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Tax Notes Newsletter

What's In (and What's Out) – The New Senate Reconciliation Bill

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This week, the Senate released draft legislative language on a reconciliation bill apparently agreed to by Senate Majority Leader Chuck Schumer and West Virginia Senator Joe Manchin, whose objections had been one of the main stumbling blocks to prior legislative plans proposed by the Biden administration and other members of Congress. As a result, it appears there is a bill with some significant tax provisions that has a strong likelihood of passage. How does it compare to the broad, sweeping provisions of the Build Back Better (BBB) Act, proposed last fall, which we covered in a previous article?

By contrast, the "Inflation Reduction Act of 2022" (the Act) is a much narrower piece of legislation on the tax side. Below is a summary of key provisions, as well as key pieces of tax policy that are not currently included. While nothing is sure to be enacted until it goes through both the Senate and the House of Representatives, we think this is an excellent time to review the bill language currently released.

What's In

The tax provisions in the current legislation are limited and apply to specific types of taxpayers and industries.

- **Corporate Alternative Minimum Tax:** The Act includes a 15% alternative minimum tax on corporations based on book income, but only on companies with average financial statement income of over $1 billion (over a three-year period).

- **Carried Interest Provisions:** The holding period required to receive capital gain treatment on carried interest income is increased to five years, with some limited exceptions. This covers both long-term capital gains and income taxed like long-term capital gains (such as qualified dividend income).

PKF O'Connor Davies' Observation: There are certain taxpayers for whom the proposed law may actually be more advantageous than current IRC §1061. For example, if a taxpayer has held their carried interest ("applicable partnership interest") for more than five years and the partnership acquired substantially all of its assets (however that is determined) more than five years ago, it appears no gains or income would be reclassified as short-term capital gains under the proposed rules. Under current law, regardless of how long the partner has held their interest or how long the partnership has been active, a three-year holding period on the asset is required to avoid reclassification under IRC §1061. The precise scope of this potential advantage will only be able to be determined once additional regulations are issued. In particular, based on how the acquisition of "substantially all of the partnership's assets" is defined, the required holding period to achieve the long-term capital gain rate could be long enough to render the benefit moot.

- **IRS Enforcement:** The IRS would receive a range of funding (about $80 billion in total) to increase hiring of auditors, improve customer service and modernize technology.

- **Credits and Incentives:** The Act includes a number of tax credits relating to renewable energy and electric cars

What's NOT in the Bill

Wait, you may be saying, when PKF O'Connor Davies wrote about BBB – wasn't the article way longer than this one? Yes, indeed. Not only does the Act continue to exclude some of the main tax changes people were concerned about last year (increases in individual and corporate rates, increase in capital gains rate, estate tax changes and limitations on IRC §1031 exchanges, among other things), the bill also excludes a number of BBB provisions, including proposed surcharges on high income taxpayers and international tax reforms that would bring the U.S. in line with recent global tax deals.

Also missing, to the chagrin of many, is an increase in that state and local tax deduction cap from $10,000 up to as much as $80,000 (which had appeared in prior proposals). Given Manchin's opposition on that point, that change appears unlikely to be included.

Of course, just because these provisions are not in the current bill does not mean they are completely dead. Negotiations are ongoing and an increase on the spending side could lead to any one of these provisions being added back.

Next Steps

It's unclear how much negotiation may still be to come on this reconciliation bill, or if the bill will pass muster with the wider Democratic caucus.

PKF O'Connor Davies is monitoring the situation in Washington and, as it changes, we will keep you informed.

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