enactment of the Act if the taxpayer makes a payment of dividends, interest, compensation for services, rentals or royalties, guarantees or any other fixed, determinable, annual, or periodic amount (1) to a prohibited foreign entity in an amount equal to or greater than 5 percent of such total payments made by the taxpayer, related to the production of eligible components within such eligible component category, during the taxable year or (2) to more than one prohibited foreign entity in an amount that, in aggregate, is equal to or greater than 15 percent of such total payments made by the taxpayer, related to the production of eligible components within such eligible component category, during the taxable year. For this purpose, the eligible component categories are solar energy components, wind energy components, certain inverters, qualifying battery components, and applicable critical minerals.[1230]

The proposal modifies the phaseout of the credit. Wind energy components sold after December 31, 2027, do not qualify for the credit. All other eligible components, including applicable critical minerals, sold after December 31, 2031, do not qualify for the credit.

The proposal terminates transferability of the credit attributable to components sold after December 31, 2027.

Effective Date

In general, the proposal is effective for taxable years beginning after the date of enactment. The repeal of transferability is effective for components sold after December 31, 2027.

[1229] Sec. 45X(d)(1) and (3).

[1230] Eligible components are categorized according to section 45X(c)(1)(A).

O. Phase-out of Credit for Certain Energy Property

Present Law

In general

An investment credit is available for qualified energy property originally placed in service by the taxpayer.[1231] The base credit rate is 6 percent. This rate is increased to 30 percent if certain wage and apprenticeship requirements are met. The credit is generally available for property placed in service before January 1, 2025, except for geothermal heat pump property, which must be placed in service before January 1, 2035.

Qualified property

The following types of property qualify for the energy credit.

- Solar energy property
- Fuel cell property
- Geothermal power property
- Fiber optic solar and electrochromic glass property
- Small wind property
- Waste energy recovery property
- Energy storage technology property
- Biogas property
- Microgrid controller property
- Combined heat and power system property, and
- Geothermal heat pump property

A taxpayer may also make an irrevocable election to have certain property which is part of a qualified renewable electricity production facility treated as energy property eligible for an investment credit under section 48. For purposes of the investment credit, qualified facilities are facilities otherwise eligible for the renewable electricity production credit with respect to which no credit under section 45 has been allowed. A taxpayer electing to treat a facility as energy property may not claim the renewable electricity production credit.

Wage and apprenticeship

A taxpayer can meet the prevailing wage requirements if it ensures that prevailing wages are paid to any laborers and mechanics employed by the taxpayer or any contractor or subcontractor in the construction of an energy project, and for the alteration or repair of such

[1231] Sec. 48.

project during the 5-year period beginning on the date the energy project is originally placed in service.[1232] Prevailing wages are wages paid at rates not less than the prevailing wage rates for construction, alteration, or repair of a similar character in the locality as determined by the Secretary of Labor, in accordance with subchapter IV of chapter 31, of title 40, United States Code. Rules for correction and penalties related to failure to satisfy wage requirements similar to those in section 45(b)(7)(B) apply.[1233]

The apprenticeship requirements in section 45(b)(8) require that, generally, not less than a certain percentage of total labor hours of the construction, alteration, or repair work (including work performed by any contractor or subcontractor) on a project must be performed by qualified apprentices.[1234]

Domestic content bonus

Where certain domestic content requirements are satisfied, the energy credit rate is increased by two percentage points (ten percentage points where the wage and apprenticeship requirements are met).[1235] The domestic content requirements are similar to those provided for in section 45(b)(9).[1236]

Reduction of elective payment if domestic content rules are not satisfied

Certain taxpayers may elect to have the credit paid directly to the extent there is insufficient income tax liability to absorb the credit.[1237] The amount of this direct payment is reduced by 10 percent for energy property that begins construction in 2024 if the domestic content requirements described above for the domestic content bonus are not satisfied.[1238] This rule is similar to those provided in section 45(b)(10).[1239]

[1232] Sec. 48(a)(10)(A).

[1233] See the present law description for the proposal "Phase-out and Restrictions on Clean Electricity Production Credit" above for more detail.

[1234] *Ibid.*

[1235] Sec. 48(a)(12).

[1236] See the present law description for the proposal "Phase-out and Restrictions on Clean Electricity Production Credit" above for more detail.

[1237] Sec. 6417.

[1238] Sec. 48(a)(13).

[1239] See the present law description for the proposal "Phase-out and Restrictions on Clean Electricity Production Credit" above for more detail.

Credit reduced for tax-exempt bonds

The energy credit is reduced when the qualified property is financed using tax-exempt bonds.[1240] The rules governing this reduction are similar to those provided in section 45(b)(3).[1241]

Energy communities bonus

If energy property is placed in service in an "energy community," the energy credit rate increases by two percentage points (10 percentage points where the wage and apprenticeship requirements are met).[1242] The definition of energy community is the same as that set forth in section 45(b)(11).[1243]

Phase-out of investment credit for geothermal heat pump property

The investment credit for geothermal heat pump property phases out beginning in 2033.[1244] The base credit for geothermal heat pump property that begins construction before January 1, 2033, and is placed in service after December 31, 2021, is six percent. The base credit for geothermal heat pump property that begins construction after December 31, 2032, and before January 1, 2034, is 5.2 percent. The base credit for geothermal heat pump property that begins construction after December 31, 2033, and before January 1, 2035, is 4.4 percent. No investment credit is available for geothermal heat pump property that begins construction on or after January 1, 2035.

Reduction of elective payment if domestic content rules are not satisfied

Under section 6417, applicable entities may elect to have the credit paid directly to the extent there is insufficient tax liability to absorb the credit.[1245] The amount of this direct payment is reduced by 10% for energy property with a maximum net output of 1 megawatt or more (as measured in alternating current) that begins construction in calendar year 2024 if the

[1240] Sec. 48(a)(4).

[1241] See the present law description for the proposal "Phase-out and Restrictions on Clean Electricity Production Credit" above for more detail.

[1242] Sec. 48(a)(14).

[1243] See the present law description for the proposal "Phase-out and Restrictions on Clean Electricity Production Credit" above for more detail.

[1244] Sec. 48(a)(7).

[1245] See the present law description for the proposal "Phase-out and Restrictions on Clean Electricity Production Credit" above for more detail.

domestic content requirements described above for the bonus credit are not satisfied under rules similar to the rules in section 45(b)(10).[1246]

Transferability

Under section 6418, an eligible taxpayer may elect to transfer all or a portion of a clean electricity investment credit determined with respect to such taxpayer for any taxable year to an unrelated taxpayer.[1247]

Description of Proposal

The proposal modifies the phase-out of the investment credit for geothermal heat pump property. The base credit for geothermal heat pump property that begins construction before January 1, 2030, and is placed in service after December 31, 2021, is six percent. The base credit for geothermal heat pump property that begins construction after December 31, 2029, and before January 1, 2031, is 5.2 percent. The base credit for geothermal heat pump property that begins construction after December 31, 2030, and before January 1, 2032, is 4.4 percent. No investment credit is available for geothermal heat pump property that begins construction on or after January 1, 2032.

The proposal disallows any credit for any taxable year beginning after the date of enactment if the taxpayer is a specified foreign entity (as defined in section 7701(a)(51)(B)).

The proposal disallows any credit for any taxable year beginning after the date that is two years after the date of enactment if the taxpayer is a foreign-influenced entity (as defined in section 7701(a)(51)(D)).

The proposal terminates transferability of the credit for property that begins construction after the date that is two years after the date of enactment.

Effective Date

In general, the proposal is effective for taxable years beginning after the date of enactment. The repeal of transferability is effective for property that begins construction after the date that is two years after the date of enactment.

[1246] Sec. 48(a)(13). See the present law description for the proposal "Phase-out and Restrictions on Clean Electricity Production Credit" above for more detail.

[1247] See the present law description for the proposal "Phase-out and Restrictions on Clean Electricity Production Credit" above for more detail.

P. Income from Hydrogen Storage, Carbon Capture Added to Qualifying Income of Certain Publicly Traded Partnerships Treated as Corporations

Present Law

Partnerships in general

A partnership generally is not treated as a taxable entity (except for certain publicly traded partnerships), but rather, is treated as a pass-through entity. Income earned by a partnership, whether distributed or not, is taxed to the partners.[1248] The character of partnership items passes through to the partners, as if the items were realized directly by the partners.[1249] For example, a partner's share of the partnership's dividend income is generally treated as dividend income in the hands of the partner.

Publicly traded partnerships

Under present law, a publicly traded partnership generally is treated as a corporation for Federal tax purposes.[1250] For this purpose, a publicly traded partnership means any partnership if interests in the partnership are traded on an established securities market, or interests in the partnership are readily tradable on a secondary market (or the substantial equivalent thereof).

An exception from corporate treatment is provided for certain publicly traded partnerships, 90 percent or more of whose gross income is qualifying income.[1251] However, this exception does not apply to any partnership that would be described in section 851(a) if it were a domestic corporation, which includes a corporation registered under the Investment Company Act of 1940 as a management company or unit investment trust.[1252]

Qualifying income includes interest, dividends, and gains from the disposition of a capital asset (or of property described in section 1231(b)) that is held to produce qualifying income. Qualifying income also includes rents from real property, gains from the sale or other disposition of real property, and income and gains from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource (including fertilizer, geothermal energy, and timber), industrial source carbon dioxide, or the transportation or storage of any alcohol fuel mixture, biodiesel fuel mixture or alternative fuel described in subsection (b), (c), (d), or (e) of section 6426, or any alcohol fuel defined in section 6426(b)(4)(A) or any biodiesel fuel as defined in section 40A(d)(1). It also includes income and gains from commodities (not described in section 1221(a)(1)) or futures, options, or forward contracts with respect to such commodities (including foreign currency transactions of a commodity pool) in the case of

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[1248] Sec. 701.

[1249] Sec. 702.

[1250] Sec. 7704(a).

[1251] Sec. 7704(c)(2).

[1252] Sec. 7704(c)(3).

partnership, a principal activity of which is the buying and selling of such commodities, futures, options or forward contracts.[1253]

Description of Proposal

The proposal expands the definition of qualifying income of a publicly traded partnership to include income and gains with respect to the transportation or storage of sustainable aviation fuel as described in section 6426(k) or section 40B, liquified hydrogen, or compressed hydrogen.

The proposal also expands qualifying income of a publicly traded partnership to include income and gains with respect to the generation, availability for such generation, or storage of electric power, as well as the capture of carbon dioxide by a qualified facility.[1254] A qualified facility means any industrial facility or direct air capture facility in which not less than 50 percent of the total carbon oxide production is qualified carbon oxide.[1255]

Effective Date

The proposal applies to taxable years beginning after December 31, 2025.

[1253] Sec. 7704(d).

[1254] As defined in Sec. 45Q(d), determined without regard to any date by which construction of the facility is required to begin.

[1255] Sec. 45Q(c).

Q. Limitation on Amortization of Certain Sports Franchises

Present Law

Under section 197, the adjusted basis of an "amortizable section 197 intangible" held in connection with a trade or business is amortizable on a straight-line basis over 15 years.[1256] Section 197 intangibles include goodwill; going concern value; workforce in place including its composition and terms and conditions (contractual or otherwise) of its employment; business books and records, operating systems, or other information base; any patent, copyright, formula, process, design, pattern, knowhow, format, or similar item; customer based intangibles; supplier based intangibles; and any other similar item.[1257] The definition of a section 197 intangible also includes any license, permit, or other rights granted by governmental units (even if the right is granted for an indefinite period or is reasonably expected to be renewed indefinitely); any covenant not to compete; and any franchise, trademark, or trade name.[1258]

Description of Proposal

The proposal excludes 50 percent of the adjusted basis of an amortizable section 197 asset from amortization in the case of a franchise engaged in professional football, basketball, baseball, hockey, soccer, or other professional sport, or any item acquired in connection with such franchise.

Effective Date

The proposal applies to section 197 intangibles acquired after the date of enactment.

[1256] Sec. 197(a) and 197(c).

[1257] Sec. 197(d).

[1258] *Ibid.*

R. Limitation on Individual Deductions for Certain State and Local Taxes, etc.

Present Law

Limitation on individual deductions for certain State and local and foreign tax payments for taxable years 2018 through 2025

Public Law 115-97 provided that in the case of an individual[1259] and a taxable year beginning after December 31, 2017, and before January 1, 2026, as a general matter, State and local[1260] income, war profits, and excess profits taxes are not allowable as a deduction, and State and local and foreign property taxes and State and local sales taxes are allowed as a deduction only when paid or accrued in carrying on a trade or business or an activity described in section 212 (relating to expenses for the production of income).[1261] However, an individual may claim an itemized deduction of up to $10,000 ($5,000 for a married taxpayer filing a separate return) for the aggregate of (i) State and local property taxes not paid or accrued in carrying on a trade or business or an activity described in section 212, and (ii) State and local income, war profits, and excess profits taxes (or sales taxes in lieu of income, etc. taxes) paid or accrued in the taxable year.[1262] Foreign real property taxes may not be deducted under this exception.

For taxable years beginning after January 1, 2026, an individual is permitted a deduction for certain taxes paid or accrued, whether or not incurred in a trade or business. These taxes are: (i) State and local and foreign real property taxes,[1263] (ii) State and local personal property taxes,[1264] (iii) State and local and foreign income, war profits, and excess profits taxes,[1265] and (iv) other State and local and foreign taxes not described in the preceding clauses which are paid or accrued in carrying on a trade or business or an activity described in section 212.[1266] At the election of the taxpayer, an itemized deduction may be taken for State and local general sales taxes in lieu of the itemized deduction for State and local income taxes.[1267] Property taxes are allowed as a deduction in computing adjusted gross income if incurred in connection with

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[1259] See sec. 641(b) regarding the computation of taxable income of an estate or trust in the same manner as an individual.

[1260] State and local taxes include taxes imposed by a State, a U.S. possession, or a political subdivision of any of the foregoing, or by the District of Columbia. Sec. 164(b)(2).

[1261] Sec. 164(b)(6).

[1262] Sec. 164(b)(6)(B).

[1263] Sec. 164(a)(1).

[1264] Sec. 164(a)(2).

[1265] Sec. 164(a)(3). A foreign tax credit, in lieu of a deduction, is allowable for foreign income, war profits, and excess profits taxes if the taxpayer so elects. Sec. 901.

[1266] Sec. 164(a).

[1267] Sec. 164(b)(5).

property used in a trade or business; otherwise, they are an itemized deduction.[1268] In the case of State and local income taxes, the deduction is an itemized deduction notwithstanding that the tax may be imposed on profits from a trade or business.[1269] Individuals also are permitted a deduction for Federal and State generation-skipping transfer taxes imposed on certain income distributions that are included in the gross income of the distributee.[1270]

In determining a taxpayer's alternative minimum taxable income, no itemized deduction for property, income, or sales tax is allowed.[1271]

State and taxpayer responses to Public Law 115-97

Credits for charitable contributions

In response to the temporary limitation on individual deductions for tax payments enacted by Public Law 115-97, some taxpayers sought to rely on State or local tax credit programs under which States or local jurisdictions provide tax credits in return for contributions by taxpayers to or for the use of certain entities described in section 170(c). On June 13, 2019, the IRS issued final regulations,[1272] effective for transfers made after August 27, 2018, generally providing that if a taxpayer makes a payment or transfers property to or for the use of an entity described in section 170(c), the amount of the taxpayer's charitable contribution deduction under section 170(a) is reduced by the amount of any State or local tax credit the taxpayer receives or expects to receive in consideration for the payment or transfer.[1273]

Employer wage tax and employee credit

In 2018, the State of New York implemented an Employer Compensation Expense Program, under which employers may elect to pay a quarterly tax to New York of up to 5% of certain wages and compensation paid to employees employed in New York. A New York employee of an electing employer may then claim a nonrefundable credit against such employee's New York State personal income tax, equal to the tax paid by the employer with respect to such employee's wages and compensation. In effect, such employee may partially avoid the temporary Federal limitation on individual tax deductions by converting a personal

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[1268] Sec. 62(a)(1).

[1269] See Committee Report to accompany H.R. 4646, Individual Income Tax Bill of 1944, H.R. Rep. No. 78-1365, April 24, 1944, p. 23.

[1270] Sec. 164(a)(4).

[1271] Sec. 56(b)(1)(A).

[1272] T.D. 9864, 84 Fed. Reg. 27513, June 13, 2019.

[1273] Treas. Reg. sec. 1.170A-1(h)(3)(i). A corresponding regulation was issued for estates and trusts. Treas. Reg. sec. 1.642(c)-3(g).

income tax liability (potentially nondeductible for the employee) into an employer-level tax liability (deductible for the employer).

Passthrough entity taxes

For Federal tax purposes, a partner of a partnership must take into account separately such partner's distributive share of the partnership's: (1) short-term capital gain or loss, (2) long-term capital gain or loss, (3) gain or loss from the sale or exchange of section 1231 business property, (4) charitable contributions, (5) qualified dividend income and dividends eligible for certain deductions,[1274] (6) income taxes paid to foreign countries and U.S. possessions, (7) other items of income, gain, loss, deduction or credit to the extent provided by regulations prescribed by the Secretary, and (8) partnership taxable income or loss exclusive of the items listed above requiring separate computation.[1275] The Secretary has provided by regulation that a partner of a partnership must take into account separately such partner's distributive share of any partnership item which, if separately taken into account by any partner, would result in an income tax liability for that partner, or for any other person, different from that which would result if that partner did not take the item into account separately.[1276] For a partner's Federal income tax purposes, the character of the partner's distributive share of any separately stated item of income, gain, loss, deduction, or credit (*i.e.*, (1)–(7) above) is determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.[1277]

A partnership computes its taxable income in the same manner as an individual, except that the items required to be taken into account separately by the partners must be separately stated, and the following deductions are disallowed: (1) the deduction for personal exemptions, (2) the deduction for income taxes paid to foreign countries and U.S. possessions, (3) the charitable contribution deduction, (4) the net operating loss deduction, (5) certain additional itemized deductions for individuals, and (5) the deduction for depletion with respect to oil and gas wells.[1278]

An S corporation shareholder must take into account separately such shareholder's pro rata share of the corporation's items of income, loss, deduction, or credit, the separate treatment of which could affect the liability for tax of any shareholder.[1279] The character of any such separately stated item included in the shareholder's pro rata share is determined as if such item were realized directly from the source from which realized by the corporation, or incurred in the

[1274] See secs. 243, 245, and 245A.

[1275] Sec. 702(a).

[1276] Treas. Reg. sec. 1.702-1(a)(8)(ii).

[1277] Sec. 702(b).

[1278] Sec. 703(a).

[1279] Sec. 1366(a) and (b).

same manner as incurred by the corporation.[1280] An S corporation computes its taxable income in the same manner as an individual, except that (among other things) the items required to be taken into account separately by the shareholders must be separately stated, and any deductions which must be taken into account separately by the shareholders are disallowed.[1281]

In the Committee Report to accompany H.R. 1, Tax Cuts and Jobs Act, the explanation of the temporary limitation on individual tax deductions contained the following clarification: "[T]axes imposed at the entity level, such as a business tax imposed on pass-through entities, that are reflected in a partner's or S corporation shareholder's distributive or pro-rata share of income or loss on a Schedule K–1 (or similar form), will continue to reduce such partner's or shareholder's distributive or pro-rata share of income as under present law."[1282]

In a Notice published on November 30, 2020, the IRS announced its intention to issue regulations providing that State and local income tax payments made by partnerships and S corporations are deductible by such partnerships and S corporations in computing non-separately stated income or loss.[1283] Although the IRS has not issued any such regulations to date, many States have enacted passthrough entity tax regimes, under which certain partnerships and S corporations may elect to pay an entity-level income tax to a State, in return for which some or all of the entity's owners may claim a credit against their personal income tax liability owed to such State, of equal or approximately equal value to their distributive or pro rata share of the entity's tax payment. In effect, Notice 2020-75 provided authority for certain passthrough entity owners to partially avoid the temporary Federal limitation on individual tax deductions by converting a personal income tax liability (potentially nondeductible for such owners) into an entity-level tax liability (putatively deductible for the entity in computing non-separately stated income).

Limitation on allowance of partnership losses

A partner's distributive share of partnership loss (including capital loss) is allowed only to the extent of the adjusted basis (before reduction by current year's losses) of the partner's interest in the partnership at the end of the partnership taxable year in which the loss occurred.[1284] Any disallowed loss is allowable as a deduction at the end of the first succeeding partnership taxable year, and subsequent taxable years, to the extent that the partner's adjusted basis in its partnership interest at the end of any such year exceeds zero (before reduction by the loss for the year).[1285] A partner's basis in its partnership interest is increased each year by such

[1280] Sec. 1366(b).

[1281] Sec. 1363(b).

[1282] Conference Report to accompany H.R. 1, Tax Cuts and Jobs Act, H.R. Rep. No. 115-466, December 15, 2017, p. 260 n. 172.

[1283] Notice 2020-75, 2020-49 I.R.B. 1453, November 30, 2020.

[1284] Sec. 704(d)(1).

[1285] Sec. 704(d)(2) and Treas. Reg. 1.704-1(d)(1).

partner's distributive share of partnership income (including tax exempt income), and the partner's basis is decreased each year (but not below zero) by distributions by the partnership to such partner and by such partner's distributive share of partnership losses and of expenditures of the partnership not deductible in computing partnership taxable income and not properly chargeable to capital account.[1286]

In determining a partner's distributive share of partnership loss for purposes of the basis limitation on losses, there is taken into account not only the partner's distributive shares of separately stated and non-separately stated partnership losses but also the partner's distributive share of the partnership's charitable contributions and income taxes paid to foreign countries and to U.S. possessions.[1287] If the aggregate of a partner's distributive shares of the items of partnership loss for these purposes (including capital loss, section 1231 business property loss, non-separately stated loss, charitable contributions, and foreign and U.S. possession income taxes) exceeds the partner's adjusted basis (before reduction by current year's losses), the limitation on loss is allocated to the partner's distributive share of each such loss item. This allocation is determined by taking the proportion that the partner's distributive share of each loss item bears to the aggregate of the partner's distributive shares of the loss items (including losses disallowed and carried forward from prior years).[1288]

Capitalization of State and local and foreign taxes

A taxpayer generally may not deduct and, instead, must capitalize amounts paid to facilitate the acquisition of real or personal property, including sales and transfer taxes.[1289]

In the case of real or tangible property produced by a taxpayer, as well as inventory acquired by the taxpayer for resale, the taxpayer generally must capitalize, or include in inventory costs, both the direct costs of such property and such property's proper share of indirect costs (including taxes) allocable to such property.[1290]

A taxpayer may elect, as provided by regulations, to capitalize certain taxes and carrying charges with respect to property that are otherwise deductible,[1291] including annual taxes on unimproved and unproductive real property, certain taxes on real property paid or incurred for such property's development or improvement before the development or improvement work has

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[1286] Sec. 705(a).

[1287] Sec. 704(d)(3)(A). In the case of a charitable contribution by the partnership of property whose fair market value exceeds its adjusted basis, a special rule provides that the basis limitation on partner losses does not apply to the extent of the partner's distributive share of the excess. Sec. 704(d)(3)(B).

[1288] Treas. Reg. sec. 1.704-1(d)(2).

[1289] Sec. 263(a); Treas. Reg. sec. 1.263(a)-2(f).

[1290] Sec. 263A(a) and (b).

[1291] Sec. 266.

been completed, and taxes on personal property paid or incurred before such property's installation or being first put into use by the taxpayer.[1292]

Except in the case of real property taxes, personal property taxes, and income taxes, any State or local or foreign tax paid or accrued in connection with an acquisition or disposition of property is treated as part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition.[1293]

Description of Proposal

Limitation on individual deductions for certain tax payments

The proposal removes the temporary limitation, enacted by Public Law 115-97, on individual State and local and foreign tax deductions taken under section 164. In its place, the proposal modifies section 275, which denies deductions for certain taxes, to permanently deny individuals[1294] a deduction for certain State and local[1295] and foreign taxes. The proposal denies a deduction for "disallowed foreign real property taxes," defined as foreign real property taxes other than those paid or accrued in carrying on a trade or business or an activity described in section 212 (relating to expenses for the production of income).

The proposal also limits the deduction for the taxpayer's aggregate of "specified taxes," defined to comprise: (i) State and local and foreign property taxes, other than disallowed foreign real property taxes and State and local property taxes paid or accrued in a trade or business or an activity described in section 212, (ii) State and local income, war profits, excess profits, and general sales taxes, other than income, etc. taxes paid or accrued by a partnership or S corporation in carrying on a qualified trade or business (within the meaning of section 199A(d)(1))[1296] if at least 75 percent of the gross receipts (within the meaning of section 448(c)) of all trades or businesses under common control with such partnership or S corporation are

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[1292] Treas. Reg. sec. 1.266-1(b)(1).

[1293] Sec. 164(a).

[1294] See sec. 641(b) regarding the computation of taxable income of an estate or trust in the same manner as an individual. See secs. 703(a) and 1363(b) regarding the computation of taxable income of a partnership or S corporation, respectively, in the same manner as an individual. However, see below for a description of the proposal's complete denial of a deduction for "specified taxes" in the case of a partnership or S corporation.

[1295] State and local taxes include taxes imposed by a State, a U.S. possession, or a political subdivision of any of the foregoing, or by the District of Columbia. Sec. 164(b)(2).

[1296] A qualified trade or business means any trade or business other than a specified service trade or business or the trade or business of performing services as an employee. A specified service trade or business means any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, or brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners, or which involves the performance of services that consist of investing and investment management, trading, or dealing in securities, partnership interests, or commodities. Sec. 199A(d)(2).

derived from qualified trades or business,[1297] (iii) real estate taxes paid by a cooperative housing corporation, and (iv) "substitute payments," as defined below.

A substitute payment is generally defined as any amount (other than a tax already defined as a specified tax) paid, incurred, or accrued to a State or local jurisdiction if, by reason of the payment, one or more persons are entitled to "specified tax benefits" equal to or exceeding 25 percent of the payment. Specified tax benefits are benefits determined with respect to such payment and allowed against, or determined by reference to, a tax already defined as a specified tax. In determining whether a payment is a substitute payment, the following two assumptions apply: First, the value of a tax credit or refund is assumed to be the amount of such credit or refund, and the value of a tax deduction or exclusion is assumed to be 15 percent of the amount of such deduction or exclusion. Second, in the case of a payment by a partnership or S corporation, it is assumed that all the owners of such entity are individuals resident in the jurisdiction of the entity or entities providing the specified tax benefits (and otherwise eligible for such benefits).[1298]

For example, if a taxpayer makes a charitable payment to a State or local entity described in section 170(c) and receives a State or local tax credit in the amount of at least 25 percent payment, or a deduction equal to at least 167 percent of the payment, then the payment is a substitute payment and is included in the taxpayer's aggregate of specified taxes. Likewise, if a partnership not engaged in a qualified trade or business pays a gross receipts tax or personal property tax imposed on the partnership by a State, and by reason of such payment the partnership's partners receive credits against their State personal income tax liabilities, the partnership tax payment is a substitute payment and is included in the partnership's aggregate of specified taxes.

The individual deduction for the aggregate of specified taxes is limited to $30,000 ($15,000 in the case of a married individual filing a separate return). This limitation amount is reduced by 20 percent of the excess of the taxpayer's modified adjusted gross income over $400,000 ($200,000 in the case of a married individual filing separately). However, the limitation amount may not be reduced below $10,000 ($5,000 in the case of a married individual filing separately). Modified adjusted gross income is defined as adjusted gross income increased

[1297] For these purposes, common control is determined under the rules of sec. 52(b).

[1298] The proposal excludes a payment from the definition of "substitute payment" to the extent it is nondeductible (other than by reason of the limitation on the charitable contribution deduction, the specific deduction disallowance provisions for partnerships and S corporations, the basis limitation on a partner's current-year share of partnership loss, and the proposal's new limitation on specified tax deductions). For instance, if a partnership makes a State income tax withholding payment in respect of distributions to its partners, the payment is not a substitute payment (notwithstanding that the partners receive State income tax credits in the amount of the withholding payment) because it is a nondeductible distribution. The proposal also authorizes the Secretary to issue regulations excluding a payment from the definition of "substitute payment" if the payment is an amount withheld on behalf of another person and the full amount is included in such person's Federal gross income. For instance, if a partnership pays a State withholding tax on the wages owed to an employee, the payment should not be a substitute payment (notwithstanding that it is deductible by the partnership and that the employee receives a State income tax credit in the amount of the payment) because the full payment included in the employee's Federal gross income as wages.

by any exclusion for foreign earned income, foreign housing costs, and income from sources within certain U.S. possessions.[1299]

Partnerships and S corporations must separately state, and not deduct, specified taxes

The proposal modifies the list of items for which a partner of a partnership must separately take into account such partner's distributive share.[1300] The proposal requires separate accounting of a partner's distributive share of the partnership's: (i) foreign income, war profits, and excess profits taxes, (ii) income, war profits, and excess profits taxes paid or accrued to U.S. possessions, (iii) specified taxes (other than income, etc. taxes paid or accrued to U.S. possessions), and (iv) disallowed foreign real property taxes. The proposal further denies the partnership a deduction for any such taxes or payments in computing its taxable income.[1301] The proposal thereby abrogates IRS Notice 2020-75.

Allowable specified tax deductions taken into account for purposes of the basis limitation on partnership losses

The proposal modifies the basis limitation on a partner's current-year deduction for such partner's distributive share of partnership losses.[1302] The proposal provides that for purposes of the basis limitation, a partner's distributive share of partnership loss generally includes such partner's distributive share of the partnership's specified taxes to the extent that the partner otherwise would be able to deduct such distributive share (taking into account the proposal's new limitation on specified tax deductions). If the partner elects the tax credit for income taxes paid to foreign countries and U.S. possessions,[1303] then for purposes of the basis limitation the partner must take into account such partner's full distributive share of the partnership's income taxes paid to U.S. possessions. Otherwise, for purposes of the basis limitation the partner takes into account such partner's distributive share of income taxes paid to U.S. possessions only to the extent that, when added to such partner's distributive share of the rest of the partnership's specified taxes, such amount is otherwise deductible by the partner. Accordingly, if a partner does not have adequate basis to account for such partner's full distributive share of otherwise deductible specified taxes (in addition to other partnership items taken into account for purposes of the basis limitation), some or all of such distributive share is denied as a deduction in the current year and carried forward to future years.

[1299] Secs. 911, 931, and 933.

[1300] Sec. 702(a).

[1301] These modifications to the provisions governing partnerships and partners induce corresponding modifications (via cross-reference) to the provisions governing S corporations and their shareholders. See secs. 1366(a)(1) and 1363(b)(2).

[1302] Sec. 704(d).

[1303] Sec. 901.

Addition to tax for State and local allocation mismatches

The proposal imposes an addition to the Federal income tax owed by an individual, estate, or trust in the case of a "State and local tax allocation mismatch." Such a mismatch occurs whenever (1) a partnership of which the taxpayer is a direct or indirect partner pays or accrues a specified tax, (2) the taxpayer is entitled to specified tax benefits with respect to the partnership specified tax payment, and (3) such specified tax benefits exceed the taxpayer's distributive share of the partnership specified tax payment. For these purposes, a specified tax benefit is any benefit determined with respect to the partnership specified tax payment and allowed against, or determined by reference to, a specified tax (other than a substitute payment) owed by the taxpayer.

The addition to tax equals the product of (i) the highest rate in effect under section 1 of the Code, and (ii) the taxpayer's aggregate State and local tax allocation mismatches for the taxable year. For purposes of computing the value of an allocation mismatch, any specified tax benefit received by the taxpayer is deemed to equal the increase in specified tax liability (or reduction in credit or refund) that the taxpayer would incur in the taxable year if such benefit were not taken into account, plus, in the case of any carryforward of some or all of the specified tax benefit, the amount of such carryforward (in the case of a credit or refund) or the amount of such carryforward multiplied by the highest rate imposed on individuals under the relevant State or local tax (in the case of a deduction or exclusion). In lieu of the foregoing computation, the taxpayer may elect to determine the value of a specified tax benefit under the following simplified approach: The value of a credit or refund is the amount of such credit or refund, and the value of a deduction or exclusion is 15 percent of such deduction or exclusion.

The operation of the proposal's new addition to tax may be illustrated by the following example: Partnership P is a State S partnership. One of P's partners is individual I (whose specified taxes exceed his Federal deduction limitation for the year), and the other is corporation C (a C corporation). P pays an entity-level income tax imposed by S, by reason of which I is entitled to a credit against his personal income tax liability owed to S. For Federal tax purposes, P allocates the entire entity-level income tax payment to C, which is not subject to a Federal deduction limitation on specified taxes. Unless P is compelled to modify the allocation for lack of substantial economic effect,[1304] the proposal's new addition to tax increases I's Federal income tax liability to approximately the amount that I would have owed had P allocated the entity-level income tax payment to I in proportion to I's S-level tax credit (relative to C's S-level tax credit, if any).

Limitation on capitalization of specified taxes

The proposal prohibits an individual[1305] from charging any specified tax (including a substitute payment) to capital account under any provision of the Code, including without

[1304] See sec. 704(b)(2).

[1305] See section 641(b) regarding the computation of taxable income of an estate or trust in the same manner as an individual. See secs. 703(a) and 1363(b) regarding the computation of taxable income of a partnership or S corporation, respectively, in the same manner as an individual.

limitation sections 263 (dealing with amounts paid out for property or improvements), 263A (dealing with real or personal property produced by the taxpayer or acquired for resale), 471 (dealing with inventories), 266 (providing an election to treat certain otherwise deductible taxes as chargeable to capital account), and 164(a) (dealing with certain State and local and foreign taxes paid or accrued in connection with an acquisition or disposition of property).

Accordingly, a taxpayer may not rely on capitalization to take future-year deductions for specified taxes that are denied in the current taxable year.

Reporting by partnerships and S corporations with respect to specified service trade or business income

The proposal requires partnerships and S corporations to report, both on their own returns (Form 1065 and Form 1120–S, respectively) and their reports to owners (Schedule K–1), whether or not they derived any gross receipts (within the meaning of section 448(c)) from specified service trades or businesses (within the meaning of section 199A(d)(2)) in the taxable year.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

S. Excessive Employee Remuneration from Controlled Group Members and Allocation of Deduction

Present Law

In general

Under present law, an employer generally may deduct reasonable compensation for personal services as an ordinary and necessary business expense. Section 162(m) provides an explicit limitation on the deductibility of compensation expenses in the case of publicly traded corporate employers.[1306] The otherwise allowable deduction for compensation with respect to a covered employee of a publicly held corporation is limited to no more than $1 million per year.[1307] The deduction limitation applies when the deduction attributable to the compensation would otherwise be taken.

Publicly held corporation

For purposes of the section 162(m) deduction disallowance, a publicly held corporation means any corporation which is an issuer of securities required to be registered under section 12 of the Securities Exchange Act of 1934[1308] ("Exchange Act"), or any issuer that is required to file reports under section 15(d) of such Act.[1309] All U.S. publicly traded companies, including their foreign affiliates, and foreign companies publicly traded through American depository receipts ("ADRs") are subject to the registration requirement of section 12 of the Exchange Act. An issuer required to file reports under section 15(d) of the Exchange Act may also include certain additional corporations that are not publicly traded, such as large private C corporations or S corporations.

Under present law, section 162(m) does not include an entity aggregation rule.

Covered employee

Section 162(m)(3)(A), (B) and (D) defines a covered employee as (1) the principal executive officer or principal financial officer of the corporation (or an individual acting in such capacity) at any time during the taxable year, or was an individual acting in such a capacity,

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[1306] Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, sec. 13211, August 10, 1993 ("OBRA 1993"). Pub. L. No. 115-97, sec. 13601, December 22, 2017 ("Public Law No. 115-97"), modified section 162(m) for taxable years beginning after December 31, 2017 (with a transition rule for remuneration provided pursuant to a binding contract which was in effect on November 2, 2017, and which was not modified in any material respect on or after such date). For a detailed description of prior law and the changes made by Public Law No. 115-97, see Joint Committee on Taxation, *General Explanation of Public Law No. 115–97* (JCS-1-18), December 2018, pp. 257–263. This document can be found on the Joint Committee on Taxation website at www.jct.gov.

[1307] Sec. 162(m)(1).

[1308] Pub. L. No. 73-291, June 6, 1934; 15 U.S.C. sec. 78a, *et seq*.

[1309] Sec. 162(m)(2). See also Treas. Reg. sec. 1.162-33(c)(1).

(2) any employee whose total compensation is required to be reported to shareholders under the Exchange Act by reason of being among the corporation's three most highly compensated officers for the taxable year (other than the principal executive officer or principal financial officer), and (3) any individual who was a covered employee with respect to the corporation for any preceding taxable year beginning after December 31, 2016.[1310]

In the case of taxable years beginning after December 31, 2026, the definition of a "covered employee" (in section 162(m)(3)(C)) also includes the next five highest-compensated employees of the corporation (regardless of whether they are officers), for a total of at least 10 covered employees for each taxable year.[1311] However, these additional covered employees are only covered employees for the taxable year(s) in which they are among the five highest compensated employees of the corporation, other than the five officers whose compensation is subject to the deduction limitation.

Description of Proposal

The proposal adds an entity aggregation rule to section 162(m) for purposes of the deduction disallowance. The rule provides that in the case of any publicly held corporation which is a member of a controlled group, if any person which is a member of such controlled group provides applicable employee remuneration to an individual who is a specified covered employee of such controlled group and the aggregate amount of applicable employee remuneration provided by all such members with respect to such specified covered employee exceeds $1,000,000 then the deduction allowed to such members of the controlled group for the applicable employee remuneration paid to such specified covered employee is limited to $1,000,000.[1312] Controlled group means any group treated as a single employer under the rules used to treat related entities as a single employer for other employee benefit purposes.[1313]

A specified covered employee means (1) a covered employee described in paragraphs (A), (B) or (D) of section 162(m)(3)[1314] with respect to the publicly held corporation which is a

[1310] See also, Treas. Reg. sec. 1.162-33(c)(2).

[1311] Sec. 162(m)(3)(C) as added by section 9708 of the American Rescue Plan Act of 2021 ("ARPA"), Pub. L. No. 117-2, March 11, 2021.

[1312] In other words, if the renumeration of an employee exceeds $1 million in a taxable year taking into account remuneration paid to that employee by any member of the employer's controlled group, the amount of the remuneration paid to such employee that exceeds $1 million results in a disallowance of the deduction to the employer(s) in the amount of the excess. For example, if the publicly held corporation pays $750,000 in remuneration to Employee A and another member of the controlled group pays $750,000 to Employee A, the total amount of remuneration to that employee in the taxable year is $1,500,000, however, the deduction to the publicly held corporation and the member of the controlled group that paid the remuneration to Employee A is limited between them to $1,000,000 and the excess of $500,000 [$1,500,000-$1,000,000] is subject to a deduction disallowance.

[1313] Under sec. 414(b), (c), (m), and (o).

[1314] As described above.

member of such controlled group, and (2) any employee described in section 162(m)(3)(C)[1315] if such subparagraph were applied by taking into account the employees of all members of the controlled group.

In any case in which remuneration is paid to the specified covered employee by more than one member of the controlled group for a taxable year and the aggregate amount of such remuneration exceeds $1 million (determined without regard to this rule), the proposal allocates the amount of the $1 million deduction among each member of the controlled group that paid remuneration to such specified covered employee for the taxable year. The term "allocable limitation amount" means with respect to any member of the controlled group with respect to any specified covered employee of such controlled group, the amount which bears the same ratio to $1,000,000 as (1) the amount of applicable employee remuneration provided by such member with respect to such specified covered employee bears to (2) the aggregate amount of applicable employee remuneration provided by all such members with respect to such specified covered employee.[1316]

Effective Date

The proposal applies to taxable years beginning after December 31, 2025.

[1315] As described above.

[1316] In the example described in footnote 1312, the amount of the $1,000,000 deduction would be allocated equally to the publicly held corporation and the member of the controlled group that each paid $750,000 in applicable employee remuneration to Employee A. Each would be permitted to deduct $500,000 [$1,000,000 x [$750,000 divided by $1,500,000] = $500,000]. The excess amount of $500,000 [$1,500,000 - $1,000,000] results in a $250,000 deduction disallowance to each of the two members of the controlled group, since each paid $750,000 in remuneration to the covered employee [$750,000 - $500,000, or $250,000].

T. Expanding Application of Tax on Excess Compensation within Tax-Exempt Organizations

Present Law

In general

The Code imposes an excise tax on employers who pay over $1 million in remuneration or who pay an excess parachute payment to certain highly-paid employees of tax-exempt organizations.[1317] Specifically, an employer is liable for an excise tax equal to the corporate tax rate (21 percent) multiplied by the sum of (1) any remuneration (other than an excess parachute payment) in excess of $1 million paid to a covered employee by an applicable tax-exempt organization for a taxable year, and (2) any excess parachute payment paid by the applicable tax-exempt organization to a covered employee. Accordingly, the excise tax applies as a result of an excess parachute payment even if the covered employee's remuneration does not exceed $1 million.

A covered employee for this purpose is an employee (including any former employee) of an applicable tax-exempt organization if the employee is one of the five highest compensated employees of the organization for the taxable year or was a covered employee of the organization (or a predecessor) for any preceding taxable year beginning after December 31, 2016.[1318]

An "applicable tax-exempt organization" is an organization exempt from tax under section 501(a), an exempt farmers' cooperative,[1319] a Federal, State or local governmental entity with excludable income,[1320] or a political organization.[1321]

Rules regarding remuneration

For purposes of the timing of application of the excise tax, remuneration is treated as paid when there is no substantial risk of forfeiture of the rights to such remuneration. The rights of a person to compensation are subject to a substantial risk of forfeiture if such rights are conditioned upon the future performance of substantial services by any individual.[1322] Accordingly, the tax imposed by this provision may apply to the value of remuneration that is vested even if it is not yet received. Therefore, the excise tax may apply to remuneration at a

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[1317] Sec. 4960.

[1318] Sec. 4960(c)(2).

[1319] Sec. 521(b).

[1320] Sec. 115(1).

[1321] Sec. 527(e)(1).

[1322] Substantial risk of forfeiture is defined with reference to section 457(f)(3)(B). Sec. 4960(a).

time that is different than the time remuneration is required to be included in gross income as wages.[1323]

Remuneration for this purpose means wages as defined for income tax withholding purposes,[1324] but does not include any designated Roth contribution.[1325] In addition, the definition of remuneration for this purpose includes amounts required to be included in gross income under section 457(f), which applies to certain deferred compensation plans of a State or local government or a tax-exempt entity.[1326] Remuneration paid to a licensed medical professional (including a veterinarian) that is directly related to the performance of medical or veterinary services by such professional is not taken into account, whereas remuneration paid to such a professional in any other capacity is taken into account.[1327] Thus, for example, if a surgeon performs direct medical services as part of his or her medical practice, and also performs services that are not direct medical services (such as teaching, research, or acting as dean, officer, or board member of a hospital), that portion of such a medical professional's remuneration attributable to those services that are direct medical services is not treated as remuneration.

Remuneration of a covered employee includes any remuneration paid with respect to employment of the covered employee by any person or governmental entity related to the applicable tax-exempt organization.[1328] A person or governmental entity is treated as related to an applicable tax-exempt organization if the person or governmental entity (1) controls, or is controlled by, the organization, (2) is controlled by one or more persons that control the organization, (3) is a supported organization[1329] during the taxable year with respect to the

[1323] For example, even though remuneration may be vested in one year but paid within the first two and one-half months of the following year such that the income inclusion is required in the year paid, the remuneration is treated as paid for this purpose in the year when vested. Additionally, earnings on previously vested remuneration, even if paid or payable in future years, are treated as paid for this purpose as they accrue.

[1324] Sec. 3401(a).

[1325] Under section 402A(c), a designated Roth contribution is an elective deferral (that is, a contribution to a tax-favored employer-sponsored retirement plan made at the election of an employee) that the employee designates as not being excludable from income.

[1326] Such amounts may not be treated as wages under section 3401(a), but are treated as remuneration for purposes of the excise tax application. Sec. 457(f) applies to an "ineligible" deferred compensation plan of a State or local government or a tax-exempt employer (that is, a plan that does not meet the requirements to be an eligible plan under section 457(b)). Under an ineligible plan, deferred amounts are treated as nonqualified deferred compensation and includible in income for the first taxable year in which there is no substantial risk of forfeiture of the rights to such compensation. For this purpose, a person's rights to compensation are subject to a substantial risk of forfeiture if the rights are conditioned on the future performance of substantial services by any individual. Earnings post-vesting are generally taxed when paid.

[1327] Sec. 4960(c)(3)(B).

[1328] Sec. 4960(c)(4).

[1329] Sec. 509(f)(3).

organization, (4) is a supporting organization[1330] during the taxable year with respect to the organization, or (5) in the case of a voluntary employees' beneficiary association ("VEBA"),[1331] establishes, maintains, or makes contributions to the VEBA. However, remuneration of a covered employee that is not deductible by reason of the $1 million limit on deductible compensation[1332] is not taken into account for this purpose.[1333]

Excess parachute payment

An excess parachute payment is the amount by which any parachute payment exceeds the portion of the base amount allocated to the payment. A parachute payment is a payment in the nature of compensation to (or for the benefit of) a covered employee if the payment is contingent on the employee's separation from employment and the aggregate present value of all such payments equals or exceeds three times the base amount. The base amount is the average annualized compensation includible in the covered employee's gross income for the five taxable years ending before the date of the employee's separation from employment. Parachute payments do not include payments under a qualified retirement plan, a simplified employee pension plan, a simple retirement account, a tax-deferred annuity,[1334] or an eligible deferred compensation plan of a State or local government employer.[1335] Parachute payments include amounts contingent on separation from employment from severance and deferred compensation plans (including supplemental executive retirement plans), and do not exclude *bona fide* severance or separation pay plans under section 457(f) or section 409A.

Payments to employees who are not highly compensated employees (within the meaning of section 414(q), $160,000 for 2025), and payments attributable to medical services of certain licensed medical professionals,[1336] are exempt from the definition of parachute payment.

The employer of a covered employee is liable for the excise tax. If remuneration of a covered employee from more than one employer is taken into account in determining the excise tax, each employer is liable for the tax in an amount that bears the same ratio to the total tax as the remuneration paid by that employer bears to the total remuneration paid by all of the employers to the covered employee.

[1330] Sec. 509(a)(3).

[1331] Sec. 501(c)(9).

[1332] Sec. 162(m).

[1333] Sec. 4960(c)(6).

[1334] Sec. 403(b).

[1335] Sec. 457(b).

[1336] Sec. 4960(c)(4)(C). The principles of allocation described above that apply to determine exempt remuneration attributable to medical services also apply to determine exempt payments attributable to medical services for purposes of parachute payments.

Description of Proposal

The proposal revises the definition of a covered employee to mean any employee or former employee. Thus, an employee need not be one of the five highest compensated employees of the organization for the taxable year, or have been a covered employee of the organization (or predecessor) in a taxable year beginning after December 31, 2016, in order to be a covered employee. The employee also need not be an employee (or former employee) of an applicable tax-exempt organization to be a covered employee, provided that the employee is employed (or formerly employed) by a related person or governmental entity.

Effective Date

The proposal applies to taxable years beginning after December 31, 2025.

U. Modification of Excise Tax on Investment Income of Certain Private Colleges and Universities

Present Law

In general

Section 4968 imposes an excise tax on an applicable educational institution for each taxable year equal to 1.4 percent of the net investment income of the institution for the taxable year. Net investment income is determined using rules similar to the rules of section 4940(c) (relating to the net investment income of a private foundation). Net investment income generally is the amount by which the sum of gross investment income and the capital gain net income exceeds certain deductions.[1337] Gross investment income is the gross amounts of income from interest, dividends, rents, payments with respect to securities loans, and royalties, but not including any such income to the extent included in computing unrelated business income tax under section 511.[1338] The following items are excluded from gross investment income: (1) interest income from a student loan that was made by the applicable educational institution or a related organization to a student of the institution in connection with the student's attendance at the institution; (2) rental income from the provision of housing by the applicable educational institution or a related organization to students of the institution and from housing for faculty and staff if the housing is provided contingent on their roles as faculty or staff of the institution; and (3) royalty income that is derived from patents, copyrights, and other intellectual property and intangible property to the extent those assets resulted from the work of students or faculty members in their capacities as such with the applicable educational institution.[1339]

An applicable educational institution is an eligible education institution (as defined in section 25A):[1340] (1) that has at least 500 tuition-paying students during the preceding taxable year; (2) more than 50 percent of the tuition-paying students of which are located in the United States; (3) that is not described in the first sentence of section 511(a)(2)(B) of the Code (generally describing State colleges and universities); and (4) the aggregate fair market value of the assets of which at the end of the preceding taxable year (other than those assets that are used directly in carrying out the institution's exempt purpose)[1341] is at least $500,000 per student (the "asset-per-student threshold"). For these purposes, the number of students of an institution is

[1337] Treas. Reg. sec. 53.4968-2(a)(1).

[1338] Treas. Reg. sec. 53.4968-2(b)(1).

[1339] Treas. Reg. sec. 53.4968-2(b)(2).

[1340] Section 25A(f)(2) defines an eligible educational institution as an institution that (1) is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. sec. 1088), as in effect on August 5, 1997, and (2) is eligible to participate in a program under title IV of such Act.

[1341] Assets used directly in carrying out the institution's exempt purpose include, for example, classroom buildings and physical facilities used for educational activities and office equipment or other administrative assets used by employees of the institution in carrying out exempt activities, among other assets.

based on the average daily number of full-time students attending the institution, with part-time students being taken into account on a full-time student equivalent basis.

For purposes of determining whether an educational institution meets the asset-per-student threshold[1342] and for purposes of determining net investment income, assets and net investment income of a related organization with respect to the educational institution are treated as assets and net investment income, respectively, of the educational institution, except that:

- No such amount is taken into account with respect to more than one educational institution; and
- Unless the related organization is controlled by the educational institution or is a supporting organization (described in section 509(a)(3)) with respect to the institution for the taxable year, assets and net investment income that are not intended or available for the use or benefit of the educational institution are not taken into account. For example, assets of a related organization that are earmarked or restricted for (or fairly attributable to) the educational institution would be treated as assets of the educational institution, whereas assets of a related organization that are held for unrelated purposes (and are not fairly attributable to the educational institution) would be disregarded.

An organization is treated as related to the institution for this purpose if the organization: (1) controls, or is controlled by, the institution; (2) is controlled by one or more persons that control the institution; or (3) is a supported organization[1343] or a supporting organization[1344] during the taxable year with respect to the institution.

Reporting requirements

A private college or university generally must file an annual information return with the IRS using IRS Form 990, "Return of Organization Exempt from Income Tax." Part V, question 16 of the Form 990 for the year 2024 asks whether the filing organization is an educational institution that is subject to the section 4968 excise tax on net investment income. The instructions to the form include a worksheet to assist the organization in making this determination.[1345]

An organization that answers "yes" to question 16 is required to complete Schedule O of IRS Form 4720, "Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal

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[1342] In cross-referencing the asset-per-student threshold for this purpose, section 4968(d)(1) includes a reference to subsection "(b)(1)(C)" that should instead read "(b)(1)(D)." A clerical correction may be necessary to correct this cross-reference.

[1343] Sec. 509(f)(3).

[1344] Sec. 509(a)(3).

[1345] See 2024 Instructions for Form 990, pp. 18-19. The student counts used in determining whether an institution is an applicable educational institution are referenced in the worksheet but are not provided to the IRS.

Revenue Code." Form 4720 is used to report certain excise taxes that apply to tax-exempt organizations, including the section 4968 excise tax on the net investment income of private colleges and universities. On Schedule O, the organization must provide information about the net investment income of the filing organization and its related organizations and compute the amount of section 4968 excise tax owed by the organization.

Description of Proposal

The proposal replaces the excise tax on applicable educational institutions with a new rate structure. Under the proposal, the amount of tax imposed on an applicable educational institute for each taxable year is equal to the applicable percentage of the net investment income for the taxable year. The applicable percentage is 1.4 percent in the case of an institution with a student adjusted endowment in excess of $500,000 and not in excess of $750,000; 7 percent in the case of an institution with a student adjusted endowment in excess of $750,000 and not in excess of $1,250,000; 14 percent in the case of an institution with a student adjusted endowment in excess of $1,250,000 and not in excess of $2,000,000; and 21 percent in the case of an institution with a student adjusted endowment in excess of $2,000,000.

The proposal modifies the term "applicable educational institution" to mean an eligible education institution (as defined in section 25A(f)(2)): (1) that has at least 500 tuition-paying students during the preceding taxable year; (2) more than 50 percent of the tuition-paying students of which are located in the United States; (3) that is not described in the first sentence of section 511(a)(2)(B) of the Code (generally describing State colleges and universities); (4) that is not a qualified religious institution; and (5) the student adjusted endowment of which is at least $500,000. A qualified religious institution is an institution (i) established after July 4, 1776; (ii) that was established by, or in association with, and has continuously maintained an affiliation with an organization described in section 170(b)(1)(A)(i) (churches and conventions or associations of churches); and (iii) which maintains a published institutional mission that is approved by the governing body of the institution and that includes, refers to, or is predicated upon religious tenets, beliefs, or teachings. The student adjusted endowment of an institution for a taxable year is equal to the aggregate fair market value of the assets of the institution (determined as of the end of the preceding taxable year), other than those assets which are used directly in carrying out the institution's exempt purpose, divided by the number of eligible students of the institution. For this purpose, the term "eligible student" means a student of the institution that meets the eligibility requirements under section 484(a)(5) of the Higher Education Act of 1965.[1346] That section requires that the student "be a citizen or national of the United States, a permanent resident of the United States, or able to provide evidence from the Immigration and Naturalization Service that he or she is in the United States for other than a temporary purpose with the intention of becoming a citizen or permanent resident."

Under the proposal, the Secretary is directed to prescribe regulations or other guidance as necessary to prevent avoidance of the tax, including regulations or other guidance to prevent

[1346] 20 U.S.C. sec. 1091(a)(5).

avoidance of tax through the restructuring of endowment funds or other arrangements designed to reduce or eliminate the value of net investment income or assets subject to the tax.

The proposal also requires an applicable educational institution that is required to file an annual information return (Form 990) to include on the return the number of eligible students taken into account for purposes of calculating student adjusted endowment, and the number of students determined after application of section 4968(e) (determining number of students of an institution based on daily attendance).

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

V. Increase in Rate of Tax on Net Investment Income of Certain Private Foundations

Present Law

Under section 4940(a), private foundations that are recognized as exempt from Federal income tax under section 501(a) (other than exempt operating foundations)[1347] are subject to an excise tax of 1.39 percent on their net investment income.[1348] Net investment income generally includes interest, dividends, rents, royalties (and income from similar sources), and capital gain net income, and is reduced by expenses incurred to earn this income. The two-percent rate of tax is reduced to one-percent in any year in which a foundation exceeds the average historical level of its charitable distributions. Specifically, the excise tax rate is reduced if the foundation's qualifying distributions (generally, amounts paid to accomplish exempt purposes)[1349] equal or exceed the sum of (1) the amount of the foundation's assets for the taxable year multiplied by the average percentage of the foundation's qualifying distributions over the five taxable years immediately preceding the taxable year in question, and (2) one percent of the net investment income of the foundation for the taxable year.[1350] In addition, the foundation cannot have been subject to tax in any of the five preceding years for failure to meet minimum qualifying distribution requirements in section 4942.

Private foundations that are not exempt from tax under section 501(a), such as certain charitable trusts, are subject to an excise tax under section 4940(b). The tax is equal to the excess of the sum of the excise tax that would have been imposed under section 4940(a) if the foundation were tax exempt and the amount of the tax on unrelated business income that would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation under subtitle A of the Code.

Private foundations are required to make a minimum amount of qualifying distributions each year to avoid tax under section 4942. The minimum amount of qualifying distributions a foundation has to make to avoid tax under section 4942 is reduced by the amount of section 4940 excise taxes paid.[1351]

[1347] Sec. 4940(d)(1). Exempt operating foundations generally include organizations such as museums or libraries that devote their assets to operating charitable programs but have difficulty meeting the "public support" tests necessary not to be classified as a private foundation. To be an exempt operating foundation, an organization must: (1) be an operating foundation (as defined in section 4942(j)(3)); (2) be publicly supported for at least 10 taxable years; (3) have a governing body no more than 25 percent of whom are disqualified persons and that is broadly representative of the general public; and (4) have no officers who are disqualified persons. Sec. 4940(d)(2).

[1348] Sec. 4940(a). The Taxpayer Certainty and Disaster Relief Act of 2019, Pub. L. 116-94, Div. Q, sec. 206(a), revised the excise tax from two percent to 1.39 percent, effective for taxable years beginning after December 20, 2019.

[1349] Sec. 4942(g).

[1350] Sec. 4940(e).

[1351] Sec. 4942(d)(2).

Description of Proposal

The proposal replaces the 1.39 percent excise tax with a tiered structure. The 1.39 percent rate continues to apply to a private foundation with assets of less than $50 million. In the case of a private foundation with assets equal to or greater than $50 million, but less than $250 million, the rate of the excise tax is 2.78 percent. In the case of a private foundation with assets equal to or greater than $250 million, but less than $5 billion, the rate of the excise tax is five percent, and the rate is 10 percent for a foundation with assets of at least $5 billion.

Assets of a private foundation are determined for this purpose with respect to any taxable year as being the aggregate fair market value of all assets of such private foundation, as of the close of the taxable year. There is no reduction for any liabilities.

Under the proposal, assets of an organization that is related to the private foundation are treated as assets of the private foundation. However, no assets are taken into account with respect to more than one private foundation, and assets that are not intended or available for the use or benefit of the private foundation are not taken into account unless the related organization is controlled by the private foundation. For this purpose, an organization is a related organization with respect to a private foundation if the organization controls or is controlled by the private foundation, or the organization is controlled by one or more persons that also control the private foundation.

Effective Date

The proposal is effective for taxable years beginning after the date of enactment.

W. Certain Purchases of Employee-Owned Stock Disregarded for Purposes of Foundation Tax on Excess Business Holdings

Present Law

Public charities and private foundations

An organization qualifying for tax-exempt status under section 501(c)(3) is further classified as either a public charity or a private foundation. An organization may qualify as a public charity in several ways.[1352] Certain organizations are classified as public charities *per se*, regardless of their sources of support. These include churches, certain schools, hospitals and other medical organizations (including medical research organizations), certain organizations providing assistance to colleges and universities, and governmental units.[1353] Other organizations qualify as public charities because they are broadly publicly supported. First, a charity may qualify as publicly supported if at least one-third of its total support is from gifts, grants or other contributions from governmental units or the general public.[1354] Alternatively, it may qualify as publicly supported if it receives more than one-third of its total support from a combination of gifts, grants, and contributions from governmental units and the public plus revenue arising from activities related to its exempt purposes (*e.g.*, fee for service income). In addition, this category of public charity must not rely excessively on endowment income as a source of support.[1355] A supporting organization, *i.e.*, an organization that provides support to another section 501(c)(3) entity that is not a private foundation and meets certain other requirements of the Code, also is classified as a public charity.[1356]

A section 501(c)(3) organization that does not fit within any of the above categories is a private foundation. In general, private foundations receive funding from a limited number of sources (*e.g.*, an individual, a family, or a corporation).

[1352] The Code does not expressly define the term "public charity," but rather provides exceptions to those entities that are treated as private foundations.

[1353] Sec. 509(a)(1) (referring to sections 170(b)(1)(A)(i) through (iv) for a description of these organizations).

[1354] Treas. Reg. sec. 1.170A-9(f)(2). Failing this mechanical test, the organization may qualify as a public charity if it passes a "facts and circumstances" test. Treas. Reg. sec. 1.170A-9(f)(3).

[1355] To meet this requirement, the organization must normally receive more than one-third of its support from a combination of (1) gifts, grants, contributions, or membership fees and (2) certain gross receipts from admissions, sales of merchandise, performance of services, and furnishing of facilities in connection with activities that are related to the organization's exempt purposes. Sec. 509(a)(2)(A). In addition, the organization must not normally receive more than one-third of its public support in each taxable year from the sum of (1) gross investment income and (2) the excess of unrelated business taxable income as determined under section 512 over the amount of unrelated business income tax imposed by section 511. Sec. 509(a)(2)(B).

[1356] Sec. 509(a)(3). Organizations organized and operated exclusively for testing for public safety also are classified as public charities. Sec. 509(a)(4). Such organizations, however, are not eligible to receive deductible charitable contributions under section 170.

The deduction for charitable contributions to private foundations is in some instances less generous than the deduction for charitable contributions to public charities. In addition, private foundations are subject to a number of operational rules and restrictions that do not apply to public charities, as well as a tax on their net investment income.[1357]

Excess business holdings of private foundations

A private foundation is subject to tax on excess business holdings if it holds more than certain permitted percentages of a business enterprise.[1358] In general, a private foundation is permitted to hold 20 percent of the voting stock in a corporation, reduced by the percentage of voting stock held by all disqualified persons (as defined in section 4946).[1359] A private foundation can hold any amount of nonvoting stock in a corporation if disqualified persons do not own more than 20 percent of the voting stock of the corporation. If it is established that effective control of the corporation is in one or more persons who are not disqualified persons with respect to the foundation, a private foundation and disqualified persons together may own up to 35 percent of the voting stock of a corporation. A private foundation is not treated as having excess business holdings in any corporation if it owns (together with certain other related private foundations) not more than two percent of the voting stock and not more than two percent in value of all outstanding shares of all classes of stock in that corporation. Similar rules apply with respect to holdings in a partnership (substituting "profits interest" for "voting stock" and "capital interest" for "nonvoting stock") and to other unincorporated enterprises (by substituting "beneficial interest" for "voting stock"). Private foundations are not permitted to have holdings in a proprietorship.[1360]

The initial tax is equal to 10 percent of the value of the excess business holdings held during the foundation's applicable taxable year. The tax is imposed on the last day of the taxable year, but the amount of the tax is computed using the greatest amount of the excess business holdings during the taxable year.[1361] An additional tax is imposed if an initial tax is imposed

[1357] Unlike public charities, private foundations are subject to tax on their net investment income at a rate of 1.39 percent. Sec. 4940. Private foundations also are subject to more restrictions on their activities than are public charities. For example, private foundations are prohibited from engaging in self-dealing transactions (sec. 4941), are required to make a minimum amount of charitable distributions each year (sec. 4942), are limited in the extent to which they may control a business (sec. 4943), may not make speculative investments (sec. 4944), and may not make certain expenditures (sec. 4945). Violations of these rules result in excise taxes on the foundation and, in some cases, may result in excise taxes on the managers of the foundation.

[1358] Sec. 4943. Taxes imposed may be abated if certain conditions are met. Secs. 4961 and 4962.

[1359] Disqualified persons include, among others, substantial contributors to the foundation, foundation managers, and certain family members of disqualified persons. See sec. 4946.

[1360] The excess business holdings rules do not apply to holdings in a functionally related business or to holdings in a trade or business at least 95 percent of the gross income of which is derived from passive sources. Sec. 4943(d)(3).

[1361] This initial tax is not levied on excess business holdings (other than those acquired by purchase) if the foundation disposes of such excess business holdings within 90 days from the date on which it knows or has reason to know of the event that caused it to have such excess holdings. Treas. Reg. sec. 53.4943-2(a)(1)(ii).

and, at the close of the taxable period[1362] with respect to such holdings, the foundation continues to have excess business holdings. The amount of the additional tax is equal to 200 percent of such excess business holdings.

If there is a change in the holdings in a business enterprise (other than by purchase by the foundation or a disqualified person) that causes the private foundation to have excess business holdings, the private foundation generally has five years from the date of the change to dispose of the excess without being subject to tax.[1363] This five-year period may be extended an additional five years in limited circumstances.[1364]

Special grandfathering rules apply to private foundations that had holdings in a business enterprise in excess of the applicable percentage limitations on May 26, 1969. In general, the actual percentage of such holdings as of that date is substituted for 20 percent.[1365] If holdings in the business enterprise subsequently decrease for any reason, the decreased percentage generally is substituted for the previously applicable percentage, and the decreased percentage applies for all subsequent periods (known as the "downward ratchet" rule).[1366]

Description of Proposal

The proposal amends the excess business holdings rules so that certain voting stock repurchased by a business enterprise is treated as outstanding stock when calculating a private foundation's present and permitted holdings in the business enterprise under the excess business holdings rules. The proposal applies to voting stock that is: (1) not readily tradable on an established securities market; (2) purchased by the business enterprise on or after January 1, 2020, from an employee stock ownership plan (described in Code section 4975(e)(7)) in which employees of such business enterprise participate, in connection with a distribution from such plan; and (3) held by the business enterprise as treasury stock, cancelled, or retired.

The proposal applies only to the extent that treating the repurchased stock as outstanding voting stock does not result in permitted holdings exceeding 49 percent (*i.e.*, a minority voting stake). The proposal does not apply to purchases of stock made during the 10-year period beginning on the date the plan is established.

1362 For this purpose, the term "taxable period" means the period beginning on the first day on which there are excess holdings and ending on the earlier of (1) the date of the mailing of a notice of deficiency with respect to tax on such holdings and (2) the date on which the tax on excess business holdings with respect to such excess holdings is assessed. Sec. 4943(d)(2).

1363 Sec. 4943(c)(6).

1364 Sec. 4943(c)(7).

1365 Sec. 4943(c)(4)(a)(i).

1366 Sec. 4943(c)(4)(a)(ii).

The "downward ratchet" rule, described above, does not apply with respect to any decrease in the percentage of holdings in a business enterprise by reason of application of the proposal.

Effective Date

The proposal is effective for taxable years ending after the date of enactment and to purchases by a business enterprise of voting stock in taxable years beginning after December 31, 2019.

X. Unrelated Business Taxable Income Increased by Amount of Certain Fringe Benefit Expenses for Which Deduction Is Disallowed

Present Law

Unrelated business income tax

Tax exemption for certain organizations

Section 501(a) exempts certain organizations from Federal income tax. Such organizations include: (1) tax-exempt organizations described in section 501(c) (including among others section 501(c)(3) charitable organizations and section 501(c)(4) social welfare organizations); (2) religious and apostolic organizations described in section 501(d); and (3) trusts forming part of a pension, profit-sharing, or stock bonus plan of an employer described in section 401(a).

Unrelated business income tax, in general

The unrelated business income tax ("UBIT") generally applies to income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions.[1367] An organization that is subject to UBIT and that has $1,000 or more of gross unrelated business taxable income must report that income on Form 990-T (Exempt Organization Business Income Tax Return).

Most exempt organizations may operate an unrelated trade or business so long as the organization remains primarily engaged in activities that further its exempt purposes. Therefore, an organization may generally engage in a substantial amount of unrelated business activity without jeopardizing exempt status. A section 501(c)(3) (charitable) organization, however, may not operate an unrelated trade or business as a substantial part of its activities.[1368] Therefore, the unrelated trade or business activity of a section 501(c)(3) organization must be insubstantial.

An organization determines its unrelated business taxable income by subtracting from its gross unrelated business income the deductions directly connected with the unrelated trade or business.[1369]

Organizations subject to tax on unrelated business income

Most exempt organizations are subject to UBIT. Specifically, organizations subject to UBIT generally include: (1) organizations exempt from tax under section 501(a), including organizations described in section 501(c) (except for U.S. instrumentalities and certain charitable

[1367] Secs. 511-514.

[1368] Treas. Reg. sec. 1.501(c)(3)-1(e).

[1369] Sec. 512(a).

trusts);[1370] (2) qualified pension, profit-sharing, and stock bonus plans described in section 401(a);[1371] and (3) certain State colleges and universities.[1372]

Exclusions from unrelated business taxable income

Certain types of income are specifically excluded from unrelated business taxable income, such as dividends, interest, royalties, and certain rents,[1373] unless derived from debt-financed property or from certain 50-percent controlled subsidiaries.[1374] Certain types of activities are not considered unrelated trade or business activities, such as activities in which substantially all the work is performed by volunteers, which involve the sale of donated goods, or which are carried on for the convenience of members, students, patients, officers, or employees of a charitable organization.[1375] Additional activities exempt from UBIT include certain activities of trade shows and State fairs,[1376] conducting bingo games,[1377] and the distribution of low-cost items incidental to the solicitation of charitable contributions.[1378]

Specific deduction against unrelated business taxable income

In computing unrelated business taxable income, an exempt organization may take a specific deduction of $1,000. This specific deduction may not be used to create a net operating loss that will be carried back or forward to another year.[1379]

In the case of a diocese, province of a religious order, or a convention or association of churches, there is also allowed a specific deduction with respect to each parish, individual church, district, or other local unit. The specific deduction is equal to the lower of $1,000 or the gross income derived from any unrelated trade or business regularly carried on by the local unit.[1380]

[1370] Sec. 511(a)(2)(A).

[1371] Sec. 511(a)(2)(A).

[1372] Sec. 511(a)(2)(B).

[1373] Sec. 512(b).

[1374] Sec. 512(b)(13).

[1375] Sec. 513(a).

[1376] Sec. 513(d).

[1377] Sec. 513(f).

[1378] Sec. 513(h).

[1379] Sec. 512(b)(12).

[1380] *Ibid*.

Limitation on employer deductions for qualified transportation fringe

A deduction for the expense of any qualified transportation fringe provided to an employee of the taxpayer is disallowed.[1381] The term "qualified transportation fringe" includes qualified parking,[1382] and therefore encompasses costs associated with providing parking on or near the business premises of the employer.[1383] Under IRS guidance, this includes appropriate allocations of costs with respect to facilities used for parking (*e.g.*, parking lot attendant expenses, property taxes, repairs and maintenance, rent or lease payments, etc.), but does not include depreciation on a parking facility owned by a taxpayer and used for parking by the taxpayer's employees.[1384] The term "qualified transportation fringe" also includes transportation in a commuter highway vehicle if such transportation is in connection with travel between the employee's residence and place of employment, any transit pass, and any qualified bicycle commuting reimbursement.[1385]

The amount of the deduction disallowance is equal to the amount of direct and other properly allocable costs of the taxpayer to provide the qualified transportation fringe.[1386] Accordingly, the deduction disallowance is not determined by reference to the value of the transportation fringe benefit to the employee.

Generally, the deduction disallowance does not apply to qualified transportation fringe expenses that are treated by the taxpayer as compensation to its employees.[1387]

Annual filing requirement for tax-exempt organizations

A tax-exempt organization generally is required to file an annual information return with the IRS. An organization that has not received a determination of its tax-exempt status, but that claims tax-exempt status under section 501(a), is subject to the same annual reporting requirements and exceptions as organizations that have received a formal determination.

In general, organizations described in section 501(c) and exempt from taxation under section 501(a) are required to file an annual return (Form 990 series), stating specifically the items of gross income, receipts, disbursements, and such other information as the Secretary may

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[1381] Sec. 274(a)(4).

[1382] Sec. 132(f)(1).

[1383] Sec. 132(f)(5)(C).

[1384] Treas. Reg. sec. 1.274-13(b)(12)(i).

[1385] Sec. 132(f)(1). The term "qualified transportation fringe" does not include any qualified bicycle commuting reimbursement for taxable years beginning after December 31, 2017, and before January 1, 2026. Sec. 132(f)(8).

[1386] See Treas. Reg. sec. 1.274-13(d)(2)(i)(A) and (d)(3).

[1387] Sec. 274(e)(2); Treas. Reg. sec. 1.274-13(e)(2)(i).

prescribe.[1388] An organization that is required to file an information return, but that has gross receipts of less than $200,000 during its taxable year, and total assets of less than $500,000 at the end of its taxable year, may file Form 990-EZ. Section 501(c)(3) private foundations are required to file Form 990-PF rather than Form 990. Any organization that is subject to UBIT and that has $1,000 or more of gross unrelated business taxable income must also file Form 990-T (Exempt Organization Business Income Tax Return).[1389]

The requirement that an exempt organization file an annual information return (Form 990 or Form 990-EZ) does not apply to certain tax-exempt organizations. There are three mandatory exceptions from the filing requirement: (1) churches, their integrated auxiliaries, and conventions or associations of churches;[1390] (2) certain organizations (other than private foundations) the gross receipts of which in each taxable year normally are not more than $5,000;[1391] (3) the exclusively religious activities of any religious order.[1392]

The IRS has relieved certain other organizations from the filing requirement pursuant to its statutory discretionary authority, including certain church-affiliated elementary and high schools and any organization described in section 501(c)(3) (other than a private foundation of a section 509(a)(3) supporting organization) that normally has annual gross receipts of not more than $50,000, among other organizations.[1393]

Description of Proposal

Under the proposal, unrelated business taxable income of a tax-exempt organization is increased to include any amounts paid or incurred by the organization for any qualified transportation fringe[1394] or any parking facility used in connection with qualified parking[1395] for which a deduction is not allowable by reason of section 274.[1396] The proposal does not apply to

[1388] Sec. 6033(a).

[1389] Tax-exempt organizations also generally must file reports and returns applicable to taxable entities with respect to Social Security taxes and, in certain instances, Federal unemployment taxes.

[1390] Sec. 6033(a)(3)(A)(i).

[1391] Sec. 6033(a)(3)(A)(ii).

[1392] Sec. 6033(a)(3)(A)(iii).

[1393] Sec. 6033(a)(3)(B); Treas. Reg. sec. 1.6033-2(g)(1). Treas. Reg. sec. 1.6033-2(g)(1) provides a partial list of organizations that are not required to file annual returns either because they are excepted by statute or because the IRS has exercised its discretionary authority. Organizations that are excused from filing an information return by reason of normally having gross receipts below $50,000 must furnish to the Secretary an annual notice (Form 990-N), in electronic form, containing certain basic information about the organization. Sec. 6033(i).

[1394] As defined in sec. 132(f).

[1395] As defined in sec. 132(f)(5)(C).

[1396] Sec. 274(a)(4).

any amounts that are directly connected with an unrelated trade or business that is regularly carried on by the organization.

For purposes of computing unrelated business taxable income for organizations with more than one unrelated trade or business,[1397] any increase in unrelated business taxable income under the proposal is treated as unrelated business taxable income with respect to an unrelated trade or business separate from any other unrelated trade or business of the organization.

However, the proposal does not apply to the following organizations: (1) organizations that do not have a filing requirement by reason of section 6033(a)(3)(A)(i) or (iii) (i.e., churches, their integrated auxiliaries, and conventions or association of churches, and the exclusively religious activities of any religious order), and (2) any church-affiliated organization described in section 501(c) which is not required to file an annual return under section 6033(a)(1) by reason of section 6033(a)(3)(B).

The proposal directs the Secretary to issue regulations or other guidance as may be necessary or appropriate to carry out the purposes of this proposal, including regulations or other guidance providing for the appropriate allocation of costs with respect to facilities used for parking.

Effective Date

The proposal applies to amounts paid or incurred after December 31, 2025.

[1397] See sec. 512 (a)(6).

Y. Name and Logo Royalties Treated as Unrelated Business Taxable Income

Tax exemption for certain organizations

Section 501(a) exempts certain organizations from Federal income tax. Such organizations include: (1) tax-exempt organizations described in section 501(c) (including among others section 501(c)(3) charitable organizations and section 501(c)(4) social welfare organizations); (2) religious and apostolic organizations described in section 501(d); and (3) trusts forming part of a pension, profit-sharing, or stock bonus plan of an employer described in section 401(a).

Unrelated business income tax, in general

The unrelated business income tax ("UBIT") generally applies to income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions.[1398] An organization that is subject to UBIT and that has $1,000 or more of gross unrelated business taxable income must report that income on Form 990-T (Exempt Organization Business Income Tax Return).

Most exempt organizations may operate an unrelated trade or business so long as the organization remains primarily engaged in activities that further its exempt purposes. Therefore, an organization may generally engage in a substantial amount of unrelated business activity without jeopardizing exempt status. A section 501(c)(3) (charitable) organization, however, may not operate an unrelated trade or business as a substantial part of its activities.[1399] Therefore, the unrelated trade or business activity of a section 501(c)(3) organization must be insubstantial.

An organization determines its unrelated business taxable income by subtracting from its gross unrelated business income the deductions directly connected with the unrelated trade or business.[1400]

Organizations subject to tax on unrelated business income

Most exempt organizations are subject to UBIT. Specifically, organizations subject to UBIT generally include: (1) organizations exempt from tax under section 501(a), including organizations described in section 501(c) (except for U.S. instrumentalities and certain charitable

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[1398] Secs. 511-514.

[1399] Treas. Reg. sec. 1.501(c)(3)-1(e).

[1400] Sec. 512(a).

trusts);[1401] (2) qualified pension, profit-sharing, and stock bonus plans described in section 401(a);[1402] and (3) certain State colleges and universities.[1403]

Exclusions from unrelated business taxable income

Certain types of income are specifically excluded from unrelated business taxable income, such as dividends, interest, royalties, and certain rents,[1404] unless derived from debt-financed property or from certain 50-percent controlled subsidiaries.[1405] Certain types of activities are not considered unrelated trade or business activities, such as activities in which substantially all the work is performed by volunteers, which involve the sale of donated goods, or which are carried on for the convenience of members, students, patients, officers, or employees of a charitable organization.[1406] Additional activities exempt from UBIT include certain activities of trade shows and State fairs,[1407] conducting bingo games,[1408] and the distribution of low-cost items incidental to the solicitation of charitable contributions.[1409]

Specific deduction against unrelated business taxable income

In computing unrelated business taxable income, an exempt organization may take a specific deduction of $1,000. This specific deduction may not be used to create a net operating loss that will be carried back or forward to another year.[1410]

In the case of a diocese, province of a religious order, or a convention or association of churches, there is also allowed a specific deduction with respect to each parish, individual church, district, or other local unit. The specific deduction is equal to the lower of $1,000 or the gross income derived from any unrelated trade or business regularly carried on by the local unit.[1411]

[1401] Sec. 511(a)(2)(A).

[1402] Sec. 511(a)(2)(A).

[1403] Sec. 511(a)(2)(B).

[1404] Sec. 512(b).

[1405] Sec. 512(b)(13).

[1406] Sec. 513(a).

[1407] Sec. 513(d).

[1408] Sec. 513(f).

[1409] Sec. 513(h).

[1410] Sec. 512(b)(12).

[1411] *Ibid*.

Description of Proposal

The proposal modifies the UBIT treatment of the licensing of a tax-exempt organization's name or logo generally to subject royalty income derived from such a license to UBIT. Specifically, the proposal provides that any sale or licensing by an organization of any name or logo of the organization (including any trademark or copyright related to a name or logo) is treated as an unrelated trade or business that is regularly carried on by the organization.

In addition, the proposal provides that income derived from any such sale or licensing of a name or logo of the organization is included in the organization's gross unrelated business taxable income, notwithstanding the provisions of section 512 that otherwise exclude certain types of passive income (including royalties) from unrelated business taxable income.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

Z. Exclusion of Research Income Limited to Publicly Available Research

Present Law

Tax exemption for certain organizations

Section 501(a) exempts certain organizations from Federal income tax. Such organizations include: (1) tax-exempt organizations described in section 501(c) (including among others section 501(c)(3) charitable organizations and section 501(c)(4) social welfare organizations); (2) religious and apostolic organizations described in section 501(d); and (3) trusts forming part of a pension, profit-sharing, or stock bonus plan of an employer described in section 401(a).

Unrelated business income tax, in general

The unrelated business income tax ("UBIT") generally applies to income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions.[1412] An organization that is subject to UBIT and that has $1,000 or more of gross unrelated business taxable income must report that income on Form 990-T (Exempt Organization Business Income Tax Return).

Most exempt organizations may operate an unrelated trade or business so long as the organization remains primarily engaged in activities that further its exempt purposes. Therefore, an organization may generally engage in a substantial amount of unrelated business activity without jeopardizing exempt status. A section 501(c)(3) (charitable) organization, however, may not operate an unrelated trade or business as a substantial part of its activities.[1413] Therefore, the unrelated trade or business activity of a section 501(c)(3) organization must be insubstantial.

An organization determines its unrelated business taxable income by subtracting from its gross unrelated business income the deductions directly connected with the unrelated trade or business.[1414]

Organizations subject to tax on unrelated business income

Most exempt organizations are subject to UBIT. Specifically, organizations subject to UBIT generally include: (1) organizations exempt from tax under section 501(a), including organizations described in section 501(c) (except for U.S. instrumentalities and certain charitable

[1412] Secs. 511-514.

[1413] Treas. Reg. sec. 1.501(c)(3)-1(e).

[1414] Sec. 512(a).

trusts);[1415] (2) qualified pension, profit-sharing, and stock bonus plans described in section 401(a);[1416] and (3) certain State colleges and universities.[1417]

Exclusions from unrelated business taxable income

In general

Certain types of income are specifically excluded from unrelated business taxable income, such as dividends, interest, royalties, and certain rents,[1418] unless derived from debt-financed property or from certain 50-percent controlled subsidiaries.[1419] Certain types of activities are not considered unrelated trade or business activities, such as activities in which substantially all the work is performed by volunteers, which involve the sale of donated goods, or which are carried on for the convenience of members, students, patients, officers, or employees of a charitable organization.[1420] Additional activities exempt from UBIT include certain activities of trade shows and State fairs,[1421] conducting bingo games,[1422] and the distribution of low-cost items incidental to the solicitation of charitable contributions.[1423]

Research income

Certain income derived from research activities of exempt organizations is excluded from unrelated business taxable income. For example, income derived from research performed for the United States, a State, and certain agencies and subdivisions is excluded.[1424] Income from research performed by a college, university, or hospital for any person also is excluded.[1425] Finally, if an organization is operated primarily for purposes of carrying on fundamental research the results of which are freely available to the general public, all income derived by research

1415 Sec. 511(a)(2)(A).

1416 Sec. 511(a)(2)(A).

1417 Sec. 511(a)(2)(B).

1418 Sec. 512(b).

1419 Sec. 512(b)(13).

1420 Sec. 513(a).

1421 Sec. 513(d).

1422 Sec. 513(f).

1423 Sec. 513(h).

1424 Sec. 512(b)(7).

1425 Sec. 512(b)(8).

performed by such organization for any person may be excluded, not only income derived from fundamental research available to the general public.[1426]

Specific deduction against unrelated business taxable income

In computing unrelated business taxable income, an exempt organization may take a specific deduction of $1,000. This specific deduction may not be used to create a net operating loss that will be carried back or forward to another year.[1427]

In the case of a diocese, province of a religious order, or a convention or association of churches, there is also allowed a specific deduction with respect to each parish, individual church, district, or other local unit. The specific deduction is equal to the lower of $1,000 or the gross income derived from any unrelated trade or business regularly carried on by the local unit.[1428]

Description of Proposal

The proposal modifies the exclusion from unrelated business taxable income for income that is derived from research performed by an organization operated primarily for purposes of carrying on fundamental research the results of which are freely available to the general public. Under the proposal, the organization may exclude from unrelated business taxable income only the income that is derived from such fundamental research the results of which are freely available to the general public.

Effective Date

The proposal is effective for amounts received or accrued after December 31, 2025.

[1426] Sec. 512(b)(9).

[1427] Sec. 512(b)(12).

[1428] *Ibid*.

AA. Limitation on Excess Business Losses of Noncorporate Taxpayers

Present Law

Limitation on excess business losses of a taxpayer other than a corporation

In general

An excess business loss of a taxpayer other than a corporation is not allowed for the taxable year.[1429]

An excess business loss not allowed for a taxable year is treated as a net operating loss ("NOL") for the taxable year that is carried over to subsequent taxable years under the applicable NOL carryover rules.[1430]

An excess business loss for the taxable year is the excess of aggregate deductions of the taxpayer attributable to trades or businesses of the taxpayer (determined without regard to the limitation of the provision)[1431] over the sum of aggregate gross income or gain attributable to trades or businesses of the taxpayer plus a threshold amount. The threshold amount is indexed for inflation for taxable years beginning after 2018. The threshold amount for a taxable year beginning in 2025 is $313,000 as indexed (or, in the case of a joint return, twice the otherwise applicable threshold amount, or $626,000 for 2025 as indexed).[1432]

The aggregate business deductions taken into account to determine the excess business loss of the taxpayer for the taxable year that are attributable to trades or businesses of the taxpayer are determined without regard to any deduction under section 172 (relating to NOLs) or 199A (relating to the deduction for qualified business income). For example, assume that a

[1429] Sec. 461(l), as modified in 2017 by section 11012 of Public Law 115-97, was applicable to taxable years beginning after December 31, 2017, and before January 1, 2026. Section 2304 of Division A of Public Law 116-136 further modified Code section 461(l) so that it does not apply for a taxable year beginning in 2018, 2019, or 2020. In 2021, section 9041 of Public Law 117-2 extended section 461(l) for one year, effective for taxable years beginning after December 31, 2025, and beginning before January 1, 2027. In 2022, section 13903(b) of Public Law 117-169 extended section 461(l) for two additional years, effective for taxable years beginning after December 31, 2026, and beginning before January 1, 2029.

[1430] See generally sec. 172. The amount of the taxpayer's NOL (including any excess business loss that is not allowed for the taxable year) carried to a subsequent taxable year is limited to 80 percent of the taxable income (determined without regard to the NOL deduction and deductions under sections 199A and 250) for that subsequent taxable year. Sec. 172(a)(2). For a discussion of the changes made in 2017 to section 172, see the description of section 13302 of Public Law 115-97 (Modification of Net Operating Loss Deduction) in Joint Committee on Taxation, *General Explanation of Public Law 115-97* (JCS-1-18), December 2018, page 180. Changes made by section 2303 of the Division A of Public Law 116-136 to rules governing NOLs (section 172) are described in Joint Committee on Taxation, *General Explanation of the Tax Legislation Enacted in the 116th Congress* (JCS-1-22), February 2022, page 325.

[1431] Aggregate deductions (for purposes of section 461(l)) do not include the amount of any NOL carryback or carryover under section 172 that is attributable to such trades or businesses from a different taxable year.

[1432] Sec. 2.32 of Rev. Proc. 2024-40, 2024-45 I.R.B., November 4, 2024.

taxpayer has an NOL carryover from a prior taxable year to the current taxable year. Such NOL carryover is not part of the taxpayer's aggregate deductions attributable to the trade or business for the current taxable year under section 461(l).

An excess business loss under section 461(l) does not take into account any deductions, gross income, or gains attributable to any trade or business of performing services as an employee.[1433] For this purpose, the trade or business of performing services as an employee has the same meaning as it does under section 62(a)(1). For example, assume married taxpayers filing jointly for the taxable year have a loss from a trade or business conducted by one spouse as a sole proprietorship, as well as wage income of the other spouse from employment. The wage income is not taken into account in determining the amount of the deduction limited under section 461(l).

In the case of a partnership or S corporation, the provision applies at the partner or shareholder level. Each partner's distributive share and each S corporation shareholder's pro rata share of items of income, gain, deduction, or loss of a partnership or S corporation are taken into account in applying the limitation under the provision for the taxable year of the partner or S corporation shareholder. Regulatory authority is provided to require any additional reporting as the Secretary determines is appropriate to carry out the purposes of the provision (including with respect to any other passthrough entity to the extent necessary to carry out the purposes of the provision).

Section 461(l) applies after the application of certain other limitations on losses, namely, the passive activity loss limitation,[1434] the at-risk limitation,[1435] and in the case of a taxpayer who is a partner or S corporation shareholder, the rules limiting the taxpayer's distributive or pro rata share of loss for the taxable year to the taxpayer's adjusted basis in the partnership interest or in the S corporation stock and debt.[1436] Thus, for example, the amount of any income, deduction, gain, or loss from a passive activity that is taken into account under the passive activity loss limitation is not taken into account in determining whether a taxpayer has an excess business loss.

[1433] See also the IRS explanation of "Excess business losses" at https://www.irs.gov/newsroom/excess-business-losses , which conforms to this rule. The rule was clarified in Pub. L. No. 116-136, Div. A, sec. 2304(b), effective as if included in section 11012 of Public Law 115-97 (that is, starting with the taxable year beginning after December 31, 2017; Pub. L. No 116-136, Div. A, sec. 2304, however, later provided that section 461(l) does not apply for a taxable year beginning in 2018, 2019, or 2020).

[1434] Sec. 469.

[1435] Sec. 465.

[1436] Sec. 704(d) (for partners) and sec. 1366(d) (for S corporation shareholders). See sec. 461(l)(6) (applying section 461(l) after section 469), and Treas. Reg. sec. 1.469-2T(d)(6) (applying section 469 after sections 704(d), 1366(d), and 465). Note that other rules could potentially limit a taxpayer's loss (*e.g.*, section 267). A discussion of all potential loss limitation rules is beyond the scope of the description of this provision.

Treatment of capital losses

In the case of a taxpayer other than a corporation, section 1211(b) limits the deduction for losses from sales or exchanges of capital assets to gains from such sales or exchanges plus up to $3,000. Section 172(d)(2)(A), relating to NOLs, provides a similar limitation but without regard to the $3,000 additional amount. Because capital losses cannot offset ordinary income under the NOL rules, any capital loss deductions are not taken into account in computing the section 461(l) limitation. Further, the amount of capital gain taken into account in calculating the section 461(l) limitation cannot exceed the lesser of capital gain net income from a trade or business or capital gain net income.

Excess farm losses

A limitation on excess farm losses applies to taxpayers other than C corporations.[1437] For taxable years beginning after December 31, 2017, and before January 1, 2026, the limitation relating to excess farm losses does not apply.[1438]

Under the limitation relating to excess farm losses, if a taxpayer other than a C corporation receives an applicable subsidy[1439] for the taxable year, the amount of the excess farm loss is not allowed for the taxable year and is carried forward and treated as a deduction attributable to farming businesses in the next taxable year. An excess farm loss for a taxable year means the excess of aggregate deductions that are attributable to farming businesses over the sum of aggregate gross income or gain attributable to farming businesses plus the threshold amount. The threshold amount is the greater of (1) $300,000 ($150,000 for married individuals filing separately), or (2) for the five-consecutive-year period preceding the taxable year, the excess of the aggregate gross income or gain attributable to the taxpayer's farming businesses over the aggregate deductions attributable to the taxpayer's farming businesses.

Description of Proposal

Permanency

The proposal makes permanent the limitation on excess business loss of a taxpayer other than a corporation (section 461(l)). Specifically, the section 461(l) limitation applies for taxable

[1437] Sec. 461(j).

[1438] In 2021, section 9041 of Public Law 117-2 extended the period in which section 461(j) does not apply for one year, effective for taxable years beginning after December 31, 2017, and beginning before January 1, 2027. In 2022, section 13903(b) of Public Law 117-169 extended the period in which section 461(j) does not apply for two additional years, effective for taxable years beginning after December 31, 2020, and beginning before January 1, 2029.

[1439] For this purpose, an applicable subsidy means (A) any direct or counter-cyclical payment under title I of the Food, Conservation, and Energy Act of 2008, or any payment elected to be received in lieu of such payment, or (B) any Commodity Credit Corporation loan. Sec. 461(j)(3). Note that the Agricultural Act of 2014 repealed direct and counter-cyclical payments under the Food, Conservation, and Energy Act of 2008. See secs. 1101 and 1102 of Pub. L. No. 113-79, February 7, 2014. Thus, only Commodity Credit Corporation loans currently fall within the definition of an applicable subsidy for purposes of section 461(j).

years beginning after December 31, 2020. The proposal also provides that the limitation on excess farm losses (section 461(j)) does not apply for taxable years beginning after December 31, 2017.

Modification of limitation

Additionally, the proposal modifies the section 461(l) limitation. For purposes of determining the excess business loss for a taxable year, the aggregate deductions attributable to trades or businesses of the taxpayer are increased by the portion of the allowable net operating loss carryover or carryback that is a specified loss. A specified loss means a disallowed excess business loss under the limitation set forth in section 461(l)(1) for a taxable year beginning after December 31, 2024.

This means that the full amount of the specified loss (not reduced by limitations of section 172(a)) attributable to an excess business loss disallowance must increase the subsequent taxable year aggregate deductions used in calculating the excess business loss under section 461(l)(1) for such subsequent taxable year. A specified loss is treated as an NOL arising from the original taxable year incurred.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

BB. 1-Percent Floor on Deduction of Charitable Contributions Made by Corporations

Present Law

In general

Section 170(a) allows for a deduction for any charitable contribution payment made within the taxable year. Total deductions for charitable contributions by corporate taxpayers for any taxable year are generally limited to 10 percent of the taxpayer's taxable income.[1440] For purposes of the charitable deduction, a corporate taxpayer's taxable income is computed without regard to any deduction for charitable contributions under section 170, the dividends received deduction, the deductions allowable to corporations under Subtitle A, Chapter 1, Subchapter B, Part VIII (except section 248), any net operating loss carryback to the taxable year under section 172, and capital loss carryback to the taxable year under section 1212(a)(1), and section 199A(g). Charitable contributions over the percentage limitation in any taxable year can be carried forward to the next five taxable years.[1441] The amount of charitable contributions carried forward are reduced to the extent that the contributions in excess of the percentage limitation reduces taxable income (as computed for purposes of the second sentence of section 172(b)(2)) and increases a net operating loss carryover under section 172 to a succeeding taxable year.

Qualified conservation contributions by certain corporate farmers and ranchers

A qualified conservation contribution is a type of partial-interest contribution that is deductible.[1442] A qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes.[1443] A qualified real property interest is defined as: (1) the entire interest of the donor other than a qualified mineral interest; (2) a remainder interest; or (3) a restriction (granted in perpetuity) on the use that may be made of the real property (generally, a conservation easement).[1444] Qualified organizations include certain governmental units, public charities that meet certain public support tests, and certain supporting organizations.[1445] Conservation purposes include: (1) the preservation of land areas for outdoor recreation by, or for the education of, the general public; (2) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; (3) the preservation of open space (including farmland and forest land) where such preservation will yield a significant public benefit and is either for the scenic enjoyment of the general public or pursuant to a clearly delineated Federal, State, or local governmental

[1440] Sec. 170(b)(2)(A).

[1441] Sec. 170(d)(2)(A).

[1442] Secs. 170(f)(3)(B)(iii) and 170(h).

[1443] Sec. 170(h)(1).

[1444] Sec. 170(h)(2).

[1445] Sec. 170(h)(3).

conservation policy; and (4) the preservation of an historically important land area or a certified historic structure.[1446]

In the case of a corporation (other than a publicly traded corporation) that is a qualified farmer or rancher for the taxable year in which the contribution is made, any qualified conservation contribution is allowable up to 100 percent of the excess of the corporation's taxable income (as computed under section 170(b)(2)) over the amount of all other allowable charitable contributions.[1447] Any excess may be carried forward for up to 15 years as a contribution subject to the 100 percent limitation.[1448] The qualified conservation contribution must be a contribution of property that is used in agriculture or livestock production and is subject to a restriction that such property remain available for such production.[1449] A qualified farmer or rancher means a taxpayer whose gross income from the trade or business of farming (within the meaning of section 2032A(e)(5)) is greater than 50 percent of the taxpayer's gross income for the taxable year.[1450]

Qualified conservation contributions by certain native corporations

In the case of a Native Corporation, any qualified conservation contribution which is a contribution of land conveyed under the Alaska Native Claims Settlement Act is allowable up to 100 percent of the excess of the Native Corporation's taxable income (as computed under section 170(b)(2)) over the amount of all other allowable charitable contributions.[1451] Any excess may be carried forward for up to 15 years as a contribution subject to the 100 percent limitation.[1452] A Native Corporation has the meaning given the term by section 3(m) of the Alaska Native Claims Settlement Act.[1453]

Description of Proposal

The proposal allows a deduction for a corporate charitable deduction only to the extent that the aggregate of corporate charitable contributions exceeds one percent of a taxpayer's taxable income (the "one-percent floor") and does not exceed 10 percent of the taxpayer's taxable income (the "10-percent limit").

[1446] Sec. 170(h)(4).

[1447] Sec. 170(b)(2)(B)(i).

[1448] Sec. 170(b)(2)(B)(ii).

[1449] Sec. 170(b)(2)(B)(i).

[1450] Sec. 170(b)(1)(E)(v).

[1451] Sec. 170(b)(2)(C)(i).

[1452] Sec. 170(b)(2)(C)(ii).

[1453] Sec. 170(b)(2)(C)(iii).

Contributions in excess of the 10-percent limit may be carried forward to the subsequent five taxable years and are treated as allowed on a first-in, first-out basis. The amount of charitable contributions disallowed under the one-percent floor may be carried forward only from years in which the taxpayer's charitable contributions exceed the 10-percent limit. Any carryforward is applied after contributions made in the current taxable year for the purposes of the one-percent floor and 10-percent limit. The amount of charitable contributions carried forward is reduced to the extent that the carryforward otherwise would reduce taxable income (as computed for purposes of the second sentence of section 172(b)(2)) and increase a net operating loss carryover under section 172 to a succeeding taxable year.

The proposal does not modify the treatment of qualified conservation contributions by certain corporate farmers and ranchers or Native Corporations, including the percentage limitations with respect to such qualified conservation contributions.

Effective Date

The proposal applies to taxable years beginning after December 31, 2025.

CC. Enforcement of Remedies Against Unfair Foreign Taxes

Present Law

U.S. tax rules applicable to foreign activities of U.S. persons

In general, income earned directly by a U.S. person from the conduct of a foreign trade or business is taxed currently,[1454] while income earned indirectly through certain related foreign entities (*e.g.*, controlled foreign corporations ("CFCs"))[1455] is taxed in the year earned or not at all.[1456] Earnings and profits of CFCs are generally taxable in one of two ways. First, the earnings may constitute income to U.S. shareholders under the traditional anti-deferral regime of subpart F, which applies to certain passive income and income that is readily movable from one jurisdiction to another.[1457] Subpart F was designed as an anti-abuse regime to prevent U.S. taxpayers from shifting passive and mobile income to low-tax jurisdictions.[1458] Second, the earnings may be subject to section 951A, which applies to some foreign-source income of a CFC that is not subpart F income. Such income is referred to as global intangible low-taxed income ("GILTI"). GILTI was enacted as a base protection measure to counter the participation exemption system, established by the dividends-received-deduction, under which the income could potentially be distributed back to the U.S. corporation with no U.S. tax imposed.[1459] Subpart F inclusions are taxed at full rates with related foreign taxes generally eligible for the foreign tax credit; GILTI inclusions are taxed at reduced rates with additional limitations on the use of related foreign tax credits. Both subpart F and GILTI are generally included in income by the U.S. shareholder without regard to whether the earnings are distributed by the CFC.

U.S. tax rules applicable to foreign persons

Nonresident aliens and foreign corporations generally are subject to U.S. tax only on their U.S.-source income. There are two broad types of taxation of U.S.-source income of foreign

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[1454] Such income is called foreign branch income.

[1455] A CFC generally is defined as any foreign corporation in which U.S. persons own (directly, indirectly, or constructively) more than 50 percent of the corporation's stock (measured by vote or value), taking into account only "U.S. shareholders," that is, U.S. persons who own at least 10 percent of the stock (measured by vote or value). See secs. 951(b), 957, and 958. Special rules apply with respect to U.S. persons that are shareholders (regardless of their percentage ownership) in any foreign corporation that is not a CFC but is a passive foreign investment company ("PFIC"). See secs. 1291 through 1298. The PFIC rules generally seek to prevent the deferral of passive income through the use of foreign corporations.

[1456] For a more detailed discussion of the rules, see Joint Committee on Taxation, *Background and Analysis of the Taxation of Income Earned by Multinational Enterprises* (JCX-35R-23), July 17, 2023, Part I.B. This document can be found on the Joint Committee on Taxation website at www.jct.gov.

[1457] Subpart F comprises sections 951 through 965.

[1458] See Joint Committee on Taxation, *Tax Effects of Conducting Foreign Business through Foreign Corporations* (JCT-5-61), July 21, 1961, Part V. This document can be found on the Joint Committee on Taxation website at www.jct.gov. See also Rev. Act. of 1962, Pub. L. No. 87-834.

[1459] See Reconciliation Recommendations Pursuant to H. Con. Res. 71 (December 2017).

taxpayers: (1) gross-basis tax on income that is "fixed or determinable annual or periodical gains, profits, and income" ("FDAP income"); and (2) net-basis tax on income that is "effectively connected with the conduct of a trade or business within the United States" ("ECI"). FDAP income, although nominally subject to a statutory 30-percent gross-basis tax withheld at its source, in many cases is subject to a reduced rate of, or entirely exempt from, U.S. tax under the Code or a bilateral income tax treaty. ECI generally is subject to the same U.S. tax rules and rates that apply to business income earned by U.S. persons.

Gross-basis taxation of U.S.-source income

FDAP income received by foreign persons from U.S. sources is subject to a 30-percent gross-basis tax (*i.e.*, a tax on gross income without reduction for related expenses), which is collected by withholding at the source of the payment. FDAP income includes interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, and emoluments.[1460] The items enumerated in defining FDAP income are illustrative, and the words "annual or periodical" are "merely generally descriptive" of the payments within the purview of the statute.[1461] Capital gains of nonresident aliens generally are foreign source; however, capital gains of nonresident aliens present in the United States for 183 days or more[1462] during the year are income from U.S. sources subject to gross-basis taxation.[1463] In addition, U.S.-source gains from the sale or exchange of intangibles are subject to tax and withholding if they are contingent on the productivity, use, or disposition of the property sold.[1464] The categories of income subject to the 30-percent tax and the categories for which withholding is required generally are coextensive.[1465]

Exclusions from FDAP income

FDAP income encompasses a broad range of gross income but has important exceptions.

Interest on bank deposits may qualify for exemption from treatment as FDAP income on two grounds. First, interest on deposits with domestic banks and savings and loan associations, and certain amounts held by insurance companies, is U.S.-source income but is exempt from the 30-percent tax when paid to a foreign person.[1466] Second, interest on deposits with foreign branches of domestic banks and domestic savings and loan associations is not U.S.-source

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[1460] Secs. 871(a) and 881. FDAP income that is ECI is taxed as ECI.

[1461] *Commissioner v. Wodehouse*, 337 U.S. 369, 393 (1949).

[1462] For purposes of this rule, whether a person is considered a resident in the United States is determined by application of the rules under section 7701(b).

[1463] Sec. 871(a)(2). In addition, certain capital gains from sales of U.S. real property interests are subject to tax as ECI under the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA"). See sec. 897(a)(1).

[1464] Secs. 871(a)(1)(D) and 881(a)(4).

[1465] See secs. 1441 and 1442.

[1466] Secs. 871(i)(2)(A) and 881(d); Treas. Reg. sec. 1.1441-1(b)(4)(ii).

income and, thus, is not subject to U.S. tax.[1467] Interest and original issue discount on certain short-term obligations also is exempt from U.S. tax when paid to a foreign person.[1468] In addition, an exception to information reporting requirements may apply with respect to payments of such exempt amounts.[1469]

Although FDAP income includes U.S.-source portfolio interest, such interest is specifically exempt from the 30-percent gross-basis tax. Portfolio interest is any interest (including original issue discount) that is paid on an obligation that is in registered form and for which the beneficial owner has provided to the U.S. withholding agent a statement certifying that the beneficial owner is not a U.S. person.[1470] Portfolio interest, however, does not include interest received by a 10-percent shareholder,[1471] certain contingent interest,[1472] interest received by a CFC from a related person,[1473] or interest received by a bank on an extension of credit made pursuant to a loan agreement entered into in the ordinary course of its trade or business.[1474]

Withholding of 30-percent gross-basis tax

The 30-percent tax on FDAP income is generally collected by means of withholding.[1475] Withholding on FDAP payments to foreign payees is required unless the withholding agent (*i.e.*, the person making the payment to the foreign person) can establish that the beneficial owner of the amount is eligible for an exemption from withholding or a reduced rate of withholding under an income tax treaty.[1476]

[1467] Sec. 861(a)(1); Treas. Reg. sec. 1.1441-1(b)(4)(iii).

[1468] Secs. 871(g)(1)(B) and 881(a)(3); Treas. Reg. sec. 1.1441-1(b)(4)(iv).

[1469] Treas. Reg. sec. 1.1461-1(c)(2)(ii)(A) and (B). A bank must report interest if the recipient is a nonresident alien who resides in a country with which the United States has a satisfactory exchange of information program under a bilateral agreement and the deposit is maintained at an office in the United States. Treas. Reg. secs. 1.6049-4(b)(5) and 1.6049-8. The IRS publishes lists of the countries whose residents are subject to the reporting requirements, and those countries with respect to which the reported information is automatically exchanged. See Rev. Proc. 2024-42, 2024-52 I.R.B. 1433.

[1470] Sec. 871(h)(2).

[1471] Sec. 871(h)(3). The exemption does not apply to interest payments made to a foreign lender that owns 10 percent or more of the voting power (but not value) of the stock of the borrower.

[1472] Sec. 871(h)(4).

[1473] Sec. 881(c)(3)(C).

[1474] Sec. 881(c)(3)(A).

[1475] Secs. 1441 and 1442.

[1476] A withholding agent includes any U.S. or foreign person that has the control, receipt, custody, disposal, or payment of an item of income of a foreign person subject to withholding. Treas. Reg. sec. 1.1441-7(a). See also Treas. Reg. sec. 1.1441-6 (providing, in part, the requirements (including documentary evidence) that must be satisfied for purposes of claiming the benefits of an exemption from, or reduced rate of, withholding under a treaty).

Often, the income subject to withholding is the only income of the foreign person subject to any U.S. tax. If the foreign person has no ECI and the withholding is sufficient to satisfy the tax liability with respect to FDAP income, the foreign person generally is not required to file a U.S. Federal income tax return. Accordingly, the withholding of the 30-percent gross-basis tax generally represents the collection of the foreign person's final U.S. tax liability.

To the extent that a withholding agent withholds an amount, the withheld tax is credited to the foreign recipient of the income.[1477] If the agent withholds more than is required, and that results in an overpayment of tax, the foreign recipient may file a claim for refund.

Net-basis taxation of income from conduct of a trade or business within the United States

Income that is effectively connected with the conduct of a trade or business within the United States (*i.e.*, ECI) generally is subject to tax on a net basis under the same U.S. tax rules and rates that apply to business income earned by U.S. persons.[1478]

U.S. trade or business

A foreign person is subject to U.S. tax on a net basis if the person is engaged in a U.S. trade or business. Partners in a partnership and beneficiaries of an estate or trust are treated as engaged in a U.S. trade or business if the partnership, estate, or trust is so engaged.[1479]

Whether a foreign person is engaged in a U.S. trade or business is a factual question that has generated a significant amount of case law. Basic issues include whether the activity rises to the level of a trade or business, whether a trade or business has sufficient connections to the United States, and whether the relationship between the foreign person and persons performing activities in the United States for the foreign person is sufficient to attribute those activities to the foreign person.

For eligible foreign persons, U.S. bilateral income tax treaties restrict the application of net-basis U.S. taxation. Under each treaty, the United States is permitted to tax business profits only to the extent those profits are attributable to a U.S. permanent establishment of the foreign person. The threshold level of activities that constitute a permanent establishment is generally higher than the threshold level of activities that constitute a U.S. trade or business. For example, a permanent establishment typically requires the maintenance of a fixed place of business over a significant period of time.

[1477] Sec. 1462.

[1478] Secs. 871(b) and 882.

[1479] Sec. 875.

Effectively connected income

A foreign person that is engaged in the conduct of a trade or business within the United States is subject to U.S. net-basis taxation on ECI from that trade or business. Specific statutory rules govern whether income is ECI.[1480]

In general, for a foreign person engaged in the conduct of a U.S. trade or business, all income, gain, or loss from sources within the United States is treated as ECI.[1481]

In the case of U.S.-source capital gain and U.S.-source income of a type that would be subject to gross-basis U.S. taxation, the factors taken into account in determining whether the income is ECI include whether the income is derived from assets used in or held for use in the conduct of the U.S. trade or business, and whether the activities of the U.S. trade or business were a material factor in the realization of the amount (the "asset use" and "business activities" tests).[1482] Under the asset use and business activities tests, due regard is given to whether such asset or such income, gain, deduction, or loss was accounted for through the trade or business.

A foreign person that is engaged in a U.S. trade or business may have limited categories of foreign-source income that are considered to be ECI.[1483] A foreign tax credit may be allowed with respect to foreign income tax imposed on such income.[1484] Foreign-source income not included in one of those categories generally is exempt from U.S. tax.

Allowance of deductions

Taxable ECI is computed by taking into account deductions associated with gross ECI. Regulations address the allocation and apportionment of deductions between ECI and other income. Certain deductions may be allocated and apportioned on the basis of units sold, gross sales or receipts, costs of goods sold, profits contributed, expenses incurred, assets used, salaries

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[1480] Sec. 864(c).

[1481] Sec. 864(c)(3).

[1482] Sec. 864(c)(2).

[1483] A foreign person's income from foreign sources generally is considered to be ECI only if the person has an office or other fixed place of business within the United States to which the income is attributable and the income is in one of the following categories: (1) rents or royalties for the use of patents, copyrights, secret processes or formulas, goodwill, trademarks, trade brands, franchises, or other like intangible properties derived in the active conduct of the trade or business; (2) interest or dividends derived in the active conduct of a banking, financing, or similar business within the United States or received by a corporation the principal business of which is trading in stocks or securities for its own account; or (3) income derived from the sale or exchange (outside the United States), through the U.S. office or fixed place of business, of inventory or property held by the foreign person primarily for sale to customers in the ordinary course of the trade or business, unless the sale or exchange is for use, consumption, or disposition outside the United States and an office or other fixed place of business of the foreign person in a foreign country participated materially in the sale or exchange. Foreign-source dividends, interest, and royalties are not treated as ECI if the items are paid by a foreign corporation more than 50 percent (by vote) of which is owned directly, indirectly, or constructively by the recipient of the income. Sec. 864(c)(4)(B) and (D)(i).

[1484] See sec. 906.

paid, space used, time spent, or gross income received. Specific rules provide for the allocation and apportionment of research and experimental expenditures, legal and accounting fees, income taxes, losses on dispositions of property, and net operating losses. In general, interest is allocated and apportioned based on assets rather than income.

Sales of partnership interests

Gain or loss from the sale or exchange of a partnership interest is treated as effectively connected with a U.S. trade or business to the extent that the transferor would have had effectively connected gain or loss had the partnership sold all of its assets at fair market value as of the date of the sale or exchange.[1485] Any gain or loss from such hypothetical asset sale by the partnership must be allocated to interests in the partnership in the same manner as non-separately stated income and loss.

The transferee of a partnership interest must withhold 10 percent of the amount realized on the sale or exchange of a partnership interest unless the transferor certifies that the sale qualifies for an exception from withholding (*e.g.*, that the transferor is not a nonresident alien individual or foreign corporation or that there is no realized gain from the sale).[1486] If the transferee fails to withhold the correct amount, the partnership is required to deduct and withhold from distributions to the transferee partner an amount equal to the amount the transferee failed to withhold.[1487]

Foreign Investment in Real Property Act ("FIRPTA")

A foreign person's gain or loss from the disposition of a U.S. real property interest ("USRPI") is treated as ECI.[1488] Thus, a foreign person subject to tax on such a disposition is required to file a U.S. tax return. In the case of a foreign corporation, the gain from the disposition of a USRPI may also be subject to the branch profits tax at a 30-percent rate (or lower treaty rate). Certain sales of USRPI are exempt from this tax. For example, qualified foreign pension funds are not treated as nonresident alien individuals or foreign corporations subject to tax under FIRPTA,[1489] foreign governments are exempt from FIRPTA tax on gain from certain sales of stock of U.S. real property holding corporations,[1490] and equity interests in "domestically controlled" REITs are not USRPIs.[1491]

[1485] Sec. 864(c)(8)(B).

[1486] Sec. 1446(f)(1).

[1487] Sec. 1446(f)(4); Treas. Reg. sec. 1.1446(f)-2(b).

[1488] Sec. 897(a).

[1489] Sec. 897(l)(1).

[1490] Treas. Reg. sec. 1.892-3T(a).

[1491] Sec. 897(h)(2).

The payor of income that FIRPTA treats as ECI is generally required to withhold U.S. tax from the payment.[1492] The foreign person can request a refund with its U.S. tax return, if appropriate, based on that person's overall tax liability for the taxable year.

Base erosion and anti-abuse tax

The BEAT is an additional tax imposed on certain multinational corporations with respect to payments to foreign affiliates, intended as a special measure to address potential tax avoidance.[1493]

OECD global agreement and Pillar Two

At the direction of the G-20, the Organisation of Economic Co-operation and Development ("OECD") has coordinated international efforts to agree on a new means of allocating certain income of multinational enterprises ("Pillar One") and to coordinate the implementation of a global minimum tax ("Pillar Two").

Pillar Two provides for a minimum global level of income taxation for multinational enterprises ("MNEs") based on a certain set of rules, including rules for calculating income subject to the minimum tax, calculating the effective tax rate imposed on such income before applying Pillar Two, determining priority of jurisdictions to collect the minimum tax, and establishing reporting requirements.

In December 2021, the OECD published "Global Anti-Base Erosion Model Rules (Pillar Two)," which provides for a system of taxation based on financial accounts applying a minimum rate of 15 percent on a jurisdictional ("country-by-country") basis (the "Model Rules").[1494] In March 2022, the OECD published general commentary (and related examples) on the Model Rules,[1495] and in December 2022, the OECD published guidance on a transitional safe harbor, a framework for a permanent safe harbor, and transitional penalty relief.[1496] In 2023 through

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[1492] Sec. 1445 and regulations thereunder.

[1493] Sec. 59A. For a description of the BEAT, see *supra* the description of present law for section 111005, Extension of base erosion minimum tax amount.

[1494] OECD, "Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS," 2022, available at https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm.

[1495] OECD, "Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two), First Edition: Inclusive Framework on BEPS," 2022, available at https://web-archive.oecd.org/2022-03-14/626821-tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-commentary.pdf. For the related examples, see OECD, "Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) Examples," 2022, available at https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-examples.pdf.

[1496] OECD, "Safe Harbours and Penalty Relief: Global Anti-Base Erosion Rules (Pillar Two), OECD/G20 Inclusive Framework on BEPS," 2022, available at https://www.oecd.org/tax/beps/safe-harbours-and-penalty-relief-global-anti-base-erosion-rules-pillar-two.pdf.

2025, the OECD published several sets of administrative guidance on the Model Rules to address certain specific questions in need of clarification and simplification. A number of jurisdictions have agreed in principle to adopt Pillar Two, and many have already enacted legislation or proposed legislation to adopt (or partially adopt) the Model Rules.

The Model Rules apply to MNE groups (and their constituent entities) that have annual revenue of €750 million or more in the consolidated financial statements of the ultimate parent entity in at least two of the four fiscal years immediately preceding the tested fiscal year.[1497]

<u>Application of the top-up tax</u>

Top-up tax is due with respect to income in a jurisdiction if book income, subject to certain adjustments ("Globe income") in the jurisdiction is subject to an effective tax rate ("ETR") of less than 15 percent. The additional top-up tax may be collected first by the source country pursuant to a qualified domestic minimum top-up tax ("QDMTT"), second by the residence country of the MNE's ultimate parent entity pursuant to the income inclusion rule ("IIR"), third by the residence country of a lower-tier parent entity (also pursuant to the IIR), and finally by the residence country of any other affiliated entity pursuant to the so-called undertaxed profits rule ("UTPR").

<u>Globe income and the base of the top-up tax</u>

Globe income (or loss) in a country generally is the net income (or loss) determined for an entity in preparing consolidated financial statements of the ultimate parent entity.[1498] If Globe income in a country is subject to an ETR of less than 15 percent, then the Globe income is subject to a top-up tax.

The ETR for a jurisdiction is equal to the sum of the "adjusted covered taxes" paid in that jurisdiction divided by the net Globe income in that jurisdiction.[1499] Adjusted covered taxes are the current tax expenses that have accrued for purposes of calculating that year's financial accounting net income, adjusted for taxes on certain temporary differences between tax and financial reporting.[1500]

[1497] Art. 1.1.1 of the Model Rules. An MNE group (or here just MNE) means a collection of entities that are related through ownership or control such that the assets, liabilities, income, expenses, and cash flows of those entities are included in the consolidated financial statements of the ultimate parent entity with at least one entity (or permanent establishment) that is not located in the jurisdiction of the ultimate parent entity. Art. 1.1.1 and Art. 1.2.2 of the Model Rules. The ultimate parent entity generally is one that owns (directly or indirectly) a controlling interest in any other entity and in which no other entity owns a controlling interest. Art. 1.4.1 of the Model Rules.

[1498] Art. 3.1.2 of the Model Rules. Several adjustments are made. Art 3.2.1 of the Model Rules.

[1499] Art. 5.1.1 of the Model Rules.

[1500] Art. 4.1 of the Model Rules.

The base of the top-up tax ("excess profit") generally is Globe income[1501] less the substance-based income exclusion for the country.[1502] The substance-based income exclusion is five percent of (1) eligible payroll costs in the country and (2) the carrying value of eligible tangible assets in the country.[1503]

QDMTT

The primary right to tax income (including Globe income) arising in a jurisdiction is with the jurisdiction (the source country) itself. Thus, if in country X an MNE earns Globe income that is subject to an ETR of less than 15 percent, country X has priority in applying a top-up tax. The mechanism for applying that top-up tax (*i.e.*, a top-up tax on domestic income) is the QDMTT.

A natural question arises: why would country X choose to apply a new tax (the QDMTT) instead of simply changing its local corporate tax, whether by increasing the rate (to 15 percent) or expanding the base (to resemble Globe income more closely)? The answer is that the tax base for purposes of determining an MNE's ETR is generally greater than the tax base for purposes of determining the top-up tax. A 15-percent corporate tax that followed the Model Rules in determining its tax base would tend to collect more corporate tax than required under the top-up tax.[1504] In other words, the QDMTT represents the only way under Pillar Two for a country to collect in every case the minimum tax liability due with respect to Globe income arising in its jurisdiction while increasing its effective tax rate by as little as possible.

As described below, if a source country does not impose a QDMTT, the Model Rules allow other countries to collect any top-up tax due with respect to Globe income earned in the source country.

IIR

The secondary right to collect a top-up tax with respect to Globe income earned in a source country is with the jurisdiction of the MNE's ultimate parent entity.[1505] This top-up tax is known as the IIR. The mechanism is like other tax regimes ("CFC taxes") that require a parent entity to pay current tax on the income of CFCs, including Subpart F income and GILTI under U.S. law. In terms of ordering, QDMTTs come before CFC taxes, and CFC taxes come before IIRs (which all come before the UTPR, as discussed below).

[1501] "Globe" income is an acronym for Global Anti-Base Erosion income (officially, "GloBE" income).

[1502] Art. 5.2.3 of the Model Rules.

[1503] Art. 5.3 of the Model Rules. Initially, the substance-based income exclusion is set to be 10 percent for eligible payroll costs and eight percent for the carrying value of eligible tangible assets, both phased down to five percent over a 10-year transition period.

[1504] A 15-percent corporate tax imposed on only the base of the top-up tax would be treated in most cases as having an ETR of less than 15 percent.

[1505] Art. 2.1.1 to 2.1.3 of the Model Rules.

If the jurisdiction of the ultimate parent entity does not impose an IIR, the jurisdiction of an intermediate parent entity (*i.e.*, between the ultimate parent entity and the source country) is allowed to collect under their own IIRs any top-up tax due with respect to Globe income earned in the source country.[1506]

UTPR

The final mechanism providing for the collection of top-up tax is the UTPR. If the source country does not impose a QDMTT and no parent entity is in a jurisdiction imposing an IIR, but a top-up tax is due, then countries in which other MNE affiliates are located may collect the top-up tax under a UTPR. Those countries share the top-up tax according to the number of employees in each UTPR jurisdiction and the value of tangible assets in each UTPR jurisdiction.[1507]

ETR

The ETR on Globe income in a source country may depend on the treatment of certain incentives provided by the country. Grants are treated as additions to Globe income, whereas tax credits are treated as reductions to taxes paid for purposes of calculating the ETR. Certain refundable tax credits (*i.e.*, "qualified refundable tax credits" or "QRTCs"), however, are treated as grants and, therefore, increase Globe income rather than reduce taxes paid.[1508]

For example, consider an MNE in country X with Globe income of 100x, taxes of 20x, and tax credits of 6x. Before accounting for credits, the MNE has an ETR of 20 percent (20x/100x). Whether the MNE is subject to top-up tax depends on the treatment of the credits. If the tax credits are QRTCs, then the ETR is 18.9 percent (20x/106x), well above 15 percent. If the tax credits are not QRTCs, however, then the ETR is 14 percent (14x/100x) and the MNE is subject to top-up tax.

Digital services taxes

Overview

Digital services taxes ("DSTs") refer to unilateral attempts by countries to impose taxes on the revenue generated by the digital activity of (largely) foreign multinational companies operating within their jurisdiction. Often, companies who generate digital revenue across many jurisdictions do not maintain a physical presence in the countries in which they operate. DSTs

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[1506] The IIR has ordering rules to ensure that Globe income in a country is subject to top-up tax exactly once.

[1507] The formula is: UTPR percentage = (50 percent of number of employees in a UTPR jurisdiction / number of employees in all UTPR jurisdictions) + (50 percent of net book value of tangible assets in a UTPR jurisdiction / net book value of tangible assets in all UTPR jurisdictions). Thus, the allocation of UTPR liability is half by number of employees and half by net book value of tangible assets.

[1508] Art. 4.1.2(d) of the Model Rules. The Model Rules generally define QRTC as "a refundable tax credit designed in a way such that it must be paid as cash or available as cash equivalents within four years from when . . . [the MNE] satisfies the conditions for receiving the credit under the laws of the jurisdiction granting the credit."

are a mechanism for taxing the activity of companies who might otherwise fall out of the country's income tax base. DSTs can target a range of digital activities, including advertising, streaming, the operation of intermediary services (such as online marketplaces), and the collection and sale of user data. For example, the United Kingdom's DST imposes a two-percent tax on the revenue from online marketplaces, search engines, and social media platforms which derive value from United Kingdom users. Austria's DST imposes a five percent tax on revenues from digital advertisement services. Certain countries like Colombia have enacted laws that deem a foreign company to have a significant economic presence ("SEP") if they provide digital services to domestic users. Companies with SEP status are subject either to the country's income tax or to a tax on their revenues.

<u>DSTs and Pillar One</u>

One of the original goals of Pillar One was to stop the promulgation of DSTs. In October 2021, the OECD and the G-20 announced that the Inclusive Framework had agreed in principle to the proposed two-pillar solution to address the tax challenges arising from the current state of international taxation of MNEs. The statement included a moratorium on adoption or enforcement of unilateral measures. The signatories agreed that "[n]o newly enacted Digital Services Taxes or other relevant similar measures will be imposed on any company from [October 8, 2021] and until the earlier of [December 31, 2023] or the coming into force of the [Multilateral Convention on Pillar One]."[1509]

In addition, the statement included an Annex describing the planned implementation of the two pillars. Pillar One provides for the removal of unilateral measures such as DSTs and revises the principles governing profit allocation among related parties and the amount and kind of contact between a business and a country (*i.e.*, nexus) that is deemed sufficient to justify that country's taxation of that business.

In October 2023, the OECD published a consolidated draft of a proposed Multilateral Convention on Pillar One (the "MLC"), limited to implementation of Amount A.[1510] Under the terms of the Pillar One Blueprint, as well as all subsequent iterations of the terms of Pillar One, members of the Inclusive Framework agree to rescind existing, and forgo future, DSTs and other unilateral measures in return for international consensus regarding the proper allocation of taxing rights with respect to certain profits of the largest MNEs.[1511] Such allocation requires

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[1509] OECD, "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy" ("October 2021 Statement"), 2021, available at https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.htm.

[1510] The three documents published by the OECD on October 11, 2023, are "Multilateral Convention to Implement Amount A of Pillar One" ("MLC"), available at https://www.oecd.org/tax/beps/multilateral-convention-to-implement-amount-a-of-pillar-one.pdf; "Explanatory Statement to the Multilateral Convention to Implement Amount A of Pillar One," available at https://www.oecd.org/tax/beps/explanatory-statement-multilateral-convention-to-implement-amount-a-of-pillar-one.pdf; and "Understanding on the Application of Certainty for Amount A of Pillar One" ("Tax Certainty Understanding"), available at https://www.oecd.org/tax/beps/understanding-on-the-application-of-certainty-for-amount-a-of-pillar-one.pdf.

[1511] Pillar One Blueprint, pars. 9, 89, and 847.

determination of the residual profit that is allocated to market jurisdictions ("Amount A") and ceding taxing rights to market jurisdictions within a framework that ensures tax certainty for the affected firms within scope of the measure. In addition, Pillar One provides for a streamlined determination and allocation of profit from routine controlled transactions ("Amount B"). A jurisdiction joining the MLC may not enact or enforce a DST and if in violation of that prohibition, cannot receive any allocation of residual profits under Amount A.[1512]

The MLC includes a definition of DSTs and similar measures prohibited under Pillar One.[1513] Whether a tax is a DST or similar measure is determined by reference to criteria such as whether the tax is based on location of users or other market-based factors; is applicable only to nonresidents, either explicitly or in practice, because of revenue thresholds or other factors that insulate local business from such taxes; and is not within the scope of covered taxes in bilateral agreements intended to relieve double taxation. Value-added taxes, transaction taxes, and anti-abuse measures are generally not within the scope of the prohibited measures under the MLC.

The MLC enters into force only when ratified by 30 countries accounting for at least 60 percent of the ultimate parent entities of MNEs initially expected to be in scope for Amount A. Thus, the MLC cannot enter into force without ratification by the United States.[1514]

The MLC neither resolves how to ensure the rescission of DSTs nor how to preclude any new such measures. As stated above, the revocation or removal of the unilateral measures and DSTs enacted in several jurisdictions was a predicate to the agreement that resulted in the new taxing right proposed under Pillar One. However, as the likelihood of the MLC entering into force became more uncertain, various other countries began to consider the enactment of DSTs again. As of February 27, 2025, over 30 countries, including several large trading partners of the United States, have enacted DSTs, and several others have proposed legislation or announced an intention to implement DSTs.

On January 20, 2025, the President signed an Executive Order stating that the OECD global tax deal has no force or effect in the United States,[1515] followed the next day by a memorandum announcing that the United States would take action against countries enacting DSTs and other discriminatory taxes.[1516]

[1512] MLC, Article 39(1).

[1513] MLC, Article 39(2); see also MLC, Article 38 (Removal of Existing Measures) and Annex A (List of Existing Measures Subject to Removal).

[1514] MLC, Article 48 (Entry into Force) and Annex I. Ratifying jurisdictions must represent at least 600 points of the 1000 points available. Of the total 1000 points available, 463 points are allocated to the United States.

[1515] White House, *The Organization for Economic Cooperation and Development (OECD) Global Tax Deal (Global Tax Deal)*, January 20, 2025, available at https://www.whitehouse.gov/presidential-actions/2025/01/the-organization-for-economic-co-operation-and-development-oecd-global-tax-deal-global-tax-deal/.

[1516] White House, *Defending American Companies and Innovators From Overseas Extortion and Unfair Fines and Penalties*, February 21, 2025, available at https://www.whitehouse.gov/presidential-

Description of Proposal

The proposal adds a new section 899, "Enforcement of Remedies Against Unfair Foreign Taxes," to the Code. Under the proposal, the specified rate of tax that applies to an "applicable person" is increased by an "applicable number of percentage points." The specified rates of tax generally are:

(i) the 30-percent rate imposed on FDAP income, certain capital gains, and certain other types of U.S.-source income of a nonresident alien individual;[1517]

(ii) the individual income tax rates imposed on a nonresident alien individual subject to tax on ECI, but only to the extent imposed on gains and losses from the disposition of a United States real property interest;[1518]

(iii) the 30-percent rate imposed on FDAP income and certain other types of U.S.-source income of a foreign corporation;[1519]

(iv) the 21-percent corporate income tax imposed on a foreign corporation's ECI;[1520]

(v) the 30-percent rate imposed on divided equivalent amounts of a branch (*i.e.,* branch profits tax);[1521] and

(vi) the four-percent rate imposed on U.S.-source gross investment income of foreign private foundations.[1522]

However, if another rate of tax applies in lieu of such rate, such as pursuant to a treaty obligation of the United States, such other rate is increased by the applicable number of percentage points. The tax rate increase is the applicable number of percentage points in effect for the relevant discriminatory foreign country during the taxpayer's taxable year. If more than one applicable number of percentage points is in effect during the taxable year, the applicable number of percentage points is determined by using a weighted average, based on each applicable number of percentage points in effect during the taxable year and the number of days during which it was in effect. For purposes of determining the weighted average, the applicable

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actions/2025/02/defending-american-companies-and-innovators-from-overseas-extortion-and-unfair-fines-and-penalties/.

[1517] This refers to the 30-percent rate imposed under section 871(a)(1) and section 871(a)(2).

[1518] This refers to the individual income tax rates in section 1 imposed under section 871(b), but only to the extent imposed on gains and losses under section 897(a)(1)(A).

[1519] This refers to the 30-percent rate imposed under section 881(a).

[1520] This refers to the 21-percent rate imposed on income treated as ECI under section 882(a).

[1521] This refers to the tax imposed under section 884.

[1522] This refers to the four-percent tax rate imposed under section 4948.

number of percentage points is treated as zero for periods before the discriminatory foreign country's applicable date and after the taxpayer ceases to be an applicable person.

Furthermore, the proposal provides that the gross income exclusion in section 892(a), which exempts from taxation income of foreign governments received from certain investments in the United States and certain interests on deposits in U.S. banks shall be exempt from taxation, does not apply to any government (within the meaning of section 892) of a discriminatory foreign country.

The proposal also modifies the treatment of the BEAT with respect to certain corporations that are more than 50-percent owned (by vote or value), within the meaning of section 958(a), by certain other applicable persons. For those corporations, the BEAT is applied as if:

(i) the corporation has sufficient average annual gross receipts and a sufficient base erosion percentage to be an applicable taxpayer subject to the BEAT, provided the corporation meets the other requirements of an applicable taxpayer;[1523]

(ii) for purposes of calculating the base erosion minimum tax amount, modified taxable income is subject to a rate of 12.5 percent, and regular tax liability is reduced by all credits allowed under chapter 1 of the Code;

(iii) base erosion tax benefits attributable to base erosion payments are not reduced for amounts on which tax is imposed or withheld, and the base erosion percentage and base erosion payments are computed without regard to the exception for certain services in section 59A(d)(5); and

(iv) any amount (other than the purchase price of depreciable or amortizable property or inventory) that would have been a base erosion payment (as an amount paid or accrued to a related foreign party for which a deduction is allowable) but for the fact that the taxpayer capitalizes the amount is treated as if the amount had been deducted rather than capitalized for purposes of calculating the taxpayer's base erosion payments and base erosion tax benefits.

In addition, the proposal increases certain withholding taxes. Specifically, the proposal increases the following rates of tax by the applicable number of percentage points in effect on the date of payment or disposition:

(i) the 30-percent rate on payments of FDAP income, certain capital gains, and certain other types of U.S. source income to an applicable person;[1524]

[1523] For the other requirements for meeting the definition of an applicable taxpayer, see section 59(e)(1)(A).

[1524] This refers to the 30-percent rate specified in sections 1441(a) and 1442(a).

(ii) the 15-percent rate on dispositions of United States real property interests by an applicable person;[1525] and

(iii) the rate applicable in the case of certain dispositions, distributions, or other transactions involving or connected to an applicable person.[1526]

However, if another rate of tax applies in lieu of such statutory rate, such as pursuant to a treaty obligation of the United States, such other rate is increased by the applicable number of percentage points. No penalties or interest are imposed with respect to the failure to deduct or withhold under this rule before January 1, 2027, if the person required to deduct or withhold demonstrates to the satisfaction of the Secretary that they made best efforts to do so in a timely manner.

The applicable number of percentage points means, with respect to any foreign country that is not a discriminatory foreign country, zero, and with respect to any discriminatory foreign country, five percentage points during the first one-year period beginning on the applicable date, and such amount increased by an additional five percentage points for each one-year period thereafter. However, the rate increases are limited such that the rate cannot exceed the relevant statutory rate (determined without regard to any rate applicable in lieu of such statutory rate) by more than 20 percentage points. The applicable date means, with respect to any discriminatory foreign country, the first day of the first calendar year beginning on or after the latest of (i) 90 days after the date of enactment of the proposal; (ii) 180 days after the date of enactment of the unfair foreign tax that causes the country to be treated as a discriminatory foreign country, or (iii) the first date that an unfair foreign tax of the country begins to apply. If, on any day, the taxpayer is an applicable person with respect to more than one discriminatory foreign country, the highest applicable number of percentage points in effect applies. For purposes of the proposal, an "applicable person" means:

(i) any government (within the meaning of section 892) of a discriminatory foreign country;

(ii) any individual (other than a U.S. citizen or resident) who is a tax resident of a discriminatory foreign country;

(iii) any foreign corporation that is a tax resident of a discriminatory foreign country, other than U.S.-owned foreign corporations;[1527]

(iv) any private foundation (within the meaning of section 4948) created or organized in a discriminatory foreign country;

[1525] This refers to the 15-percent rate specified in section 1445(a).

[1526] This refers to the rate specified in section 1445(e).

[1527] U.S.-owned foreign corporations are as defined in section 904(h)(6).

(v) any foreign corporation, other than a publicly held corporation, that is more than 50 percent owned (by vote or value) directly or indirectly after applying certain attribution rules by other applicable persons;[1528]

(vi) any trust for which the majority of beneficial interests are held (directly or indirectly) by applicable persons; and

(vii) foreign partnerships, branches, and any other entity identified by the Secretary with respect to a discriminatory foreign country.

If a person who was an applicable person would have ceased to be an applicable person for a period of less than one year, they continue to be treated as an applicable person during that period.

The proposal defines "unfair foreign tax" to include a UTPR, DST, diverted profits tax, and, to the extent provided by the Secretary, an extraterritorial tax, discriminatory tax, or any other tax enacted with a public or stated purpose that the tax be economically born, directly or indirectly, disproportionately by U.S. persons. However, an unfair foreign tax does not include any tax that neither applies to any U.S. person (or trade or business thereof) nor to any foreign corporation (or trade or business thereof) that is a CFC and is more than 50 percent owned (by vote or value) directly or indirectly by U.S. persons.[1529]

The proposal defines "extraterritorial tax" to generally mean any tax imposed by a foreign country on a corporation (or the corporation's trade or business) that is determined by reference to the income or profits of any person (or the person's trade or business) by reason of such person being connected to the corporation through a chain of ownership (determined without regard to the ownership interests of any individual) other than as a result of the corporation having a direct or indirect ownership interest in such person.

The proposal defines "discriminatory tax" to generally mean any tax imposed by a foreign country if:

(i) the tax applies more than incidentally to items of income that would not be considered to be from sources, or effectively connected to a trade or business, within the foreign country;

(ii) the tax is imposed on a base other than net income and is not computed by permitting recovery of costs and expenses;

(iii) the tax is exclusively or predominantly applicable to nonresident individuals and foreign corporations or partnerships because of the application of revenue thresholds, exemptions, or exclusions for taxpayers subject to the foreign country's corporate income tax or other restrictions of scope that ensure that

[1528] Direct or indirect ownership after application of attribution rules is as specified in section 958(a).

[1529] Direct or indirect ownership after application of attribution rules is as specified in section 958(a).

substantially all residents supplying comparable goods or services are excluded from the tax; or

(iv) the tax is not treated as an income tax under the laws of the foreign country or is otherwise treated as outside the scope of any agreements that are in force between such country and one or more other jurisdictions for the avoidance of double taxation with respect to taxes on income.

However, except to the extent provided by the Secretary, an extraterritorial tax and a discriminatory tax do not include any generally applicable tax that constitutes:

(i) an income tax generally imposed on the citizens or residents of the foreign country, even if the computation of income includes payments that would be foreign source income;

(ii) an income tax that would otherwise be an unfair foreign tax solely because it is imposed on the income of nonresidents attributable to a trade or business in such foreign country;

(iii) an income tax that would otherwise be an unfair foreign tax solely because it is imposed on citizens or residents of such foreign country by reference to the income of a corporate subsidiary of such person;

(iv) a withholding tax or gross basis tax on any amount described in section 871(a)(1) or 881(a) (generally, FDAP income withholding), other than a withholding tax or gross basis tax imposed with respect to services performed by persons other than individuals;

(v) a value added tax, goods and services tax, sales tax, or other similar tax on consumption;

(vi) a tax imposed with respect to transactions on a per-unit or per-transaction basis;

(vii) a tax on real or personal property, an estate tax, gift tax, or other similar tax;

(viii) a tax that would otherwise be an extraterritorial tax or discriminatory tax solely by reason of consolidation or loss sharing rules, provided that the consolidation or loss sharing rules generally apply only with respect to income of tax residents of the foreign country; or

(ix) any other tax identified by the Secretary.

For purposes of the proposal, the term “discriminatory foreign country” means any foreign country that has unfair foreign taxes; “foreign country” includes foreign countries, political subdivisions thereof, and dependent territories or possessions of the country (but not any possession of the United States); and a “tax” includes any increase in tax, whether effectuated by an increase in the rate of tax or the base on which the tax is imposed, or by a denial of deductions, denial of credits, or other means.

The proposal instructs the Secretary to issue regulations or other guidance that are necessary and appropriate to carry out the purposes of new section 899, including to: (i) provide for adjustments to its application to prevent the avoidance of its purposes, including with respect to the application to branches, partnerships, and other entities; (ii) publish guidance quarterly listing the discriminatory foreign countries (and each country's applicable date); (iii) notify Congress of any changes to such list; (iv) exercise the authority to provide exceptions to the definitions of applicable person, extraterritorial tax, and discriminatory tax; and (v) prevent certain payments to a foreign related party that are treated as base erosion payments and base erosion tax benefits from being double counted in the denominator of the base erosion percentage for purposes of the BEAT.

Effective Date

The proposal is effective on the date of enactment.

The rate increases on FDAP income, ECI, the branch profits tax, and the excise tax on foreign private foundations and the modifications to the application of the BEAT apply to taxable years beginning after the later of (i) 90 days after the date of enactment of the proposal, (ii) 180 days after the date of enactment of the unfair foreign tax that causes such country to be treated as a discriminatory foreign country, and (iii) the first date that the unfair foreign tax of such country begins to apply; and before the last date on which the discriminatory foreign country imposes an unfair foreign tax. The rate increases on withholding tax apply with respect to a person for each calendar year beginning during the period that such person is an applicable person, provided that they do not apply if the foreign country is not listed as a discriminatory foreign country by the Secretary (or in the case of certain foreign corporations or trusts that are applicable persons because their owners or beneficiaries are applicable persons, if the discriminatory foreign country and its applicable date have not been so listed for 90 days).

DD. Reduction of Excise Tax on Firearms Silencers

Present Law

The National Firearms Act (the "NFA"),[1530] which is codified as chapter 53 of the Code, requires importers, manufacturers, and dealers in firearms to pay a special occupational tax and register with the Treasury, and also imposes excise taxes on the transfer and making of firearms.[1531] Generally, in order to engage in business, an importer or manufacturer of firearms is required to pay a special occupational tax of $1,000 for each year and for each place of business; a dealer of firearms is required to pay an special occupational tax of $500 for each year and for each place of business.[1532] However, persons who conduct businesses exclusively with, or on behalf of, the United States or any department or agency of the United States are generally exempt from the special occupational tax.[1533] Generally, importers, manufacturers, and dealers in firearms are required to register with the Secretary of the Treasury (the "Secretary") in each internal revenue district in which the business is carried on.[1534]

An excise tax of $200 is generally imposed on each firearm that is transferred ("transfer tax") or made ("making tax").[1535] However, a firearm may be transferred to the United States, or a department, independent establishment, or agency of the United States, without payment of the transfer tax.[1536] A firearm may also be transferred or made without payment of the transfer tax or making tax, respectively, if the firearm is transferred or made by or on behalf of a State, possession of the United States, any political subdivision, or any official police organization of a government entity engaged in criminal investigations.[1537] Further, a firearm registered to a person that is qualified under the NFA to engage in business as an importer, manufacturer, or dealer may be transferred without payment of transfer tax to any other person qualified to manufacture, import, or deal in that type of firearm.[1538] A manufacturer qualified under the NFA may also make the type of firearm which the manufacturer is qualified to manufacture without payment of the making tax.[1539]

[1530] Pub. L. No. 73-474.

[1531] Secs. 5801 *et seq.*

[1532] Sec. 5801(a).

[1533] Sec. 5851.

[1534] Sec. 5802.

[1535] Secs. 5811 and 5821.

[1536] Sec. 5852(a).

[1537] Sec. 5853.

[1538] Sec. 5852(d).

[1539] Sec. 5852(c).

Under the NFA, a "firearm" means (1) a shotgun having a barrel or barrels of less than 18 inches in length; (2) a weapon made from a shotgun if such weapon as modified has an overall length of less than 26 inches or a barrel or barrels of less than 18 inches in length; (3) a rifle having a barrel or barrels of less than 16 inches in length; (4) a weapon made from a rifle if such weapon as modified has an overall length of less than 26 inches or a barrel or barrels of less than 16 inches in length; (5) any other weapon;[1540] (6) a machine gun; (7) a silencer; and (8) a destructive device. The term "firearm" does not include an antique firearm or any device (other than a machine gun or destructive device) which, although designed as a weapon, the Secretary finds by reason of the date of its manufacture, value, design, and other characteristics is primarily a collector's item and is not likely to be used as a weapon.[1541]

Description of Proposal

Under the proposal, the transfer tax on silencers is reduced from $200 to $0 for each silencer transferred.

Effective Date

The proposal is effective for transfers after the date of enactment.

[1540] As defined in sec. 5845(e). The term "any other weapon" includes, for example, a weapon or device capable of being concealed on the person from which a shot can be discharged through the energy of an explosive and a pistol or revolver having a barrel with a smooth bore designed or redesigned to fire a fixed shotgun shell. The term does not include a pistol or a revolver having a rifled bore.

[1541] Sec. 5845(a).

EE. Limitation on Drawback of Taxes Paid with Respect to Substituted Merchandise

Present Law

In certain cases, importers may be eligible for a "drawback" of excise tax on certain products. A drawback is the refund of certain duties, taxes, and fees that are paid when a product is imported and refunded when the product is exported or destroyed.

"Substitution drawback" is one common type of drawback. Substitution drawback involves the refunds of certain duties, taxes, and fees that are paid upon importation and refunded when similar goods (usually merchandise having the same Harmonized Tariff Schedule code) are exported. Since 2008, substitution drawback has been allowed for similar types of imported and exported wine.[1542] As a result, some companies that both import and export wine have claimed drawbacks for duties, taxes, and fees paid on the imported wine based on their exports of wine of similar type and quality. Substitution drawback has been permitted even though exported wine is generally not subject to excise tax.[1543] This practice is referred to as "double drawback," because a company receives a refund of tax paid on the imported product, even though the imported product is not directly exported and the exported product is not subject to tax.

The Department of the Treasury and Customs and Border Protection promulgated a series of regulations in 2018 to stop the practice of double drawbacks by making exports that are not subject to excise tax ineligible for a drawback claim.[1544] These regulations were not limited to wine, but also covered other products, such as tobacco products, exports of which are generally not subject to tax.[1545] However, in August 2021, the U.S. Court of Appeals for the Federal Circuit in *National Association of Manufacturers v. Department of the Treasury* affirmed a lower court's ruling invalidating the regulations.[1546] As a result, U.S. companies that both import goods subject to excise tax and export similar goods not subject to excise tax, such as wine and tobacco, are allowed to continue to use double drawback to seek refunds of excise tax.

Description of Proposal

Under the proposal, for purposes of drawback of tax imposed under chapter 52 of the Code (tobacco products and related products), the amount of drawback granted under the Code or the Tariff Act of 1930 on the export or destruction of substituted merchandise may not exceed

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[1542] See *National Ass'n of Manufacturers v. Dep't of the Treasury*, 10 F.4th 1279 (Fed. Cir. 2021).

[1543] Sec. 5362.

[1544] 83 Fed. Reg. 64942, December 18, 2018.

[1545] *Ibid.*; see sec. 5704.

[1546] *National Ass'n of Manufacturers v. Dep't of the Treasury*, 10 F.4th 1279 (Fed. Cir. 2021).

the amount of taxes paid (and not returned by refund, credit, or drawback) on the substituted merchandise.

Effective Date

The proposal is effective for claims filed on or after July 1, 2026.

PART 2—REMOVING TAXPAYER BENEFITS FOR ILLEGAL IMMIGRANTS

A. Permitting Premium Tax Credit only for Certain Individuals

Present Law

In general

A refundable tax credit (the "premium assistance credit" or "premium tax credit") is provided for eligible individuals and families to subsidize the purchase of "qualified health plans," [1547] which are health insurance plans offered through an American Health Benefit Exchange ("Exchange") created by the Patient Protection and Affordable Care Act ("PPACA").[1548] In general, the Secretary makes advance payments with respect to the premium assistance credit during the year directly to the insurer, as discussed below.[1549] However, eligible individuals may instead pay their total health insurance premiums without advance payments and claim the credit for the taxable year on a Federal income tax return.

The premium assistance credit is generally available for individuals (single or joint filers) with household incomes between 100 percent and 400 percent of the Federal poverty level ("FPL") for the applicable family size.[1550] Household income is defined as the sum of (1) the individual's modified adjusted gross income ("AGI"), plus (2) the aggregate modified AGI of all other individuals taken into account in determining the individual's family size (but only if the other individuals are required to file tax returns for the taxable year).[1551] Modified AGI is defined as AGI increased by (1) any amount excluded from gross income for citizens or residents living abroad,[1552] (2) any tax-exempt interest received or accrued during the tax year, and (3) any portion of the individual's Social Security benefits not included in gross income.[1553] To be

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[1547] Sec. 36B. Qualified health plans generally must meet certain requirements. Secs. 1301 and 1302 of the Patient Protection and Affordable Care Act, 42 U.S.C. secs. 18021 and 18022.

[1548] Pub. L. No. 111-148, March 23, 2010. The PPACA was modified by the Health Care and Education Reconciliation Act of 2010 ("HCERA"), Pub. L. No. 111-152, Title I, sec. 1001, March 30, 2010. PPACA and HCERA are referred to collectively as the PPACA.

[1549] Sec. 1412 of the PPACA, 42 U.S.C sec. 18082.

[1550] Sec. 36B(c)(1). Federal poverty level refers to the most recently published poverty guidelines determined by the Secretary of Health and Human Services. Levels for 2025 are available at https://aspe hhs.gov/topics/poverty-economic-mobility/poverty-guidelines. Levels for previous years are available at https://aspe.hhs.gov/prior-hhs-poverty-guidelines-and-federal-register-references.

Currently, under sec. 36B(c)(1)(B), a taxpayer with household income less than 100 percent of FPL who is an alien lawfully present but is ineligible for Medicaid under title XIX of the Social Security Act by reason of such alien status may be treated as an applicable taxpayer with a household income equal to 100 percent of FPL.

[1551] Sec. 36B(d)(2).

[1552] Sec. 911.

[1553] Under section 86, only a portion of an individual's Social Security benefits is included in gross income.

eligible for the premium assistance credit, individuals who are married generally must file a joint return.[1554] Individuals who are listed as dependents on a return are not eligible for the premium assistance credit.

An individual who is eligible for minimum essential coverage from a source other than the individual insurance market generally is not eligible for the premium assistance credit.[1555] However, an individual who is offered minimum essential coverage under an employer-sponsored health plan may be eligible for the premium assistance credit if (1) the coverage is either unaffordable or does not provide minimum value, and (2) the individual declines the employer-offered coverage.[1556] Thus, an individual who enrolls in an employer-sponsored health plan generally is ineligible for the premium assistance credit even if the coverage is considered unaffordable or does not provide minimum value. Coverage is considered unaffordable if an employee's share of the premium for self-only coverage under the plan exceeds 9.02 percent (for 2025)[1557] of the employee's household income.[1558] Coverage is considered not to provide minimum value if the plan's share of total allowed costs of plan benefits is less than 60 percent of such costs.

Beginning in 2023, Treasury regulations provide that coverage affordability is determined separately for employees and family members of employees. Affordability is determined (1) for the employee, based on the employee's share of the premium for self-only coverage, and (2) for the family members of the employee, based on the employee's share of the premium for covering the employee and those family members (*i.e.*, family coverage).[1559]

Amount of credit

The premium assistance credit amount is generally the lower of (1) the premium for the qualified health plan in which the individual or family enrolls, and (2) the premium for the second lowest cost silver plan in the rating area where the individual resides,[1560] reduced by the

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[1554] Sec. 36B(c)(1)(C).

[1555] Sec. 36B(c)(2). Minimum essential coverage is defined in section 5000A(f).

[1556] Sec. 36B(c)(2)(C).

[1557] Rev. Proc. 2024-35, 2024-39 I.R.B. 638.

[1558] Employees and their family members who are provided a qualified small employer health reimbursement arrangement ("QSEHRA") that constitutes affordable coverage are not eligible for the premium assistance credit. Sec. 36B(c)(4)(C). The affordability determination for QSEHRAs is similar to the affordability determination for an employer-sponsored health plan. Specifically, a QSEHRA is treated as constituting affordable coverage for a month if an employee's share of the premium for self-only coverage under the second lowest cost silver plan offered in the relevant individual health insurance market does not exceed 9.02 percent (for 2025) of the employee's household income. A QSEHRA is defined in section 9831(d)(2).

[1559] T.D. 9968, 87 Fed. Reg. 61979, October 13, 2022.

[1560] A "silver plan" refers to the level of coverage provided by the health plan. Sec. 1302(d) of the PPACA, 42 U.S.C. sec. 18022. Most health plans sold through an Exchange are required to meet actuarial value ("AV") standards, among other requirements. AV is a summary measure of a plan's generosity, expressed as a individual's or family's share of premiums (the "applicable contribution percentage").[1561] The individual's or family's applicable contribution percentage is indexed so that the individual's or family's share of premiums rises if health coverage premium increases are greater than increases in income across the economy.[1562]

Table 3 shows an individual's or family's unindexed share of premiums applicable to taxable years prior to 2021.

Table 3.−Household's Share of Premiums[1563]
(Prior to 2021, unindexed)

Household income (expressed as a percent of FPL)	Initial percentage of household income*	Final percentage of household income
Less than 133%	2.0	2.0
133% up to 150%	3.0	4.0
150% up to 200%	4.0	6.3
200% up to 250%	6.3	8.05
250% up to 300%	8.05	9.5
300% up to 400%	9.5	9.5

*The initial percentage of household income corresponds to the bottom of the corresponding FPL range, and the final percentage of household income corresponds to the top of the corresponding FPL range.

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percentage of medical expenses estimated to be paid by the insurer for a standard population and set of allowed charges. Silver-level plans are designed to provide benefits that are actuarially equivalent to 70 percent of the full AV of the benefits provided under the plan. The premium assistance credit looks to the second lowest cost plan of all the silver plans available in the relevant rating area.

An individual's "rating area" refers to the geographical unit within the State where the individual resides. Insurers may vary individual market premiums based on rating areas, among other factors. See sec. 1201 of the PPACA, 42 U.S.C. sec. 300gg.

[1561] Sec. 36B(b). The amount of the premium assistance credit is determined on a monthly basis, and the amount of the credit for a year is the sum of the monthly amounts.

[1562] Sec. 36B(b)(3)(ii). In addition, beginning with calendar year 2019, this indexing incorporates an additional factor under which the applicable contribution percentage is subject to an additional adjustment to account for increases in premium growth over increases in the consumer price index if the aggregate amount of premium tax credits and cost-sharing reductions under section 1402 of the PPACA, 42 U.S.C sec. 18071, for the preceding calendar year exceeds an amount equal to 0.504 percent of the gross domestic product for the preceding calendar year. Sec. 36B(b)(3)(ii)(II)-(III).

[1563] Sec. 36B(b)(3)(A)(i).

For taxable year beginning in 2021 or 2022, Section 9661 of the American Rescue Plan Act of 2021 ("ARP")[1564] temporarily reduced or eliminated an individual's or family's share of premiums used in determining the amount of the premium assistance credit and eliminated the indexing of these amounts. The premium assistance credit was also made available to taxpayers with incomes above the limitation of 400 percent of FPL for the applicable family size. For taxable years beginning after 2022, section 12001 of the Inflation Reduction Act of 2022 ("IRA")[1565] extends through 2025 the reduction or elimination of an individual's or family's share of premiums used in determining the amount of the premium assistance credit and the elimination of indexing. The provision also extends through 2025 the rule making the premium assistance credit available to taxpayers with incomes above the limitation of 400 percent of FPL for the applicable family size.

Table 4 below shows an individual's or family's share of premiums applicable for 2021 through 2025. The share of premiums is a certain percentage of household income, ranging from 0.0 percent of household income (up to 150 percent of FPL) up to 8.5 percent of household income, determined on a sliding scale in a linear manner.

Table 4.−Household's Share of Premiums[1566]
(for 2021 through 2025)

Household income (expressed as a percent of FPL)	Initial percentage of household income*	Final percentage of household income
Less than 150%	0.0	0.0
150% up to 200%	0.0	2.0
200% up to 250%	2.0	4.0
250% up to 300%	4.0	6.0
300% up to 400%	6.0	8.5
400% and higher	8.5	8.5

*The initial percentage of household income corresponds to the bottom of the corresponding FPL range, and the final percentage of household income corresponds to the top of the corresponding FPL range.

[1564] Pub. L. No. 117-2, March 11, 2021.

[1565] Pub. L. No. 117-169, August 16, 2022.

[1566] Sec. 36B(b)(3)(A)(iii).

Advance payments of the premium assistance credit

As part of the process of enrollment in a qualified health plan through an Exchange, an individual may apply and be approved for advance payments with respect to a premium assistance credit ("advance payments").[1567] The individual must provide information on income, family size, changes in marital or family status or income, and citizenship or lawful presence status.[1568] Eligibility for advance payments is generally based on the individual's income for the taxable year ending two years prior to the enrollment period. The Exchange process is administered by the Department of Health and Human Services ("HHS") through the Centers for Medicare and Medicaid Services ("CMS") and includes a system through which information provided by the individual is verified using information from the Internal Revenue Service ("IRS") and certain other sources.[1569] If an individual is approved for advance payments, the Secretary pays the advance amounts on a monthly basis directly to the issuer of the health plan in which the individual is enrolled. The individual then pays to the issuer of the plan the difference between the advance payment amount and the total premium charged for the plan.

An individual on whose behalf advance payments of the premium assistance credit for a taxable year are made is required to file an income tax return to reconcile the advance payments with the premium assistance credit that the individual is allowed for the taxable year.[1570]

If the advance payments of the premium assistance credit exceed the amount of credit that the individual is allowed, the excess ("excess advance payments") is treated as an additional tax liability on the individual's income tax return for the taxable year (is "recaptured"), subject to

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[1567] Secs. 1411 and 1412 of the PPACA, 42 U.S.C. secs. 18081 and 18082. Under section 1402 of the PPACA, 42 U.S.C sec. 18071, certain individuals eligible for advance premium assistance payments also are eligible for a reduction in their share of medical costs, such as deductibles and copays, under the plan, referred to as reduced cost-sharing. Eligibility for reduced cost-sharing is also determined as part of the Exchange enrollment process. HHS is responsible for rules relating to Exchanges and the eligibility determination process.

[1568] Under section 1312(f)(3) of the PPACA, 42 U.S.C. sec. 18032(f)(3), an individual may not enroll in a qualified health plan through an Exchange if the individual is not a citizen or national of the United States or an alien lawfully present in the United States. Thus, such an individual is not eligible for the premium assistance credit.

[1569] Under section 6103, returns and return information are confidential and may not be disclosed, except as authorized by the Code, by IRS employees, other Federal employees, State employees, and certain others having access to such information. Under section 6103(l)(21), upon written request of the Secretary of HHS, the IRS is permitted to disclose certain return information for use in determining an individual's eligibility for advance premium assistance payments, reduced cost-sharing, or certain other State health subsidy programs, including a State Medicaid program under title XIX of the Social Security Act, 42 U.S.C. secs. 1396w-1 through 1396w-5, a State's Children's Health Insurance Program under title XXI of the Social Security Act, 42 U.S.C. secs. 1397aa through 1397mm, and a Basic Health Program under section 1331 of the PPACA, 42 U.S.C. sec. 18051.

[1570] Treas. Reg. sec. 1.6011-8. Under section 36B(f)(3), an Exchange is required to report to the IRS and to the individual the months during a year for which the individual was covered by a qualified health plan purchased through the Exchange; the level of coverage; the name, address, and Taxpayer Identification Number ("TIN") of the primary insured and each individual covered by the policy; the total premiums paid by the individual; and, if applicable, advance premium assistance payments made on behalf of the individual. This information is reported on Form 1095-A.

a limit on the amount of additional liability in some cases.[1571] For an individual with household income below 400 percent of FPL, recapture for a taxable year generally is limited to a specific dollar amount (the "applicable dollar amount") as shown in Table 5 below.

Table 5.−Recapture Limits (for 2025)[1572]

Household Income (expressed as a percent of FPL)	Applicable Dollar Amount (filing status of Single)	Applicable Dollar Amount (any other filing status)
Less than 200%	$375	$750
At least 200% but less than 300%	$975	$1,950
At least 300% but less than 400%	$1,625	$3,250

If the advance payments of the premium assistance credit for a taxable year are less than the amount of the credit that the individual is allowed, the additional credit amount is allowed as a refundable credit when the individual files an income tax return for the year.

An individual may not enroll in a qualified health plan through an Exchange if the individual is not a citizen or national of the United States or an alien lawfully present in the United States.[1573] Thus, such an individual is not eligible for the premium assistance credit. In addition, an individual who is not lawfully present is not eligible for cost-sharing reductions[1574] or enrollment in a basic health program.[1575]

<u>Description of Proposal</u>

The proposal provides that a lawfully-present alien is eligible for the premium assistance credit only if the individual is, and is reasonably expected to be for the entire period of enrollment for which the credit is claimed:

1. An alien who is lawfully admitted for permanent residence under the Immigration and Nationality Act.[1576]

[1571] Sec. 36B(f)(2). For a taxable year beginning in 2020, ARP temporarily removed the requirement that excess advance payments are treated as an additional tax liability on the individual's income tax return for the taxable year. Accordingly, for 2020, no excess advance payment was subject to recapture. Sec. 36B(f)(2)(B)(iii).

[1572] Rev. Proc. 2024-40, 2024-45 I.R.B. 1100. The applicable dollar amounts are indexed to reflect cost-of-living increases, with the amount of any increase rounded down to the next lowest multiple of $50.

[1573] Sec. 1312(f)(3) of the PPACA, 42 U.S.C. sec. 18032(f)(3).

[1574] Sec. 1402(e)(1) of the PPACA, 42 U.S.C. sec. 18071(e)(1).

[1575] Sec. 1331(e)(1) of the PPACA, 42. U.S.C. sec. 18051(e)(1).

[1576] 8 U.S.C. sec. 1101 *et seq*.

2. An alien who is a citizen or national of the Republic of Cuba who is a beneficiary of an approved petition under section 203(a) of the Immigration and Nationality Act and who meets all eligibility requirements for an immigrant visa but for whom such a visa is not immediately available.[1577]

3. An individual who lawfully resides in the United States in accordance with a Compact of Free Association.[1578]

In addition, the proposal makes several conforming amendments to the PPACA to extend the same treatment of the categories of aliens listed above for purposes of the verification of information as part of Exchange enrollment, eligibility for cost-sharing reductions, and eligibility for a basic health program.

The proposal provides that the Secretary of the Treasury and the Secretary of HHS may prescribe such rules and other guidance as may be necessary or appropriate to carry out the amendments made by this proposal.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2026, and for plan years beginning on or after January 1, 2027.

[1577] The individual must also be physically present in the United States pursuant to a grant of parole in furtherance of the commitment of the United States to the minimum level of annual legal migration of Cuban nationals to the United States specified in the U.S.-Cuba Joint Communiquè on Migration, done at New York September 9, 1994, and reaffirmed in the Cuba-United States: Joint Statement on Normalization of Migration, Building on the Agreement of September 9, 1994, done at New York May 2, 1995.

[1578] Referred to in section 402(b)(2)(G) of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, August 22, 1996.

B. Certain Aliens Treated as Ineligible for Premium Tax Credit

Present Law

For a description of the premium tax credit, see Section A of this Part.

Description of Proposal

The proposal adds an additional subparagraph to section 36B(e)(2) that provides that, notwithstanding the previous subparagraph (described in Section A of this Part), a lawfully-present alien is eligible for the premium assistance credit only if the individual is not, and is reasonably expected not to be for the entire period of enrollment for which the credit is claimed:

1. an alien granted or with a pending application for asylum under the Immigration and Nationality Act;[1579]

2. an alien granted parole under the Immigration and Nationality Act;[1580]

3. an alien granted temporary protected status under the Immigration and Nationality Act;[1581]

4. an alien granted deferred action or deferred enforced departure; or

5. an alien granted withholding of removal under the Immigration and Nationality Act.[1582]

The proposal provides that the Secretary of the Treasury and the Secretary of HHS may prescribe such rules and other guidance as may be necessary or appropriate to carry out the amendments made by this proposal.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2026.

[1579] Sec. 208 of the Immigration and Nationality Act, 8 U.S.C. sec. 1158.

[1580] Secs. 212(d)(5) or 236(a)(2)(B) of the Immigration and Nationality Act, 8 U.S.C. secs. 1182(d)(5) or 1226(a)(2)(B).

[1581] Sec. 244 of the Immigration and Nationality Act, 8 U.S.C. sec. 1254A.

[1582] Sec. 241(b)(3) of the Immigration and Nationality Act, 8 U.S.C. sec. 1231(b)(3).

C. Disallowing Premium Tax Credit During Periods of Medicaid Ineligibility Due to Alien Status

Present Law

For a general description of the premium tax credit and the Exchanges, see Section A of this Part.

In order to be treated as an "applicable taxpayer" and therefore eligible for the premium tax credit, a taxpayer's household income generally must be between 100 percent and 400 percent of FPL for the applicable family size. However, under a special rule, a lawfully-present alien with a household income less than 100 percent of FPL who is ineligible for Medicaid under title XIX of the Social Security Act by reason of such alien status may be treated as an applicable taxpayer with a household income equal to 100 percent of FPL ("special rule for lawfully-present aliens").[1583]

Description of Proposal

The proposal repeals the special rule for lawfully-present aliens, so that lawfully-present aliens with household incomes less than 100 percent FPL who are ineligible for Medicaid by reason of alien status are no longer eligible for premium tax credits. In addition, the proposal makes a conforming amendment to the basic health program standards so that basic health programs are not required to cover such individuals.

The proposal provides that the Secretary of the Treasury and the Secretary of HHS may prescribe such rules and other guidance as may be necessary or appropriate to carry out the amendments made by this proposal.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

[1583] Sec. 36B(c)(1)(B).

D. Excise Tax on Remittance Transfers

Present Law

Remittance transactions generally involve a sender of payments in one country, a recipient in a separate country, financial intermediaries in both countries, and a payment system used by such intermediaries. The laws applicable to remittance transfers are generally found in Titles 12 and 15 of the United States Code and the regulations thereunder. Under such provisions, a "remittance transfer" is defined as the electronic transfer of funds requested by a sender located in any State, territory, or possession of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or any political subdivision of any of the foregoing[1584] to a designated recipient that is initiated by a remittance transfer provider, whether or not the sender holds an account with the remittance transfer provider and whether or not the remittance transfer is also an electronic fund transfer.[1585] Such term does not include certain small-value transactions.[1586] A "remittance transfer provider" means any person or financial institution that provides remittance transfers for a consumer in the normal course of its business, whether or not the consumer holds an account with such person or financial institution.[1587] The term "sender" means a consumer who requests a remittance provider to send a remittance transfer for the consumer to a designated recipient.[1588] Finally, a "designated recipient" means any person located in a foreign country and identified by the sender as the authorized recipient of a remittance transfer to be made by a remittance transfer provider.[1589]

Description of Proposal

Under the proposal, a five-percent excise tax is generally imposed on any remittance transfer, to be paid by the sender (to a designated recipient) with respect to such transfer. If the sender does not make the excise tax payment at the time of the remittance transfer, and to the extent that such tax is not collected from the sender, the tax is owed by the remittance transfer provider. The excise tax is collected by the remittance transfer provider and remitted to the Secretary of the Treasury (the "Secretary"). For purposes of the proposal, the terms "remittance

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[1584] 15 U.S.C. sec. 1693a(11).

[1585] 15 U.S.C. sec. 1693o-1(g)(2)(A). In general, the term "electronic fund transfer" means any transfer of funds, other than a transaction originated by check, draft, or similar paper instrument, which is initiated through an electronic terminal, telephonic instrument, or computer or magnetic tape so as to order, instruct, or authorize a financial institution to debit or credit an account. 41 U.S.C. sec. 1693a(7).

[1586] 15 U.S.C. sec. 1693o-1(g)(2)(B).

[1587] 15 U.S.C. sec. 1693o-1(g)(3).

[1588] 15 U.S.C. sec. 1693o-1(g)(4). The regulations further state that a "sender" means a consumer in a State who primarily for personal, family, or household purposes requests a remittance transfer provider to send a remittance transfer to a designated recipient. 12 CFR sec. 1005.30(g).

[1589] 15 U.S.C. sec. 1693o-1(g)(1).

transfer," "remittance transfer provider," "designated recipient," and "sender" have the same meanings as such terms are used in section 1693o-1 of Title 15 of the United States Code.

The proposal provides two means for an exception from the excise tax for remittance transfers sent by citizens and nationals of the United States. First, the excise tax on a remittance transfer does not apply if a "verified United States sender" makes such remittance transfer through a "qualified remittance transfer provider." A "qualified remittance transfer provider" is any remittance transfer provider which enters into a written agreement with the Secretary pursuant to which such provider agrees to verify the status of a sender as a citizen or national of the United States. A "verified United States sender" is any sender who is verified by a qualified remittance transfer provider as being a citizen or national of the United States pursuant to such an agreement. The proposal applies the anti-conduit rules of section 7701(l) to remittance transfers.[1590]

The second way that a citizen or national of the United States may be relieved of the excise tax is via a tax credit. For senders who are citizens or nationals of the United States but who incur and pay the excise tax (as a result of, for instance, not sending a remittance transfer via a qualified remittance transfer provider), the proposal allows for a refundable income tax credit in the amount of the aggregate excise taxes paid by such sender on remittance transfers during the taxable year. In order to claim such credit, a taxpayer must include his or her social security number on his or her tax return for the relevant taxable year[1591] and must demonstrate, to the satisfaction of the Secretary, that: (1) he or she is a citizen or national of the United States; and (2) the excise tax with respect to which the tax credit is determined was paid by him or her and is with respect to a remittance transfer for which he or she provided certification and certain information to the remittance transfer provider.

The proposal requires that each remittance transfer provider submit a return (at such time as the Secretary may provide) setting forth: (1) in the case of remittance transfers sent by a verified United States sender via a qualified remittance transfer provider, the aggregate number and value of such remittance transfers; (2) in the case of senders who have certified to the remittance transfer provider an intent to claim the credit with respect to the excise tax on a remittance transfer, (a) the name, address, and social security number of the senders, (b) the amount of excise tax paid by such senders, and (c) the amount of excise tax remitted by the remittance transfer provider to the Secretary with respect to such remittance transfers; and (3) with respect to all other remittance transfers, (a) the aggregate amount of excise tax paid with respect to such transfers, and (b) the aggregate amount of tax remitted by the remittance transfer

[1590] Section 7701(l) provides that the Secretary may prescribe regulations recharacterizing any multiple-party financing transaction as a transaction directly among any two or more of such parties where the Secretary determines that such recharacterization is appropriate to prevent avoidance of any tax imposed by Title 26. The proposal states that for purposes of section 7701(l) with respect to any multiple-party arrangements involving the sender, a remittance transfer shall be treated as a financing transaction.

[1591] For purposes of the proposal, the term "social security number" has the same meaning as such term is given in section 24(h)(7), as amended. For a description of these requirements, see the description of *Section 110004, Extension of increased child tax credit and temporary enhancement*. For married individuals, rules similar to the rules of section 32(d) shall apply.

provider to the Secretary with respect to such transfers. Such returns shall be considered information returns.

Each person required to make a return shall furnish to each person whose has certified an intent to claim the credit a written statement with: (1) the name and address of the information contact of the required reporting person; and (2) the information provided to the Secretary with respect to such claim. Such returns shall be considered payee statements.

Effective Date

The excise tax is effective for transfers made after December 31, 2025. The tax credit available to senders that are United States citizens applies to taxable years ending after December 31, 2025.

E. Social Security Number Requirement for American Opportunity and Lifetime Learning Credits

Present Law

American Opportunity Tax Credit

The American Opportunity Tax Credit is a credit of up to $2,500 per eligible student per year for qualified tuition and related expenses paid for each of the first four years of the student's post-secondary education in a degree or certificate program. The amount of the credit is 100 percent of the first $2,000 of qualified tuition and related expenses, and 25 percent of the next $2,000 of qualified tuition and related expenses.

Qualified tuition and related expenses generally include tuition, fees, and course materials required for enrollment or attendance of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer at an eligible institution. They do not include student activity fees, other fees and expenses unrelated to an individual's academic course of instruction, or expenses with respect to a course of education involving sports, games, or hobbies that is not part of the individual's degree program. In addition, an eligible student must be carrying at least half the normal work load for the course of study being pursued.

The credit that a taxpayer may otherwise claim is phased out ratably for taxpayers with modified adjusted gross income ("modified AGI") between $80,000 and $90,000 ($160,000 and $180,000 for married taxpayers filing a joint return).[1592] The credit may be claimed against a taxpayer's alternative minimum tax liability.

Forty percent of a taxpayer's otherwise allowable modified credit is refundable.

Lifetime Learning Credit

The Lifetime Learning Credit is a nonrefundable tax credit against Federal income tax equal to 20 percent of qualified tuition and related expenses[1593] paid by the taxpayer during the taxable year for education furnished during any academic period beginning in that year to the taxpayer, the taxpayer's spouse, or any dependents.[1594] Up to $10,000 of qualified tuition and related expenses per taxpayer return may be taken into account for the Lifetime Learning Credit (with the result that the maximum credit that a taxpayer is allowed is $2,000).

[1592] Modified AGI for this purpose (and for the same purpose under the Lifetime Learning Credit, described next) is AGI increased by any amount excluded from gross income under section 911, 931, or 933. Sec. 25A(d)(2).

[1593] Qualified tuition and related expenses for the lifetime learning credit generally include tuition and fees required for enrollment or attendance of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer at an eligible institution. However, unlike the American opportunity credit, they do not include course materials.

[1594] Sec. 25A. The Lifetime Learning credit may be claimed against a taxpayer's AMT liability.

A taxpayer is allowed the Lifetime Learning credit for an unlimited number of taxable years, and the $2,000 maximum amount of the Lifetime Learning Credit allowable to a taxpayer in a year does not vary based on the number of students in the taxpayer's family. The Lifetime Learning Credit amount that is otherwise allowed is phased out ratably for taxpayers with modified AGI between $80,000 and $90,000 ($160,000 and $180,000 for married individuals filing a joint return).

A taxpayer is allowed the Lifetime Learning Credit with respect to a student who is not the taxpayer or the taxpayer's spouse (for example, in a situation in which the student is the taxpayer's child) only if the taxpayer claims the student as a dependent for the taxable year for which the credit is claimed. If a student is claimed as a dependent by a parent or another taxpayer, the student is not allowed the Lifetime Learning Credit for that taxable year on the student's own tax return. If a parent or another taxpayer claims a student as a dependent, any qualified tuition and related expenses paid by the student are treated as paid by the parent (or other taxpayer) for purposes of the provision.

A taxpayer is allowed the Lifetime Learning Credit for a taxable year with respect to one or more students even if the taxpayer also is allowed the American Opportunity Tax Credit for that same taxable year with respect to other students. If, for a taxable year, a taxpayer claims an American Opportunity Tax Credit with respect to a student, the Lifetime Learning credit is not allowed with respect to that same student for that year (although the Lifetime Learning Credit may be allowed with respect to that same student for other taxable years).

Identification requirements

A taxpayer (for example, a parent) is allowed the American Opportunity Tax Credit or Lifetime Learning Credit in a taxable year in respect of qualified tuition and related expenses for the education of an individual (for example, for the education of a student who is a dependent child of the taxpayer parent) only if (among other identification requirements) the taxpayer includes on the taxpayer's tax return for that year the taxpayer identification number ("TIN") of that individual.

A taxpayer is allowed the American Opportunity Tax Credit only if the taxpayer includes the employer identification number ("EIN") of any institution to which qualified tuition and related expenses were paid.

Description of Proposal

The proposal replaces the present law TIN requirement with a rule that a taxpayer is allowed the American Opportunity Tax Credit or Lifetime Learning Credit in a taxable year only if the taxpayer includes on the tax return for that year (1) the taxpayer's social security number, (2) in the case of a joint return, the taxpayer's spouse's social security number, and (3) in respect of qualified tuition and related expenses of an individual other than the taxpayer or the taxpayer's spouse (for example, a dependent child of a taxpayer parent), that individual's name and social security number.

The proposal clarifies that under the present law EIN requirement, the taxpayer is allowed the American Opportunity Tax Credit for a taxable year only if the taxpayer includes on the taxpayer's tax return for that year the EIN of any institution to which the taxpayer paid qualified tuition and related expenses taken into account in computing the credit.

For purposes of this rule, the term "social security number" means (under the definition of section 24(h)(7)) a social security number that is issued by the Social Security Administration, before the due date for the tax return, to a citizen of the United States or pursuant to subclause (I) (or that portion of subclause (III) that relates to subclause (I)) of section 205(c)(2)(B)(i) of the Social Security Act.

The proposal provides that a taxpayer's omission of a required correct social security number or EIN is a mathematical or clerical error for purposes of section 6213.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

PART 3—PREVENTING FRAUD, WASTE, AND ABUSE

A. Requiring Exchange Verification of Eligibility for Health Plan

Present Law

In general

A refundable tax credit (the "premium assistance credit" or "premium tax credit") is provided for eligible individuals and families to subsidize the purchase of "qualified health plans," [1595] which are health insurance plans offered through an American Health Benefit Exchange ("Exchange") created by the Patient Protection and Affordable Care Act ("PPACA").[1596] In general, the Secretary makes advance payments with respect to the premium assistance credit during the year directly to the insurer, as discussed below.[1597] However, eligible individuals may instead pay their total health insurance premiums without advance payments and claim the credit for the taxable year on a Federal income tax return.

The premium assistance credit is generally available for individuals (single or joint filers) with household incomes between 100 percent and 400 percent of the Federal poverty level ("FPL") for the applicable family size.[1598] Household income is defined as the sum of (1) the individual's modified adjusted gross income ("AGI"), plus (2) the aggregate modified AGI of all other individuals taken into account in determining the individual's family size (but only if the other individuals are required to file tax returns for the taxable year).[1599] Modified AGI is defined as AGI increased by (1) any amount excluded from gross income for citizens or residents living abroad,[1600] (2) any tax-exempt interest received or accrued during the tax year, and (3) any portion of the individual's Social Security benefits not included in gross income.[1601] To be

[1595] Sec. 36B. Qualified health plans generally must meet certain requirements. Secs. 1301 and 1302 of the Patient Protection and Affordable Care Act, 42 U.S.C. secs. 18021 and 18022.

[1596] Pub. L. No. 111-148, March 23, 2010. The PPACA was modified by the Health Care and Education Reconciliation Act of 2010 ("HCERA"), Pub. L. No. 111-152, Title I, sec. 1001, March 30, 2010. PPACA and HCERA are referred to collectively as the PPACA.

[1597] Sec. 1412 of the PPACA, 42 U.S.C sec. 18082.

[1598] Sec. 36B(c)(1). Federal poverty level refers to the most recently published poverty guidelines determined by the Secretary of Health and Human Services. Levels for 2025 are available at https://aspe hhs.gov/topics/poverty-economic-mobility/poverty-guidelines. Levels for previous years are available at https://aspe.hhs.gov/prior-hhs-poverty-guidelines-and-federal-register-references.

Currently, under sec. 36B(c)(1)(B), a taxpayer with household income less than 100 percent of FPL who is an alien lawfully present but is ineligible for Medicaid under title XIX of the Social Security Act by reason of such alien status may be treated as an applicable taxpayer with a household income equal to 100 percent of FPL.

[1599] Sec. 36B(d)(2).

[1600] Sec. 911.

[1601] Under section 86, only a portion of an individual's Social Security benefits is included in gross income.

eligible for the premium assistance credit, individuals who are married generally must file a joint return.[1602] Individuals who are listed as dependents on a return are not eligible for the premium assistance credit.

An individual who is eligible for minimum essential coverage from a source other than the individual insurance market generally is not eligible for the premium assistance credit.[1603] However, an individual who is offered minimum essential coverage under an employer-sponsored health plan may be eligible for the premium assistance credit if (1) the coverage is either unaffordable or does not provide minimum value, and (2) the individual declines the employer-offered coverage.[1604] Thus, an individual who enrolls in an employer-sponsored health plan generally is ineligible for the premium assistance credit even if the coverage is considered unaffordable or does not provide minimum value. Coverage is considered unaffordable if an employee's share of the premium for self-only coverage under the plan exceeds 9.02 percent (for 2025)[1605] of the employee's household income.[1606] Coverage is considered not to provide minimum value if the plan's share of total allowed costs of plan benefits is less than 60 percent of such costs.

Beginning in 2023, Treasury regulations provide that coverage affordability is determined separately for employees and family members of employees. Affordability is determined (1) for the employee, based on the employee's share of the premium for self-only coverage, and (2) for the family members of the employee, based on the employee's share of the premium for covering the employee and those family members (*i.e.*, family coverage).[1607]

Amount of credit

The premium assistance credit amount is generally the lower of (1) the premium for the qualified health plan in which the individual or family enrolls, and (2) the premium for the second lowest cost silver plan in the rating area where the individual resides,[1608] reduced by the

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[1602] Sec. 36B(c)(1)(C).

[1603] Sec. 36B(c)(2). Minimum essential coverage is defined in section 5000A(f).

[1604] Sec. 36B(c)(2)(C).

[1605] Rev. Proc. 2024-35, 2024-39 I.R.B. 638.

[1606] Employees and their family members who are provided a qualified small employer health reimbursement arrangement ("QSEHRA") that constitutes affordable coverage are not eligible for the premium assistance credit. Sec. 36B(c)(4)(C). The affordability determination for QSEHRAs is similar to the affordability determination for an employer-sponsored health plan. Specifically, a QSEHRA is treated as constituting affordable coverage for a month if an employee's share of the premium for self-only coverage under the second lowest cost silver plan offered in the relevant individual health insurance market does not exceed 9.02 percent (for 2025) of the employee's household income. A QSEHRA is defined in section 9831(d)(2).

[1607] T.D. 9968, 87 Fed. Reg. 61979, October 13, 2022.

[1608] A "silver plan" refers to the level of coverage provided by the health plan. Sec. 1302(d) of the PPACA, 42 U.S.C. sec. 18022. Most health plans sold through an Exchange are required to meet actuarial value ("AV") standards, among other requirements. AV is a summary measure of a plan's generosity, expressed as a individual's or family's share of premiums (the "applicable contribution percentage").[1609] The individual's or family's applicable contribution percentage is indexed so that the individual's or family's share of premiums rises if health coverage premium increases are greater than increases in income across the economy.[1610]

Table 6 shows an individual's or family's unindexed share of premiums applicable to taxable years prior to 2021.

Table 6.−Household's Share of Premiums[1611]
(Prior to 2021, unindexed)

Household income (expressed as a percent of FPL)	Initial percentage of household income*	Final percentage of household income
Less than 133%	2.0	2.0
133% up to 150%	3.0	4.0
150% up to 200%	4.0	6.3
200% up to 250%	6.3	8.05
250% up to 300%	8.05	9.5
300% up to 400%	9.5	9.5

*The initial percentage of household income corresponds to the bottom of the corresponding FPL range, and the final percentage of household income corresponds to the top of the corresponding FPL range.

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percentage of medical expenses estimated to be paid by the insurer for a standard population and set of allowed charges. Silver-level plans are designed to provide benefits that are actuarially equivalent to 70 percent of the full AV of the benefits provided under the plan. The premium assistance credit looks to the second lowest cost plan of all the silver plans available in the relevant rating area.

An individual's "rating area" refers to the geographical unit within the State where the individual resides. Insurers may vary individual market premiums based on rating areas, among other factors. See sec. 1201 of the PPACA, 42 U.S.C. sec. 300gg.

[1609] Sec. 36B(b). The amount of the premium assistance credit is determined on a monthly basis, and the amount of the credit for a year is the sum of the monthly amounts.

[1610] Sec. 36B(b)(3)(ii). In addition, beginning with calendar year 2019, this indexing incorporates an additional factor under which the applicable contribution percentage is subject to an additional adjustment to account for increases in premium growth over increases in the consumer price index if the aggregate amount of premium tax credits and cost-sharing reductions under section 1402 of the PPACA, 42 U.S.C sec. 18071, for the preceding calendar year exceeds an amount equal to 0.504 percent of the gross domestic product for the preceding calendar year. Sec. 36B(b)(3)(ii)(II)-(III).

[1611] Sec. 36B(b)(3)(A)(i).

For taxable year beginning in 2021 or 2022, Section 9661 of the American Rescue Plan Act of 2021 ("ARP")[1612] temporarily reduced or eliminated an individual's or family's share of premiums used in determining the amount of the premium assistance credit and eliminated the indexing of these amounts. The premium assistance credit was also made available to taxpayers with incomes above the limitation of 400 percent of FPL for the applicable family size. For taxable years beginning after 2022, section 12001 of the Inflation Reduction Act of 2022 ("IRA")[1613] extends through 2025 the reduction or elimination of an individual's or family's share of premiums used in determining the amount of the premium assistance credit and the elimination of indexing. The provision also extends through 2025 the rule making the premium assistance credit available to taxpayers with incomes above the limitation of 400 percent of FPL for the applicable family size.

Table 7 below shows an individual's or family's share of premiums applicable for 2021 through 2025. The share of premiums is a certain percentage of household income, ranging from 0.0 percent of household income (up to 150 percent of FPL) up to 8.5 percent of household income, determined on a sliding scale in a linear manner.

Table 7.−Household's Share of Premiums[1614]
(for 2021 through 2025)

Household income (expressed as a percent of FPL)	Initial percentage of household income*	Final percentage of household income
Less than 150%	0.0	0.0
150% up to 200%	0.0	2.0
200% up to 250%	2.0	4.0
250% up to 300%	4.0	6.0
300% up to 400%	6.0	8.5
400% and higher	8.5	8.5

*The initial percentage of household income corresponds to the bottom of the corresponding FPL range, and the final percentage of household income corresponds to the top of the corresponding FPL range.

[1612] Pub. L. No. 117-2, March 11, 2021.

[1613] Pub. L. No. 117-169, August 16, 2022.

[1614] Sec. 36B(b)(3)(A)(iii).

Advance payments of the premium assistance credit

As part of the process of enrollment in a qualified health plan through an Exchange, an individual may apply and be approved for advance payments with respect to a premium assistance credit ("advance payments").[1615] The individual must provide information on income, family size, changes in marital or family status or income, and citizenship or lawful presence status.[1616] Eligibility for advance payments is generally based on the individual's income for the taxable year ending two years prior to the enrollment period. The Exchange process is administered by the Department of Health and Human Services ("HHS") through the Centers for Medicare and Medicaid Services ("CMS") and includes a system through which information provided by the individual is verified using information from the Internal Revenue Service ("IRS") and certain other sources.[1617] If an individual is approved for advance payments, the Secretary pays the advance amounts on a monthly basis directly to the issuer of the health plan in which the individual is enrolled. The individual then pays to the issuer of the plan the difference between the advance payment amount and the total premium charged for the plan.

An individual on whose behalf advance payments of the premium assistance credit for a taxable year are made is required to file an income tax return to reconcile the advance payments with the premium assistance credit that the individual is allowed for the taxable year.[1618]

If the advance payments of the premium assistance credit exceed the amount of credit that the individual is allowed, the excess ("excess advance payments") is treated as an additional tax liability on the individual's income tax return for the taxable year (is "recaptured"), subject to

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[1615] Secs. 1411 and 1412 of the PPACA, 42 U.S.C. secs. 18081 and 18082. Under section 1402 of the PPACA, 42 U.S.C sec. 18071, certain individuals eligible for advance premium assistance payments also are eligible for a reduction in their share of medical costs, such as deductibles and copays, under the plan, referred to as reduced cost-sharing. Eligibility for reduced cost-sharing is also determined as part of the Exchange enrollment process. HHS is responsible for rules relating to Exchanges and the eligibility determination process.

[1616] Under section 1312(f)(3) of the PPACA, 42 U.S.C. sec. 18032(f)(3), an individual may not enroll in a qualified health plan through an Exchange if the individual is not a citizen or national of the United States or an alien lawfully present in the United States. Thus, such an individual is not eligible for the premium assistance credit.

[1617] Under section 6103, returns and return information are confidential and may not be disclosed, except as authorized by the Code, by IRS employees, other Federal employees, State employees, and certain others having access to such information. Under section 6103(l)(21), upon written request of the Secretary of HHS, the IRS is permitted to disclose certain return information for use in determining an individual's eligibility for advance premium assistance payments, reduced cost-sharing, or certain other State health subsidy programs, including a State Medicaid program under title XIX of the Social Security Act, 42 U.S.C. secs. 1396w-1 through 1396w-5, a State's Children's Health Insurance Program under title XXI of the Social Security Act, 42 U.S.C. secs. 1397aa through 1397mm, and a Basic Health Program under section 1331 of the PPACA, 42 U.S.C. sec. 18051.

[1618] Treas. Reg. sec. 1.6011-8. Under section 36B(f)(3), an Exchange is required to report to the IRS and to the individual the months during a year for which the individual was covered by a qualified health plan purchased through the Exchange; the level of coverage; the name, address, and TIN of the primary insured and each individual covered by the policy; the total premiums paid by the individual; and, if applicable, advance premium assistance payments made on behalf of the individual. This information is reported on Form 1095-A.

a limit on the amount of additional liability in some cases.[1619] For an individual with household income below 400 percent of FPL, recapture for a taxable year generally is limited to a specific dollar amount (the "applicable dollar amount") as shown in Table 8 below.

Table 8.−Recapture Limits (for 2025)[1620]

Household Income (expressed as a percent of FPL)	Applicable Dollar Amount (filing status of Single)	Applicable Dollar Amount (any other filing status)
Less than 200%	$375	$750
At least 200% but less than 300%	$975	$1,950
At least 300% but less than 400%	$1,625	$3,250

If the advance payments of the premium assistance credit for a taxable year are less than the amount of the credit that the individual is allowed, the additional credit amount is allowed as a refundable credit when the individual files an income tax return for the year.

<u>Enrolling in a qualified health plan on an Exchange</u>

An individual may not enroll in a qualified health plan through an Exchange if the individual is not a citizen or national of the United States or an alien lawfully present in the United States, or is incarcerated.[1621] As part of the process of enrollment in a qualified health plan through an Exchange, an individual may apply and be approved for advance payments of the premium assistance credit.[1622] Eligibility for advance payments of the premium assistance credit is generally based on the individual's income for the taxable year ending two years prior to the enrollment period.

HHS administers the Exchange process and facilitates a system through which information provided by the individual is verified using information from the IRS and other sources. The individual must provide information on income, residence, family size, changes in marital or family status or income, and citizenship or lawful presence status. The Exchange also seeks to determine whether an individual has minimum essential coverage from another source

[1619] Sec. 36B(f)(2). For a taxable year beginning in 2020, ARP temporarily removed the requirement that excess advance payments are treated as an additional tax liability on the individual's income tax return for the taxable year. Accordingly, for 2020, no excess advance payment was subject to recapture. Sec. 36B(f)(2)(B)(iii).

[1620] Rev. Proc. 2024-40, 2024-45 I.R.B. 1100. The applicable dollar amounts are indexed to reflect cost-of-living increases, with the amount of any increase rounded down to the next lowest multiple of $50.

[1621] Sec. 1312(f)(1) and (3) of the PPACA, 42 U.S.C. sec. 18032(f)(1) and (3).

[1622] Secs. 1411 and 1412 of the PPACA, 42 U.S.C. secs. 18081 and 18082. Under section 1402 of the PPACA, 42 U.S.C sec. 18071, certain individuals eligible for advance premium assistance payments also are eligible for a reduction in their share of medical costs, such as deductibles and copays, under the plan, referred to as reduced cost-sharing or cost-sharing reductions. HHS is responsible for rules relating to eligibility for this assistance, and eligibility for reduced cost-sharing is also determined as part of the Exchange enrollment process.

and whether an individual who has previously claimed advance payment of the premium tax credit has failed to file a tax return and reconcile advance payments with premium tax credits for that year.[1623] Exchanges are generally required to provide applicants 90 days to address discrepancies, [1624] during which time applicants are eligible to enroll in qualified health plans and benefit from advance payment of the premium tax credit. Under certain circumstances, Exchanges may re-enroll current enrollees in qualified health plans without any action being taken by the enrollee ("passive reenrollment").[1625]

Finally, Exchanges also verify eligibility for special enrollment periods.[1626] HHS has applied different standards for pre-enrollment verification for special enrollment periods over time.[1627] Currently, the Federal Exchange operated by HHS conducts pre-enrollment verification related to only the special enrollment period related to the loss of health coverage.[1628]

Description of Proposal

The proposal provides that the premium assistance credit (and thus advance payment) is unavailable for months of coverage under a qualified health plan for which an individual's (1) eligibility for enrollment (including new open enrollments, each annual re-enrollment, and enrollment through a special enrollment period), (2) any advance payment of the premium tax credit (if the individual has applied for advance payment),[1629] or (3) any cost-sharing reductions has not been verified by the Exchange, including during the required 90-day period during which an applicant may address any discrepancies in his or her application. Therefore, the proposal prohibits passive reenrollment.

In order to accomplish this verification, the Exchange must use applicable enrollment information that is provided or verified by the applicant. The Exchange is not permitted to rely on information provided entirely by other sources. For purposes of this proposal, applicable

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[1623] 45 C.F.R. sec. 155.305(f)(4).

[1624] Sec. 1411(e)(3), (4) of the PPACA.

[1625] See CMS, Guidance on Annual Redetermination and Re-enrollment for Marketplace Coverage for 2024 and Later Years, August 14, 2023, available at https://www.cms.gov/files/document/guidance-annual-redetermination-and-re-enrollment-marketplace-coverage-2024-and-later-years.pdf.

[1626] See 45 C.F.R. sec 155.420(g).

[1627] See Patient Protection and Affordable Care Act; Market Stabilization, Final Rule, 82 Fed. Reg. 18346, April 18, 2017; Patient Protection and Affordable Care Act; HHS Notice of Benefit and Payment Parameters for 2023, Final Rule, 87 Fed. Reg. 27208, May 6, 2022; Patient Protection and Affordable Care Act; Marketplace Integrity and Affordability, Proposed Rule, 90 Fed. Reg. 12942, March 19, 2025.

[1628] 45 C.F.R. sec. 155.420(g).

[1629] If the individual has not applied for or been determined eligible for advance payment, the individual remains eligible to file a claim for the premium tax credit at the time the individual files an income tax return for the relevant year. Assuming an individual's eligibility is otherwise verified, a month of coverage fails to be a coverage month for purposes of the premium tax credit only if the individual receives advance payment before eligibility for advance payment is verified by the Exchange.

enrollment information must at least include an affirmation from the applicant, to the extent relevant to the individual's application, regarding: (1) income; (3) any immigration status; (4) any health coverage status; (5) place of residence; (6) family size; and (7) any other information the Secretary (in consultation with the Secretary of HHS) determines as necessary to verify the individual's eligibility.

The proposal also provides, that, in the case of a month of coverage that begins before verification has been completed, such month is treated as a coverage month for purposes of the premium tax credit (and therefore for advance payment of the premium tax credit, if advance payment is made available), if the Exchange later completes verification for that month using applicable enrollment information provided by the applicant.[1630]

Additionally, the proposal provides that no month of coverage qualifies as a coverage month for purposes of the premium tax credit if the Exchange is not verifying that applicants have reconciled advance payments of the premium tax credit with the premium assistance credit that the same individual was allowed for a taxable year, if applicable, pursuant to regulations proposed by CMS in 2025,[1631] effectively codifying these proposed regulations for purposes of premium tax credit eligibility.

Finally, in order for individuals to be eligible for the premium assistance credit, the proposal requires Exchanges to establish a pre-enrollment verification process for individuals enrolled through the Exchange. The pre-enrollment verification process must allow individuals to verify with the Exchange their eligibility for enrollment, advance payment, or reduced cost-sharing for the subsequent plan year starting on August 1 of the immediately preceding year.

The proposal provides that the Secretary of the Treasury and the Secretary of HHS may prescribe such rules and other guidance as may be necessary or appropriate to carry out the amendments made by this proposal.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2027.

[1630] HHS has provided for enrollment to be "pended" for periods during which eligibility remains unverified. See 82 Fed. Reg. 18346; CMS, *Special Enrollment Period Pre-Enrollment Verification (SEPV): Review* (December 2017), available at https://www.cms.gov/marketplace/technical-assistance-resources/sepv-review.pdf.

[1631] Patient Protection and Affordable Care Act; Marketplace Integrity and Affordability, Proposed Rule, 90 Fed. Reg. 12942, amending 45 C.F.R. sec. 155.305(f)(4).

B. Disallowing Premium Tax Credit in Case of Certain Coverage Enrolled in During Special Enrollment Period

Present Law

Enrollment in a qualified health plan and special enrollment periods

For a general description of the premium tax credit and the Exchanges, see Section A of this Part.

Generally, an individual may enroll in a qualified health plan through an Exchange during the annual open enrollment period.[1632] An Exchange also must provide for special enrollment periods during which an individual may enroll in a qualified health plan or change enrollment in a qualified health plan if the individual experiences certain life events, including losing health coverage, getting married, or having a baby.[1633]

In 2021, HHS announced the creation of a monthly special enrollment period for individuals with projected annual household income no greater than 150 percent of FPL.[1634] The special enrollment period is available at the option of the Exchange. Because of the temporary reduction or elimination of an individual's or family's share of premiums through 2025, all individuals eligible for this special enrollment period currently are able to enroll in plans for which their share of the monthly premium is zero.[1635]

Description of Proposal

The proposal provides that any plan for which an individual enrolled through a special enrollment period provided on the basis of (1) expected income as a percentage of the poverty line (or such other amount) as specified by the Secretary of HHS; and (2) not provided in connection with the occurrence of an event or change in circumstances specified by the Secretary of HHS, is not plan for which premium assistance is available.

Thus, the proposal makes the premium assistance credit (and advance payment of the premium assistance credit) unavailable related to the specific plan through which an individual has enrolled using the monthly special enrollment period available for individuals with projected

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[1632] Sec. 1311 of the PPACA, 42 U.S.C. 13031.

[1633] 45 C.F.R. sec. 155.420.

[1634] Patient Protection and Affordable Care Act; Updating Payment Parameters, Section 1332 Waiver Implementing Regulations, and Improving Health Insurance Markets for 2022 and Beyond, Final Rule, 86 Fed. Reg. 53412, September 27, 2021; 45 C.F.R. 155.420(d)(16).

[1635] Originally, the special enrollment period was available only during periods when the individual's applicable percentage for purposes of calculating the premium assistance amount, as defined in section 36B(b)(3)(A), was set at zero, but HHS amended the regulation in 2024 to eliminate this requirement. Patient Protection and Affordable Care Act, HHS Notice of Benefit and Payment Parameters for 2025; Updating Section 1332 Waiver Public Notice Procedures; Medicaid; Consumer Operated and Oriented Plan (CO-OP) Program; and Basic Health Program, Final Rule, 89 Fed. Reg. 26218, April 15, 2024.

annual household income no greater than 150 percent of FPL.[1636] The proposal affects no other special enrollment periods currently specified in HHS regulations.

The proposal provides that the Secretaries of the Treasury and HHS may may each prescribe such rules and other guidance as may be necessary or appropriate to carry out this proposal, including by proceeding through interim final or temporary regulations.

Effective Date

The proposal is effective for plans enrolled in during calendar months beginning after the third calendar month ending after the date of enactment. The proposal does not affect plans enrolled in before that date.

[1636] The proposal does not affect other individuals who enroll in any particular plan through an Exchange, only those individuals that enroll through the specified special enrollment period.

C. Eliminating Limitation on Recapture of Advance Payment of Premium Tax Credit

Present Law

For a general description of the premium tax credit and the Exchanges, see Section A of this Part.

If an individual's advance payments of the premium assistance credit exceed the amount of credit that the individual is allowed, the excess advance payments is treated as an additional tax liability on the individual's income tax return for the taxable year (is "recaptured"), subject to a limit on the amount of additional liability in some cases.[1637] For an individual with household income below 400 percent of FPL, recapture for a taxable year generally is limited to a specific dollar amount (the "applicable dollar amount") as shown in Table 9 below.

Table 9.−Recapture Limits (for 2025)[1638]

Household Income (expressed as a percent of FPL)	Applicable Dollar Amount (filing status of Single)	Applicable Dollar Amount (any other filing status)
Less than 200%	$375	$750
At least 200% but less than 300%	$975	$1,950
At least 300% but less than 400%	$1,625	$3,250

Description of Proposal

The proposal provides that, for an individual with household income below 400 percent of FPL, liability for the excess advance payments is no longer limited, so that all excess advance payments are subject to recapture.

The proposal provides that the Secretary of the Treasury and the Secretary of HHS may prescribe such rules and other guidance as may be necessary or appropriate to carry out the amendments made by this proposal.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2025.

[1637] Sec. 36B(f)(2). For a taxable year beginning in 2020, ARP temporarily removed the requirement that excess advance payments are treated as an additional tax liability on the individual's income tax return for the taxable year. Accordingly, for 2020, no excess advance payment was subject to recapture. Sec. 36B(f)(2)(B)(iii).

[1638] Rev. Proc. 2024-40, 2024-45 I.R.B. 1100. The applicable dollar amounts are indexed to reflect cost-of-living increases, with the amount of any increase rounded down to the next lowest multiple of $50.

D. Enforcement Provisions with Respect to COVID-related Employee Retention Credits

Present Law

An eligible employer was entitled to claim a refundable employee retention tax credit ("ERTC") against applicable employment taxes for the second, third and fourth calendar quarters in 2020 and the first, second and third quarters of 2021 in an amount equal to a percentage of the qualified wages with respect to each employee of such employer for such calendar quarter. The percentage is 50 percent of qualified wages paid after March 12, 2020, and before January 1, 2021, and 70 percent of qualified wages for calendar quarters beginning after December 31, 2020, and before October 1, 2022, subject to a maximum amount of wages per employee. Although originally enacted in 2020, the credit was further modified by subsequent legislation enacted in 2020, 2021, and 2022, including the retroactive termination of the credit for wages paid on or after October 1, 2021, other than in the case of a recovery startup business.[1639]

If for any calendar quarter the amount of the credit exceeds the applicable employment taxes imposed on the eligible employer, reduced by certain other credits, the excess is treated as a refundable overpayment. Claiming the ERTC on an employment tax return as originally filed can either reduce the eligible employer's employment tax due, or if it exceeds the amount of such tax, give rise to a refund. An eligible employer may claim the employee retention credit on an amended employment tax return (Form 941-X) if the employer did not claim (or seeks to correct) the credit on its original employment tax return.

An employment tax return filed by April 15 for any quarter ending within a calendar year preceding April 15 is considered filed as of April 15, regardless of the quarter to which the return relates.[1640] To claim a refund with respect to a quarter within tax year 2020, an amended employment tax return was due by April 15, 2024; for tax year 2021, an amended return was due by April 15, 2025. Under ARPA, the statute of limitations for assessment of any amount attributable to an ERTC is extended from three years to five years for calendar quarters beginning after June 30, 2021, and before January 1, 2022.[1641]

[1639] The amount of qualified wages per employee that may be taken into account in calculating the credit is increased from $10,000 per employee for all calendar quarters beginning in 2020 to $10,000 per employee per calendar quarter for calendar quarters beginning after December 31, 2020. See Coronavirus Aid, Relief, and Economic Security (CARES) Act, Pub. L. No. 116-136, sec. 2301; Taxpayer Certainty and Disaster Relief Act of 2020, Pub. L. No. 116-260, secs. 206 and 207; American Rescue Plan Act ("ARPA"), Pub. L. No. 117-2, secs. 9651 (codifying the credit in Code sec. 3134) and 80604; and Infrastructure and Jobs Act, Pub. L. No. 117-58. sec. 80604 (retroactively terminating the credit for the fourth quarter of 2021 except in the case of recovery start-up businesses).

[1640] Sec. 6501(b)(2).

[1641] See sec 3134(l), which provides that, notwithstanding section 6501, the limitation on the time period for the assessment of any amount attributable to the ERTC shall not expire before the date that is 5 years after the later of— ''(1) the date on which the original return which includes the calendar quarter with respect to which such credit is determined is filed, or "(2) the date on which such return is treated as filed under section 6501(b)(2)." A similar waiver of the limitations period is provided for the paid sick leave credit. Sec. 3131(f)(6).

Since observing a significant increase in the numbers and amounts of ERTC claims in mid-2023, the IRS has taken steps to closely review such claims, published guidance for determining one's eligibility and how to amend or withdraw claims.[1642] Those measures included a voluntary disclosure program for ineligible taxpayers that had claimed and received the credit and seek to pay back the credit, under which a taxpayer would be required to pay 80 percent of the credit received and disclose information about the advisers that led the taxpayer to make the original claim, which has since ended.[1643]

Potential penalties

Present law includes obligatory disclosure by certain promoters of tax shelter or abusive transactions and imposes assessable penalties on persons who fail to comply with such due diligence and disclosure requirements.[1644] One such penalty is based on aiding and abetting the understatement of tax liability, if the person knows that an understatement of the tax liability of another person would result.[1645] Other promoter penalties are related to failure to disclose particular information with respect to a reportable transaction (generally, a transaction that the Treasury Secretary determines has the potential for tax avoidance or evasion), and require material advisors of reportable transactions to keep lists of advisees, subject to a penalty for failure.[1646]

To deter taxpayers who may take aggressive positions on refund claims, a separate penalty is imposed equal to 20 percent of the amount by which the claimed income tax refund exceeds the amount due under the Code. This penalty is not applicable to excessive refund claims for employment taxes. The penalty may apply to excessive income tax refund claims if a taxpayer presents an entirely new theory late in the audit, or as a result of a marketed tax strategy such as the abusive transactions that lead to the shelter penalties, even if the refund claim is denied. Although reasonable cause may result in a waiver of the penalty, any transaction that lacks economic substance is deemed to be without reasonable cause.[1647] There is an anti-stacking rule, i.e., if a portion of the excessive refund is subject to another penalty or addition to tax, only one of the two penalties may apply to that amount.

[1642] See, https://www.irs.gov/coronavirus/employee-retention-credit.

[1643] See IRS Announcement 2024-3, https://www.irs.gov/pub/irs-drop/a-24-03.pdf.

[1644] See sections 6111 and 6112 and the regulations thereunder with respect to reporting requirements.

[1645] Sec. 6701. See also IRM, 20.1.6.14.1 (10-13-2021), Activities Subject to the Penalty, October 13, 2021. "A tax advisor would not be subject to this penalty for suggesting to a client an aggressive but supportable filing position even though that position was later rejected by the courts and even though the client was subjected to the substantial understatement penalty. However, if the advisor suggested a position which the advisor knew could not be supported on any reasonable basis under the law, the penalty would apply."

[1646] See secs. 6700 through 6708 for promoter penalties for failure to comply with the reporting obligations. Sec. 6671 provides rules for application of assessable penalties, including that assessable penalties are payable on notice and demand (sec. 6671(a)).

[1647] Sec. 6676.

Paid tax return preparers are subject to a penalty of $500 for each failure to comply with due diligence requirements relating to the filing status and amount of certain credits with respect to a taxpayer's return or claim for refund.[1648]

Description of Proposal

The proposal adds a concept of ERTC promoter to expand the scope of existing penalties to address conduct taking place since enactment of ERTC to the present, as well as prospective conduct. The proposal bars allowance of refunds claimed after January 31, 2024. It also coordinates and extends limitations periods for certain corrective action by the IRS. In addition, regulatory authority is provided.

Definition of ERTC promoter and related penalties

An ERTC promoter is any person that provides aid, assistance, or advice with respect to an affidavit, refund, claim or other document relating to an ERTC[1649] or to eligibility or to the calculation of the amount of the credit, if the person meets certain materiality or gross receipts tests. For purposes of present-law disclosure and other requirements as well as penalties relating to reportable and listed transactions,[1650] an employee retention tax credit (whether or not the taxpayer claims the credit) is treated as a listed transaction as well as a reportable transaction with respect to an ERTC promoter that provides any aid, assistance or advice with respect to the credit, and the ERTC promoter is treated as a material advisor. As a result, ERTC promoters are subject to certain assessable promoter penalties, including enhanced penalties in certain cases.[1651]

ERTC promoter tests

Under the materiality standard, a person is treated as an ERTC promoter if the person charges or receives a fee which is based on the amount of the refund or credit only if the aggregate gross receipts of such person for aid, assistance, and advice with respect to the person's taxable year in which the person provided the assistance or the preceding taxable year with respect to all ERTC documents[1652] exceeds 20 percent of such person's gross receipts for such taxable year.

[1648] Sec. 6695(g). This is treated as an assessable penalty.

[1649] References in the proposal to the ERTC include the ERTC (under both section 3134 of the Code and section 2301 of the CARES Act).

[1650] Secs. 6111, 6112, 6707, and 6708.

[1651] E.g., the penalty for aiding or abetting an understatement of tax liability in section 6701. Assessable penalties are payable on notice and demand, and not subject to the restrictions on assessment found in section 6213(a). Sec. 6671(a).

[1652] An ERTC document is any return, affidavit, claim, or other document related to the ERTC, including any document related to eligibility for, or the calculation or determination of any amount directly related to the ERTC.

The gross receipts test is met if either (1) the aggregate gross receipts for the relevant year from such aid, assistance, and advice exceeds half of the person's gross receipts for the relevant year, or (2) both (i) the aggregate gross receipts for the relevant year from such aid exceeds 20 percent of the person's gross receipts for the relevant year and (ii) the person's aggregate gross receipts[1653] from such aid exceeds $500,000. An ERTC promoter does not include a certified professional employer organization (PEO).

Promoter penalties applicable to an ERTC promoter

In addition to adding a definition of ERTC promoter, the proposal increases the potential penalty under section 6701 to the greater of $200,000 ($10,000 in the case of an ERTC promoter that is a natural person) or 75 percent of the gross income of the ERTC promoter from providing aid, assistance, or advice with respect to a return or claim for ERTC refund or a document relating to the return or claim. The expanded penalty under section 6701 is retroactive to apply to actions taken since the ERTC was enacted.

The proposal also specifies that an ERTC promoter must comply with due diligence requirements[1654] with respect to a taxpayer's eligibility for (or the amount of) an employee retention tax credit and imposes a $1,000 penalty for each failure to comply. This amount is treated as an assessable penalty. In addition, if the ERTC promoter does not comply with these due diligence requirements, the proposal treats the "knows or has reason to know" standard as satisfied for purposes of imposing the penalty for aiding and abetting understatement of a tax liability after the date of enactment.

The standards for determining applicability of the promoter penalties are not to be construed to create any inference with respect to any aid, assistance, or advice provided by any ERTC promoter on or before the date of the enactment of the Act (or with respect to any other aid, assistance, or advice to which the proposal does not apply). Similarly, the requirement to file disclosures or maintain such lists shall not be construed to create any inference with respect to whether an ERTC is (absent the rule of this proposal that treats it as such) treated as a reportable or listed transaction with respect to an ERTC promoter.

Under a transition rule, the requirement for an ERTC promoter to file disclosures or maintain lists with respect to aid, assistance, or advice provided before the date of enactment does not require filing before 90 days after the date of enactment. However, if a party would be required to maintain such lists and reporting without regard to this proposal, the return or list is not treated as required (with respect to such aid, assistance, or advice) by reason of this proposal.

[1653] For purposes of determining aggregate gross receipts, an aggregation rule provides that all persons treated as a single employer under section 52(a) or (b) are treated as one person. A rule for short taxable years applies.

[1654] The due diligence requirements for ERTC promoters are required to be similar to the due diligence requirements of section 6695(g), and apply with respect to documents that constitute, or relate to, a return or claim for refund.

Denial of refund claims not filed on or before January 31, 2024.

No credit or refund of the ERTC is allowed after date of enactment unless such claim for such refund or credit was filed on or before January 31, 2024. To the extent that such claims were later amended to reduce otherwise excessive claims, the amended claim is considered to be part of the timely submitted original claim.

Statute of limitations extension

The proposal extends the statute of limitations on assessment for the ERTC to six years after the latest of: (1) the date on which the original return for the relevant calendar quarter is filed, (2) the date on which the return is treated as filed under present-law statute of limitations rules,[1655] or (3) the date on which the claim for credit or refund with respect to the ERTC is made.

Effective Date

The proposals described above are generally effective as of date of enactment, except as follows:

The proposed penalty changes are generally effective for aid, assistance, or advice provided after March 12, 2020.

The proposal requiring verification and due diligence is effective for aid, assistance, or advice provided after the date of enactment.

No credit or refund of the ERTC is permitted after date of enactment except with respect to claims for such credit submitted on or before January 31, 2024.

The extension of the statute of limitations on assessment is effective for assessments made after the date of enactment.

[1655] Sec. 6501.

E. Earned Income Tax Credit Reforms

Present Law

Earned income tax credit

Low- and moderate-income workers may be eligible for the refundable earned income tax credit ("EITC"). The amount of the EITC is based on the presence and number of qualifying children in the worker's family, filing status, AGI, and earned income.[1656]

The EITC generally equals a specified percentage of earned income.[1657] Earned income for this purpose cannot exceed a maximum dollar amount, known as the earned income amount. The maximum EITC amount applies over a certain income range and then diminishes to zero over a specified phaseout range. For a taxpayer with earned income (or AGI, if greater) in excess of the beginning of the phaseout range, the maximum EITC amount is reduced by the phaseout percentage multiplied by the amount of earned income (or AGI, if greater) in excess of the beginning of the phaseout range. For a taxpayer with earned income (or AGI, if greater) in excess of the end of the phaseout range, no credit is allowed. The specified percentage, maximum dollar amount, and phaseout percentage and range vary with filing status and number of children. Four separate percentage schedules apply: one for taxpayers with no qualifying children, one for taxpayers with one qualifying child, one for taxpayers with two qualifying children, and one for taxpayers with three or more qualifying children.[1658]

Table 10 below shows amounts of the EITC and determinants of those amounts by number of qualifying children for joint filers and other individuals for 2025.

[1656] Sec. 32.

[1657] Sec. 32(a), (b). Earned income is generally the sum of wages, salaries, tips, and other taxable employee compensation plus net self-employment earnings. Sec. 32(c)(2).

[1658] Sec. 32(b). All income thresholds are indexed for inflation annually.

Table 10.–2025 EITC Schedule[1659]

	Credit percentage	Earned income amount	Maximum credit	Phaseout range (single, head of household)	Phaseout range (joint filers)	Phaseout percentage
No qualifying children	7.65	$8,490	$649	$10,620 - $19,104	$17,730 - $26,214	7.65
1 qualifying child	34.0	$12,730	$4,328	$23,350 - $50,434	$30,470 - $57,554	15.98
2 qualifying children	40.0	$17,880	$7,152	$23,350 - $57,310	$30,470 - $64,430	21.06
3 or more qualifying children	45.0	$17,880	$8,046	$23,350 - $61,555	$30,470 - $68,675	21.06

For an individual to be a qualifying child for purposes of the EITC, generally that individual must meet the relationship, age, and residency tests under section 152.[1660]

No credit is allowed for a taxpayer with an aggregate amount of certain investment income that exceeds a threshold amount (this amount is $11,950 for 2025).[1661]

The EITC may be claimed by a taxpayer if the taxpayer is a U.S. citizen or a resident alien.[1662] An individual who is a nonresident alien for any portion of the taxable year is not eligible to claim the EITC unless an election is in effect for the year under section 6013(g) or (h) (relating to an individual who is married to a citizen or resident of the United States at the end of the year). In addition, individuals who claim the benefits of section 911 (relating to the income

[1659] Rev. Proc. 2024-40, 2024-45 I.R.B. 1100, November 4, 2024.

[1660] Sec. 32(c)(3)(A). See section 152(c)(1) for the definition of qualifying child. For purposes of the EITC the support test in section 152(c)(1)(D) is disregarded. The residency test in section 152(c)(1)(B) is satisfied only if the principal place of abode is in the United States.

[1661] Sec. 32(i)

[1662] Sec. 32(c)(1)(D).

exclusion election available to U.S. citizens or resident aliens living abroad) are not eligible to claim the EITC.[1663]

To claim the EITC, the taxpayer must include the taxpayer's valid social security number ("SSN") and valid SSN for the qualifying child (and, if married, the spouse's valid SSN) on their tax return.[1664] For these purposes, a valid SSN is an SSN issued to an individual, other than an SSN issued to an individual solely for the purpose of applying for or receiving Federally funded benefits, on or before the due date for filing the return for the year.[1665]

An individual with no qualifying children is allowed the EITC if the individual is aged 25 or older and below age 65, has a principal place of abode in the United States for more than half of the taxable year, and cannot be claimed as a dependent on anyone else's tax return.[1666] For purposes of the principal place of abode requirement, a member of the Armed Forces of the United States stationed outside the United States while serving on extended active duty is treated as having a principal place of abode in the United States.[1667]

General rules regarding assessment and deficiency procedures

The Federal income tax system relies upon self-reporting and assessment. A taxpayer is expected to prepare a report of his or her liability[1668] and submit it to the Internal Revenue Service ("IRS") with any payment due. The Code provides general authority for the IRS to assess all taxes shown on returns, including assessment of tax computed by the taxpayer,[1669] other than certain Federal unemployment tax and estimated income taxes.[1670] The assessment is required to be made by recording the liability in the "office of the Secretary" in a manner determined under regulations.[1671] In addition, the IRS may make supplemental assessments within the limitations period whenever it determines that an assessment was imperfect or incomplete.[1672]

[1663] Sec. 32(c)(1)(C).

[1664] Sec. 32(c)(1)(E), (c)(3)(D), (m).

[1665] Sec. 205(c)(2)(B)(i)(II) (and that portion of sec. 205(c)(2)(B)(i)(III) relating to it) of the Social Security Act.

[1666] Sec. 32(c)(1)(A)(ii).

[1667] Sec. 32(c)(4).

[1668] Secs. 6011 and 6012.

[1669] Sec. 6201.

[1670] Sec. 6201(b).

[1671] Sec. 6203.

[1672] Sec. 6204.

The authority of the IRS to assess additional tax is generally subject to certain restrictions on assessment known as deficiency procedures.[1673] These deficiency procedures generally ensure a taxpayer access to administrative review and a pre-payment judicial forum (*i.e.*, the United States Tax Court) for reviewing disputed adjustments proposed by the IRS. A deficiency of tax is the amount by which the liability determined under the Code exceeds the sum of certain taxes[1674] assessed for a period (including amounts shown on a return), after reduction for any rebates of tax.

Math error exception to restrictions on assessments

There are several exceptions to the restrictions on assessment of tax.[1675] One of the principal exceptions is the IRS's authority to make a summary assessment of tax without issuance of a notice of deficiency if the error is a result of a mathematical or clerical error, generally referred to as math error authority. Purely mathematical or clerical issues are often identified early in the processing of a return, prior to issuance of any refund rather than as a result of an examination of a return. Other grounds for math error authority may be identified after initial processing, including in the course of an examination of other issues subject to the general restrictions on assessment.

Definition of math error

The definition of mathematical or clerical errors is not limited to math, clerical, or transcription errors. It addresses over 20 categories of errors,[1676] many of which relate to rules regarding refundable credits, including the earned income tax credit.[1677] Since 2015, the math error authority covers situations for which a taxpayer claiming certain refundable credits either is subject to a multi-year ban against claiming such credits as a consequence of having made a prior fraudulent or reckless claim or, in the case of taxpayer who has made prior improper claims, omits information required by the Secretary to demonstrate eligibility for the credit.[1678] In 2020 and 2021, math error authority was expanded to cover certain errors related to valid taxpayer identification numbers and reconciliation of advance payments with respect to the 2020 recovery

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[1673] Secs. 6211 through 6215.

[1674] The taxes to which deficiency procedures apply are income, estate and gift and excise taxes arising under chapters 41, 42, or 44. Secs. 6211 and 6213.

[1675] Section 6213 provides that a taxpayer may waive the restrictions on assessment, permits immediate assessment to reflect payments of tax remitted to the IRS and to correct amounts credited or applied as a result of claims for carrybacks under section 1341(b), and requires assessment of amounts ordered as criminal restitution. Assessment is also permitted in certain circumstances in which collection of the tax would be in jeopardy. Secs. 6851, 6852, and 6861.

[1676] Sec. 6213(g)(2)(A) through (V).

[1677] Math error authority currently applies to certain errors related to the earned income tax credit, the child tax credit, the American opportunity tax credit, recovery rebate credits, and various energy-related credits.

[1678] Sec. 6213(g)(2)(K), (P), and (Q). Pub. L. No. 114-113, Div. Q, sec. 208.

rebate credit, 2020 additional recovery rebate credit, and 2021 recovery rebate credit.[1679] In 2022, math error authority was again expanded to apply to errors in documenting energy related credits, including omission of product or vehicle identification numbers.[1680]

Notice of math error assessment and request for abatement

If a mistake on the return is of a type that is within the meaning of mathematical or clerical error, the IRS immediately assesses the additional tax due as a result of correcting the mistake and sends notice to the taxpayer informing the taxpayer of the assessment. The statute is silent as to the level of detail required in the notice. Math error authority may be used to deny an improperly claimed credit, either during initial processing of a return on which the credit is claimed or in an examination of the return after the refund has been issued, and to assess immediately any additional tax due as a result without issuing a notice of deficiency. The issuance of a notice of math error begins a 60-day period within which the taxpayer may submit a request for abatement of the math error adjustment. If a taxpayer timely submits a request, the statute directs the IRS to abate the assessment and refer the unresolved issue for examination under the deficiency procedures.[1681]

Description of Proposal

Earned income tax credit certification program

The proposal creates a new earned income tax credit certification program for taxable years after 2027, with transition rules for taxable years beginning in 2025, 2026, and 2027. The proposal requires the Secretary to establish a program under which, on the taxpayer's application with respect to the child, the Secretary is required to issue an EITC certificate to establish, for purposes of section 32, a child's status as a qualifying child only of the taxpayer for a taxable year.

The proposal details the application requirements, including the time and manner of application, and how to resolve competing claims. Under the proposal, the Secretary is not permitted to issue an EITC certificate unless the taxpayer applies under the program and provides such information and supporting documentation as the Secretary by regulation requires to establish such child as a qualifying child only of the taxpayer for the taxable year. The application and supporting documentation is required in a manner as may be provided by the Secretary (including establishing an on-line portal) and not later than the due date for the tax return for the taxable year or (if later) when the return is filed. In the case of more than one taxpayer making an application with respect to a child under the program for a taxable year beginning during a calendar year, the Secretary is prohibited from issuing an EITC certification to any such taxpayer with respect to the child for such a taxable year unless the Secretary can

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[1679] Pub. L. No. 116-136, sec. 2201; Pub. L. No. 116-260, Div. N, sec. 272; Pub. L. No. 117-2, title IX, sec. 9601. See also secs. 6213(g)(2)(L); 6428(e)(1), (g)(4); 6428A(e)(1), (g)(7); 6428B(e)(2)(G), (f)(1).

[1680] Secs. 6213(g)(2)(R), (S), (T), (U), and (V). Pub. L. No. 117-169, secs. 13301(g)(2), 13401(i)(4), 13402(c), and 13403(b)(2).

[1681] Sec. 6213(b)(2)(A).

establish such child, based on information and supporting documentation provided, as the qualifying child only of one such taxpayer for such a taxable year.

For taxable years beginning after 2027, in the case of a taxpayer who takes into account as a qualifying child under section 32 a child for whom an EITC certificate has not been issued for the taxable year to the taxpayer, the Secretary is not permitted to credit the portion of any overpayment for such taxable year that is attributable to the taxpayer taking into account the child as a qualifying child, unless the taxpayer obtains, not later than the due date for the return for the taxable year, an EITC certificate with respect to such child for such taxable year, and if the taxpayer fails to obtain an EITC certificate, the failure is treated: (i) as an omission of information required by section 32 with respect to the child, and (ii) as arising out of a mathematical or clerical error and assessed according to section 6213(b)(1). Under the proposal, a termination of an EITC certificate is treated in the same manner as a failure to obtain an EITC certificate.

The proposal provides for transition rules for taxable years beginning before 2028. For any taxable year beginning after December 31, 2023, and before January 1, 2027, if more than one taxpayer makes a claim for the earned income credit under section 32 taking into account the same child as a qualifying child, the Secretary is required to send notice to each taxpayer (by certified or registered mail to the last known address of the taxpayer) detailing the resultant treatment provided under the proposal of such taxpayers with respect to the child for subsequent taxable years beginning before 2028.

For taxpayers that make a claim for the earned income credit taking into account the same child as another taxpayer in any taxable year beginning after December 31, 2023, and before January 1, 2027, in subsequent taxable years beginning before January 1, 2028, the Secretary may not credit the portion of any overpayment for the taxable year that is attributable to a taxpayer taking into account the child as a qualifying child under section 32 until the 15th day of October following the end of the taxable year, and if more than one taxpayer makes a claim for such credit for the taxable year taking into account the same child as a qualifying child, taking the same child into account is to be treated (i) as an omission of information required by section 32 with respect to the child, and (ii) as arising out of a mathematical or clerical error and assessed according to section 6213(b)(1). Qualifying child has the meaning given the term under section 32(c)(3).

The treatment in the proposal as an omission and as arising out of a mathematical or clerical error may be rebutted by providing information and supporting documentation that satisfactorily demonstrates the child is a qualifying child of the taxpayer for the taxable year.

Under the proposal, a taxpayer cannot apply for an EITC certificate under the program for any taxable year in the disallowance period. The disallowance period is (i) the period of 10 taxable years after the most recent taxable year for which there was a penalty imposed under new section 6720D on the taxpayer (but only if such penalty has been imposed on the taxpayer more than once, at least one instance of which was due to fraud under section 6720D(b)), and (ii) the period of 2 taxable years after the most recent taxable year for which there was a penalty imposed under new section 6720D on the taxpayer (but only if such penalty has been imposed on the taxpayer more than once due to reckless or intentional disregard of rules and regulations (but not imposed due to fraud)), and (iii) any disallowance period with respect to the taxpayer under section 32(k)(1).

The proposal provides that the Secretary is required to prescribe rules as may be necessary or appropriate to carry out the program, including (1) a process for establishing alternating taxable year treatment of a child as a qualifying child under a custodial arrangement, (2) a process, notwithstanding the rules applicable for taxable years beginning in 2026 and 2027, for establishing a child as a qualifying child and issuing the full credit to a taxpayer who has established a child as a qualifying child for taxable years to which such rules apply, (3) a simplified process for re-certifying a child as a qualifying child only of the taxpayer for a taxable year, and (4) a process for terminating EITC certificates in the case of competing claims with respect to a child or in cases in which issuance of the certificate is determined by the Secretary to be erroneous.

The proposal provides for penalties for improper use of the EITC certificate program. If any person makes a material misstatement or inaccurate representation in an application for an EITC certificate, and such misstatement or representation was due to reckless or intentional disregard of rules and regulations (but not due to fraud), the person is required to pay a penalty of $100 for each EITC certificate with respect to which such misstatement or representation was made. If a misstatement or representation is due to fraud on the part of the person making such misstatement or representation, in addition to any criminal penalty, the person is required to pay a penalty of $500 for each EITC certificate with respect to which such a misstatement or representation was made.

<u>Task force to design a private data bouncing system for improvements to the earned income tax credit</u>

The proposal creates a task force to provide the Secretary a report on various items with respect to the administration of the earned income credit. To create this task force, the proposal provides for an appropriation of $10,000,000 out of any money not otherwise appropriated for the fiscal year ending on September 30, 2026. The report is required to include: (i) recommendations for improvement of the integrity of the administration of the earned income tax credit, (ii) the potential use of third-party payroll and consumption datasets to verify income, and (iii) the integration of automated databases to allow horizontal verification to reduce improper payments, fraud, and abuse.

<u>Increased earned income tax credit for certain purple heart recipients</u>

The proposal increases the credit amount for specified Purple Heart recipients. The credit amount is increased by the sum of Social Security disability insurance ("SSDI") benefit substitution amounts with respect to qualified benefit termination months during the year.

A specified Purple Heart recipient is an individual who received the Purple Heart and disability insurance benefit payments under section 223(a) of the Social Security Act and whose disability insurance payments ceased to be payable by reason of section 223(e)(1) of such Act.

A qualified benefit termination month is each month during the 12-month period that begins with the first month with respect to which insurance disability payments under section

223(a) of the Social Security Act ceased to be payable by reason of section 223(e)(1) of such Act (the "eligibility period"). A qualified benefit termination month does not include any month that the specified Purple Heart recipient receives any benefit payment under section 223(a) of the Social Security Act with respect to such month.

The SSDI benefit substitution amount is an amount equal to the disability insurance benefit payment received by such recipient under section 223(a) of the Social Security Act for the month immediately preceding the eligibility period.

In general, the requirements for the earned income tax credit including being an eligible individual, the general limit on the credit amount, the calculation of credit amount based on earned income, the joint filing requirement for married taxpayers, and the disallowance of the credit for excessive investment income do not apply for the increased credit amount for specified Purple Heart recipients[1682] In other words, the earned income tax credit amount is increased by the appropriate sum of SSDI benefit substitution amounts for specified Purple Heart recipients regardless of whether such taxpayer would qualify for the earned income tax credit under present law.

Effective Dates

The proposal creating the earned income tax credit certification program, including attendant penalties applies to taxable years beginning after December 31, 2024.

The proposal creating the task force to design improvements to the earned income credit is effective on the date of enactment.

The proposal creating an increased earned income credit for certain Purple Heart recipients applies to taxable years ending after the date of enactment.

[1682] A specified Purple Heart recipient is eligible even if the recipient is not an eligible individual for purposes of section 32(c)(1). Sections 32(a)(2), (d). (e), (f), and (i) also do not apply in regard to the amount of the increase in the earned income tax credit for specified Purple Heart recipients.

F. Task Force on the Termination of Direct File

Present Law

Under The Inflation Reduction Act of 2022 ("IRA")[1683] amounts were appropriated for necessary expenses of the Internal Revenue Service ("IRS") to deliver to Congress, within nine months following the date of enactment of the Act, a report on the cost of developing and running a free direct e-file tax return system; taxpayer opinions, expectations and level of trust for such a system; and the opinions of an independent third-party on the overall feasibility approach, schedule, cost, organizational design and IRS capacity to deliver such a system.

The IRS developed a phased approach to the Direct File Pilot during the 2024 tax filing season and subsequently announced that Direct File would be a permanent option for filing tax returns beginning with the 2025 tax filing season.[1684]

Description of Proposal

The proposal directs the Secretary of the Treasury to terminate the IRS Direct File program as soon as practicable, but no later than 30 days after date of enactment.

The proposal provides appropriations for necessary expenses of the Department of Treasury to deliver to Congress, within 90 days following the date of enactment, a report on the cost of a new public-private partnership to provide for free tax filing for up to 70 percent of all taxpayers; taxpayer opinions and preferences regarding a taxpayer-funded, government-run service or a free service provided by the private sector; assessment of the feasibility of a new approach, how to make the options consistent and simple for taxpayers across all participating providers, provide features to address taxpayer needs, and how much money should be appropriated to advertise the new option.

Effective Date

The proposal is effective on the date of enactment.

[1683] Inflation Reduction Act of 2022, Pub. L. No. 117-169, sec. 10301, August 16, 2022.

[1684] Inspector General for Tax Administration, Department of the Treasury, *Inflation Reduction Act: Results of the Direct File Pilot* (TIGTA 2025-408-015), March 20, 2025.

G. Postponement of Tax Deadlines for Hostages and Individuals Wrongfully Detained Abroad

Present Law

General rules establishing Code deadlines

The United States tax system generally relies upon self-reporting and assessment. For most individuals, that self-reporting is in the form of an income tax return. Persons required to file income tax returns[1685] must file such returns in the manner prescribed by the Secretary, with any payment due, in compliance with due dates established in the Code, if any, or by regulations. The Code includes a general rule that requires income tax returns of individuals to be filed on or before the 15th day of the fourth month following the end of the taxable year, but certain exceptions are provided both in the Code and in regulations.[1686]

The Code also establishes the limitation periods within which the Internal Revenue Service ("IRS") must perform its various administrative duties, such as assessment of taxes, interest, and any additions to tax or penalties related to the taxes and collection of such taxes, interest, and additions to tax. Taxes are generally required to be assessed within three years after a taxpayer's return is filed, regardless of whether it was timely filed.[1687] Several exceptions may prevent the three-year limitation period from beginning, including failure to file a return or filing a false or fraudulent return with the intent to evade tax. In those cases, the tax may be assessed, or a proceeding in court for collection of such tax may commence without assessment, at any time.[1688] After the taxes are finally determined, whether it is through alternative payment methods, or enforced collection activity, the IRS must collect within 10 years from the date of assessment of tax.[1689] A refund or credit is authorized for a taxable year only if an overpayment exists, that is, if the amounts paid or deemed paid exceed the tax liability for that year and a claim for such amount is timely made.[1690]

Special rules authorizing extensions of time for required events in the Code

In computing the time within which they must complete an action required or prescribed by the Code, persons who serve in the United States Armed Forces or in support of the Armed

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[1685] Section 6012 provides general rules identifying who must file an income tax return.

[1686] Secs. 6072 (prescribing deadlines for filing income tax returns) and 6081 (authorization of extensions of time to file, provided tax estimated to be due is paid with the application for extension).

[1687] Sec. 6501(a). Returns that are filed before the date they are due are deemed filed on the due date. See sec. 6501(b)(1) and (2).

[1688] Sec. 6501(c)(1), (2), and (3).

[1689] Sec. 6502.

[1690] Secs. 6402 (authority for refunding an overpayment) and 6511 (limitations period for filing a claim, including both a timely filing requirement and a lookback period to determine amounts eligible to be refunded).

Forces are entitled to disregard their period of service while in designated combat zones[1691] or serving overseas in a contingency operation designated as such by the Secretary of Defense,[1692] and the 180 days succeeding such period. For this purpose, periods of hospitalization that result from such service are included in the time that may be disregarded. The period that may be disregarded by the taxpayer is also disregarded in determinations by the IRS of the amount of any underpayment interest, penalty, additional amount, or addition to tax, and the amount of any credit or refund. Special rules apply for the period a person is in missing status,[1693] for certain limitations on refunds or collection actions,[1694] as well as application of these rules to the spouse of the taxpayer.[1695]

The Code specifies a number of actions for which the specified periods of time may generally be disregarded by persons who serve in the United States Armed Forces or in support of the Armed Forces described above. These actions include those required of taxpayers as well as those performed by the IRS. The former includes actions such as the filing any return of income, estate, gift, employment, or excise tax; filing a petition with the Tax Court for redetermination of a deficiency or for review of a decision rendered by the Tax Court; and actions related to refunds, such as filing a claim or bringing suit upon such claim. Actions by the IRS for which a deadline is extended include the assessment of any tax and related notices, such as notice and demand for payment or collection of the tax; the allowance of a refund; and bringing suit by the United States in respect of any liability in respect of any tax. In addition, the statute includes a residuary clause that permits the Secretary to designate any other act required or permitted under the internal revenue laws as within the scope of section 7508(a).[1696] Finally, special rules ensure that a taxpayer to whom the extension is available remains entitled to overpayment interest rates.[1697]

Another provision of the Code, relating to disasters, mandates a 60-day extension and authorizes the Secretary to specify a period of up to one year that may be disregarded for performing various acts under the Code, such as filing tax returns, paying taxes, or filing a claim for credit or refund of tax, for eligible taxpayers. The limited relief from deadlines under this disaster extension applies to the same list of actions for which the specified time is disregarded for persons in combat zones. The provision adopts by cross reference to section 7508(b) the special rules regarding overpayment interest for affected taxpayers. To qualify for this extension,

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[1691] Sec. 112.

[1692] Sec. 7508.

[1693] Sec. 7508(d).

[1694] Sec. 7508(b) and (e).

[1695] Sec. 7508(c).

[1696] Sec. 7508(a)(1). In addition, Revenue Procedure 2018-58 supplements the list of postponed acts in section 7508(a)(1) and Treasury Regulation section 301.7508A-1(c)(1) with an additional list of time-sensitive acts.

[1697] Sec. 7508(b).

an eligible taxpayer must be affected by a Federally declared disaster, a significant fire, or a terroristic or military action.[1698]

Persons held hostage or wrongfully detained.

Neither the provision on service in a combat zone nor the rules on disaster relief address persons who fail to meet a tax filing or payment deadline that arises while they are unlawfully or wrongfully detained abroad. Federal law provides a set of criteria for determining whether a United States national[1699] is a wrongfully detained person. Such determination requires the involvement of the Hostage Recovery Fusion Cell, a multi-agency entity that addresses coordination of efforts to identify and recover those held hostage or wrongfully detained. Generally, if the person detained is held by a sovereign entity, determination of whether such person is wrongfully detained rests with the Secretary of State using prescribed criteria. Hostage status is determined by the Hostage Recovery Fusion Cell, under the leadership of the Federal Bureau of Investigation.[1700]

In recent years, the incidence of United States citizens or residents abroad being wrongfully detained or held hostage has been increasingly frequent. When they are released from detention, they face many challenges in adjusting to a return to their normal, daily life. That adjustment upon a return home is made more difficult when they must face notices that they were subject to tax inquiries, penalties or interest based on delinquencies accruing in their absence they were unable to avoid. While the IRS may work with the released hostage or detainee to abate or reverse some of those notices, the authority of the IRS may be limited to do so, especially in cases in which the period of detention was lengthy. Most penalties based on delinquency can be abated based upon reasonable cause, for example, unless the limitations period for making corrections to a year has lapsed. However, the Code narrowly restricts IRS authority to abate any interest that may have accrued for failure to pay income tax timely.

Description of Proposal

The proposal adds a new Code section that extends due dates for certain Federal tax matters for hostages and persons wrongfully detained by providing that the period of detention is disregarded in determining deadlines, interest, and penalties for the person, comparable to the rules applicable to a person deployed in a combat zone. Similar to those rules, it extends such relief to the spouse of the hostage or detainee and adopts special rules with respect to overpayment interest. The class of applicable persons is defined by reference to provisions of Title 22 on wrongfully detained persons or hostages.

[1698] Sec. 7508A.

[1699] 22 U.S.C. 1741e defines "United States national" to mean citizens and certain noncitizens within the scope of 8 U.S.C. secs. 1102(a)(22) and 1408 and lawful permanent residents with significant ties to the United States.

[1700] Sections 302 and 304 of the Robert Levinson Hostage Recovery and Hostage-Taking Accountability Act, Pub. L. 116–260, div. FF, title III, sec. 301, Dec. 27, 2020, codified at 22 U.S.C. sec. 1741 through 1741f.

Under the proposal, the period that may be disregarded in redetermining time limits is the entire period during which the person was held hostage or wrongfully detained during any taxable year ending after date of enactment. The list in present-law section 7508 identifying events for which a deadline is extended is used for the new proposal.

The proposal uses the term "applicable individual" to describe a person entitled to the extension. A person is an applicable individual if that person is either determined to be wrongfully detained under section 302 of the Robert Levinson Hostage Recovery and Hostage-Taking Accountability Act or is determined to be a hostage under findings of the Hostage Recovery Fusion Cell. The class of applicable individuals consists of persons who are identified on reports provided to the Secretary. The proposal requires the Secretary of State to provide a list of persons wrongfully detained, together with any identifying information available. The Attorney General, through the Hostage Recovery Fusion Cell, is required to provide a comparable list of persons believed to be hostages. The initial report is due no later than January 1, 2026, with further reports due annually.

The proposal also extends relief to persons who were assessed interest, penalties or additional amounts with respect to a tax liability for a failure to meet a deadline that arose during the period of detention for which extension is authorized. If the interest, penalties or fines were assessed before the person was identified as an applicable individual, the Secretary is directed to abate and refund any such amounts as overpayments in the same manner as would apply under section 6402.

In addition to the prospective relief described above, the proposal directs the Secretary, in consultation with Secretary of State and the Hostage Recovery Fusion Cell, to initiate a program under which persons who were detained during an applicable period beginning January 1, 2021, and ending before date of enactment may seek refund of interest and penalties assessed with respect to tax years ending during the applicable period. This program is to be available to eligible individuals (persons who would have been applicable individuals but for the taxable years involved and their dependent or spouse), to be identified by the Secretary of State and Attorney General in reports similar to those required with respect to applicable individuals. A person may be both an applicable individual with respect to a taxable year ending after date of enactment and an eligible individual with respect to an earlier taxable year within the applicable period. Once such persons are identified, they are entitled to notice of the potential relief within 90 days from their release from captivity, or, if released prior to date of enactment, within 90 days after enactment.

After receiving notice of the program, eligible individuals are permitted to seek abatement or claim a refund for additions to tax and interest assessed or collected in respect of a tax liability attributable to the applicable period. The limitations period for filing a claim for refund or seeking abatement is extended, so that it expires no earlier than one year from the notice issued to the eligible individual. Furthermore, the look-back period for determining payments that may be within the scope of a refund claim is not applicable.

The proposal also requires the Secretary to make necessary updates to databases and information systems to ensure that expiration dates, interest and penalty accrual, and collection activities are suspended consistent with this proposal.

Effective Date

The proposal is generally effective for applicable individuals for taxable years ending after the date of enactment. The special program for notifications, refunds or abatements to eligible individuals for the applicable period from January 1, 2021, through date of enactment, is effective only for taxable years ending before the date of enactment.

H. Termination of Tax-Exempt Status of Terrorist Supporting Organizations

Present Law

Revocation of tax-exempt status, in general

Under present law, the IRS generally issues a letter revoking recognition of an organization's tax-exempt status only after (1) conducting an examination of the organization, (2) issuing a letter to the organization proposing revocation, and (3) allowing the organization to exhaust the administrative appeal rights that follow the issuance of the proposed revocation letter. In the case of an organization described in section 501(c) or (d), the revocation letter immediately is subject to judicial review under the declaratory judgment procedures of section 7428. To sustain a revocation of tax-exempt status under section 7428, the IRS must demonstrate that the organization is no longer entitled to exemption.

Suspension of tax-exempt status of terrorist organizations (section 501(p))

To combat terrorism, the Federal government has designated a number of organizations as terrorist organizations or supporters of terrorism under the Immigration and Nationality Act, the International Emergency Economic Powers Act, and the United Nations Participation Act of 1945.

The tax-exempt status of an organization that is exempt from tax under section 501(a) is suspended for the period during which the organization is designated or identified by Federal authorities as a terrorist organization or supporter of terrorism. An organization so designated or identified is also ineligible to apply for tax-exempt status under section 501(a).[1701] The period of suspension begins on the later of (1) the date the organization is first designated or identified or (2) November 11, 2003,[1702] and ends on the date when all designations or identifications with respect to the organization have been rescinded pursuant to the law or Executive Order under which the designation or identification was made.[1703]

For this purpose, a terrorist organization is an organization that has been designated or otherwise individually identified (1) as a terrorist organization or foreign terrorist organization under the authority of section 212(a)(3)(B)(vi)(II) or section 219 of the Immigration and Nationality Act; (2) in or pursuant to an Executive Order that is related to terrorism and issued under the authority of the International Emergency Economic Powers Act or section 5 of the United Nations Participation Act for the purpose of imposing on such organization an economic or other sanction; or (3) in or pursuant to an Executive Order that refers to the provision and is issued under the authority of any Federal law if the organization is designated or otherwise individually identified in or pursuant to such Executive Order as supporting or engaging in terrorist activity (as defined in section 212(a)(3)(B) of the Immigration and Nationality Act) or

[1701] Sec. 501(p)(1).

[1702] The date of enactment of section 501(p). Pub. L. No. 108-121.

[1703] Sec. 501(p)(3).

supporting terrorism (as defined in section 140(d)(2) of the Foreign Relations Authorization Act, Fiscal Years 1988 and 1989).[1704] During the period of suspension, no deduction for any contribution to a terrorist organization is allowed under the Code, including under section 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522.[1705]

No organization or other person may challenge, under section 7428 or any other provision of law, in any administrative or judicial proceeding relating to the Federal tax liability of such organization or other person, the following: the suspension of tax-exempt status, the ineligibility to apply for tax-exempt status, a designation or identification (described above), the timing of the period of suspension, or a denial of deduction (described above).[1706] The suspended organization may maintain other suits or administrative actions against the agency or agencies that designated or identified the organization, for the purpose of challenging such designation or identification (but not the suspension of tax-exempt status under this provision).

If the tax exemption of an organization is suspended and each designation and identification that has been made with respect to the organization is determined to be erroneous pursuant to the law or Executive Order making the designation or identification, and such erroneous designation results in an overpayment of income tax for any taxable year with respect to such organization, a credit or refund (with interest) with respect to such overpayment shall be made. If the operation of any law or rule of law (including *res judicata*) prevents the credit or refund at any time, the credit or refund may nevertheless be allowed or made if the claim for such credit or refund is filed before the close of the one-year period beginning on the date that the last remaining designation or identification with respect to the organization is determined to be erroneous.[1707]

The IRS is directed to update the listings of tax-exempt organizations to take account of an organization that has had its tax-exempt status suspended and to publish appropriate notice to taxpayers of the suspension of such organization's tax-exempt status and the fact that contributions to such organization are not deductible during the period of suspension.[1708]

As of this writing, there are nine organizations on the IRS's list of organizations suspended under section 501(p).[1709]

[1704] Sec. 501(p)(2).

[1705] Sec. 501(p)(4).

[1706] Sec. 501(p)(5).

[1707] Sec. 501(p)(6).

[1708] Sec. 501(p)(7).

[1709] See https://www.irs.gov/charities-non-profits/charitable-organizations/suspensions-pursuant-to-code-section-501p#:~:text=Under%20section%20501(p)%20of,under%20section%20501(p) (last accessed on May 5, 2025).

Description of Proposal

In general

The proposal extends section 501(p) such that it applies not only to terrorist organizations (as under present law) but also to terrorist supporting organizations. The proposal treats a terrorist supporting organization as a terrorist organization described in section 501(p)(2). The effect of this treatment is that the tax-exempt status of a terrorist supporting organization, and the eligibility of such organization to apply for tax-exempt status, are suspended. The period of suspension of a terrorist supporting organization is treated as beginning on the date the Secretary designates the organization as a terrorist supporting organization and ending on the date the Secretary rescinds the designation, as described below.

A terrorist supporting organization is any organization that is designated by the Secretary as having provided, during the three-year period ending on the date of such designation, material support or resources to a terrorist organization or terrorist supporting organization described in section 501(p) in excess of a *de minimis* amount. For this purpose, the term "material support or resources" is defined by reference to section 2339B of Title 18 of the U.S. Code,[1710] except that the term does not include support or resources that were approved by the Secretary of State with the concurrence of the Attorney General, or humanitarian aid provided with the approval of the Office of Foreign Assets Control.

Notice requirement

Before designating an organization as a terrorist supporting organization, the Secretary is required to mail to the most recent mailing address provided to the IRS on its most recent annual information return or notice filed with the IRS (or subsequently submitted form indicating a change of address) a written notice. The notice must include: (1) a statement that the Secretary will designate the organization as a terrorist supporting organization unless the organization satisfies the requirements outlined in the following paragraph (relating to opportunity to cure), (2) the name of the organization or organizations with respect to which the Secretary has determined such organization provided material support or resources, (3) a description of such material support or resources, except to the extent that the Secretary determines that disclosure of the description would be inconsistent with national security and law enforcement interests, and (4) if the Secretary makes a determination described in (3) (a "national security determination"), a statement that the Secretary has made such a determination and that all or part of the description of such material support or resources is included in such notice by reason of such determination.

[1710] Section 2339B defines "material support or resources" by reference to section 2339A of Title 18 of the U.S. Code. Section 2339A, in turn, provides that material support or resources means "any property, tangible or intangible, or service, including currency or monetary instruments or financial securities, financial services, lodging, training, expert advice or assistance, safehouses, false documentation or identification, communications equipment, facilities, weapons, lethal substances, explosives, personnel (1 or more individuals who may be or include oneself), and transportation, except medicine or religious materials." The term "training" is defined as "instruction or teaching designed to impart a specific skill, as opposed to general knowledge." The term "expert advice or assistance" is defined as "advice or assistance derived from scientific, technical or other specialized knowledge."

Opportunity to cure

In the case of such a notice, the Secretary shall, at the end of the 90-day period beginning on the date the notice was sent, designate the organization as a terrorist supporting organization if, and only if, the organization has not during such period: (1) demonstrated to the satisfaction of the Secretary that the organization did not provide the material support or resources, (2) made reasonable efforts to have such support or resources returned to such organization and certified in writing to the Secretary that such organization will not provide any further support or resources to a terrorist organization or terrorist supporting organization described in section 501(p)(2), or (3) if such notice included a statement that the Secretary has made a national security determination, filed a complaint with a United States district court of competent jurisdiction alleging that the Secretary's national security determination is erroneous. Such a certification is not valid if the organization making the certification has provided any other such certification during the preceding five years.

Rescission of designation

The Secretary shall rescind a designation if and only if: (1) the Secretary determines that the designation was erroneous; (2) after the Secretary receives a certification from an organization that it did not receive the notice described above, (a) the Secretary determines that it is reasonable to believe that the organization did not receive the notice, and (b) the organization satisfies the above requirements relating to curing a deficiency (that is, the organization demonstrates that it did not provide material support or resources or made reasonable efforts to have such support or resources returned and makes the required certification); or (3) the Secretary determines that the periods of suspension for all organizations to which the material support or resources were provided have ended. The certification described in (2) above is not treated as valid if the organization making the certification has provided any other such certification during the preceding five years.

Administration and judicial review of designation

Notwithstanding the present-law rule that disallows a challenge to a designation as a terrorist organization in certain administrative or judicial proceedings (section 501(p)(5)), in the case of the designation of an organization as a terrorist supporting organization, a dispute regarding such designation is subject to resolution by the IRS Independent Office of Appeals ("IRS Appeals") under section 7803(e) (which describes IRS Appeals). The dispute is subject to IRS Appeals resolution in the same manner as if the designation were made by the IRS. In addition, notwithstanding section 501(p)(5), the United States district courts shall have exclusive jurisdiction to review a final determination with respect to an organization's designation as a terrorist supporting organization. In the case of a determination that was based on classified information,[1711] such information may be submitted to the reviewing court *ex parte* and *in camera*. For purposes of such judicial review, a determination shall not fail to be treated as a final determination merely because the organization fails to utilize the dispute resolution process of IRS Appeals described above. The Secretary is directed to establish policies and procedures

[1711] As defined in section 1(a) of the Classified Information Procedures Act.

to ensure that employees of the Department of the Treasury comply with all laws regarding the handling and review of classified information.[1712]

Effective Date

The proposal is effective for designations made after the date of enactment in taxable years ending after such date.

[1712] As defined in section 1(a) of the Classified Information Procedures Act).

I. Increase in Penalties for Unauthorized Disclosures of Taxpayer Information

Present Law

General rule of confidentiality

As a general rule, section 6103 provides that returns and return information are confidential. The definition of return information is very broad and includes any information received or collected by the Internal Revenue Service ("IRS") with respect to the liability under the Code of any person for any tax, penalty, interest, or offense. Returns and return information cannot be disclosed unless there is an applicable exception in the Code.

Section 6103 contains numerous narrowly-tailored exceptions to the general rule of confidentiality, grouped into 13 categories (paragraphs (c) through (o)): (1) disclosures of return and return information to designees of the taxpayer (consent); (2) disclosures to State tax officials and State and local law enforcement; (3) disclosures to persons having material interest; (4) disclosure to committees of Congress; (5) disclosures to the President and certain other persons; (6) disclosure to certain Federal officers and employees for purposes of tax administration, etc.; (7) disclosure to Federal officers and employees for administration of Federal laws not relating to tax administration (generally disclosures relating to criminal law enforcement and GAO for audits of the IRS and certain other agencies), (8) statistical use; (9) disclosure of certain return and return information for tax administration purposes (including investigative disclosures and passport revocation); (10) disclosures of returns and return information for purposes other than tax administration (includes 22 different exceptions); (11) disclosure of taxpayer identity information; (12) certain other persons (tax administration contractors); and (13) disclosure of return and return information with respect to certain excise taxes (alcohol, tobacco, firearms, wagering and the heavy vehicle use tax).

To protect the confidentiality of returns and return information, section 6103 imposes recordkeeping and safeguard requirements. By March 31 of each year, the IRS is required to report on the number of certain disclosures made in the previous calendar year. As a condition of receiving returns and return information, specified recipients are required to meet safeguard requirements to the satisfaction of the Secretary to protect the confidential returns and return information. In addition, the IRS performs periodic onsite inspections and is required to submit a report which describes the procedures and safeguards established and utilized by such recipients for ensuring the confidentiality of returns and return information they receive. The report also is required to describe instances of deficiencies in, and failure to establish or utilize, such procedures.

Criminal penalties for the unauthorized disclosure or inspection of returns or return information

Under section 7213, criminal penalties apply to: (1) willful unauthorized disclosures of returns and return information by Federal and State employees and other persons; (2) the offering of any item of material value in exchange for a return or return information and the receipt of such information pursuant to such an offer; and (3) the unauthorized disclosure of return information received by certain shareholders under the material interest proposal of section 6103.

Under section 7213, a person can be subject to a fine of up to $5,000, up to five years imprisonment, or both, together with the costs of prosecution.[1713] If the offense is committed by a Federal employee or officer, the employee or officer will be discharged from office upon conviction.

Under section 7213A, the willful and unauthorized inspection of returns and return information can subject Federal and State employees and others to a maximum fine of $1,000, up to a year in prison, or both, in addition to the costs of prosecution.[1714] If the offense is committed by a Federal employee or officer, the employee or officer will be discharged from office upon conviction.

In addition, any person who intentionally accesses a computer "without authorization or exceeds authorized access, and thereby obtains . . . information from any department or agency of the United States" can be prosecuted under 18 U.S.C. section 1030(a)(2) and upon conviction may be imprisoned for a year, or fined, or both.

Civil damage remedies for unauthorized disclosure or inspection

If a Federal employee makes an unauthorized disclosure or inspection, under section 7431, a taxpayer can bring suit against the United States in Federal district court. If a person other than a Federal employee makes an unauthorized disclosure or inspection, suit may be brought directly against such person. No liability results from a disclosure based on a good faith, but erroneous, interpretation of section 6103. A disclosure or inspection made at the request of the taxpayer will also relieve liability.

Upon a finding of liability, a taxpayer can recover the greater of $1,000 per act of unauthorized disclosure (or inspection), or the sum of actual damages plus, in the case of an inspection or disclosure that was willful or the result of gross negligence, punitive damages. The taxpayer may also recover the costs of the action and, if found to be a prevailing party, reasonable attorney fees.

The taxpayer has two years from the date of the discovery of the unauthorized inspection or disclosure to bring suit. The IRS is required to notify a taxpayer of an unauthorized inspection or disclosure as soon as practicable after any person is criminally charged by indictment or information for unlawful inspection or disclosure. In addition, if the Internal Revenue Service or a Federal or State agency (upon notice to the Secretary by such Federal or State agency)

[1713] A fine of up to $250,000 can be imposed pursuant to 18 U.S.C. sec. 3571. Section 3559 of Title 18 specifies that an offense with a maximum authorized term of imprisonment of "less than ten years but five or more years" is a "Class D felony," and that an offense with a maximum authorized term of imprisonment of "less than twenty-five years but ten or more years" is a "Class C felony."

[1714] A fine of up to $100,000 can be imposed pursuant to 18 U.S.C. sec. 3571(b)(4), applicable to Class A misdemeanors, defined in section 3559 of Title 18 as an offense with a maximum authorized term of imprisonment of "one year or less but more than six months."

proposes an administrative determination as to disciplinary or adverse action against an employee arising from the employee's unauthorized inspection or disclosure of the taxpayer's return or return information, the taxpayer is also required to be notified.

Description of Proposal

The proposal increases the specified maximum fine in section 7213 from $5,000 to $250,000, consistent with 18 U.S.C. section 3571. The proposal also increases from five years to 10 years the maximum term of imprisonment upon conviction of a section 7213 violation. Under the proposal, for a willful unauthorized disclosure involving the returns or return information of multiple taxpayers, a separate violation occurs with respect to each such taxpayer whose return or return information is disclosed.

Effective Date

The proposal is effective for disclosures made after the date of enactment.

J. Restriction on Regulation of Contingency Fees with Respect to Tax Returns, Etc.

Present Law

The Code provides that a taxpayer may deduct all ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business.[1715]

A current deduction for an expense for which there is a right or expectation of reimbursement may be disallowed because these payments are not expenses of the taxpayer and are instead in the nature of an advance or a loan. The extent to which the right must be established has varied. Some cases have denied the current deduction because the right of reimbursement was fixed,[1716] others have allowed the current deduction because the right of reimbursement was uncertain,[1717] and other cases have denied the current deduction if the taxpayer's right to reimbursement was subject to a contingency.

Courts have held that an attorney representing clients on a contingent fee basis may not currently deduct advances to or expenses paid on behalf of the clients as ordinary and necessary business expenses.[1718] The amounts in these cases were to be repaid from any recovery. Courts have also held that even if reimbursement is due only under certain circumstances, generally no immediate deduction is allowable.[1719]

However, the Ninth Circuit reached the opposite conclusion and held that attorneys who represent clients in "gross fee" contingency fee cases are not extending loans to clients and therefore may treat litigation costs, such as court fees and witness expenses, as deductible business expenses under the Code.[1720] The IRS does not follow this decision, except in the Ninth

[1715] Sec. 162(a); Treas. Reg. sec. 1.162-1(a).

[1716] *Charles Baloian Company, Inc. v. Commissioner*, 68 T.C. 620, 626, 628 (1977); *Manocchio v. Commissioner*, 710 F.2d 1400, 1402 (9th Cir. 1983); *Glendinning, McLeish & Co. v. Commissioner*, 61 F.2d 950, 952 (2d Cir. 1932); *Webbe v. Commissioner*, T.C. Memo. 1987-426, aff'd, 902 F.2d 688 (8th Cir. 1990).

[1717] *George K. Herman Chevrolet, Inc. v. Commissioner,* 39 T.C. 846, 853 (1963)*; Allegheny Corporation v. Commissioner,* 28 T.C. 298, 305 (1957), acq., 1957-2 C.B. 3; *Electric Tachometer Corporation v. Commissioner*, 37 T.C. 158, 161-162 (1961), acq., 1962-2 C.B. 4.

[1718] *Burnett v. Commissioner*, 356 F.2d 755, 760 (5th Cir. 1966), cert. denied, 385 U.S. 832 (1966); *Herrick v. Commissioner*, 63 T.C. 562, 567, 568 (1975); *Canelo v. Commissioner*, 53 T.C. 217, 225 (1969), aff'd, 447 F.2d 484 (9th Cir. 1971), acq. 1971-2 C.B. 2, nonacq. in part, 1982-2 C.B. 2; *Silverton v. Commissioner*, T.C. Memo. 1977-198, aff'd, 647 F.2d 172 (9th Cir.), cert. denied, 454 U.S. 1033 (1981); *Watts v. Commissioner*, T.C. Memo. 1968-183.

[1719] *Boccardo v. Commissioner*, 12 Cl Ct. 184 (1987); *Boccardo v. Commissioner*, 65 T.C. Memo 2739 (1993).

[1720] *Boccardo v. Commissioner*, 56 F.3d 1016 (9th Cir. 1995), rev'g 65 T.C. Memo 2739 (1993).

Circuit, based on the fact that amounts advanced by attorneys will be reimbursed by the client and therefore are not deductible business expenses.[1721]

Description of Proposal

The proposal specifies that the Secretary of the Treasury may not regulate, prohibit, or restrict the use of a contingent fee in connection with tax returns, claims for refund, or documents in connection with these prepared on behalf of a taxpayer.

Effective Date

The proposal is effective on date of enactment.

[1721] 1997 FSA LEXIS 442 (June 2, 1997).