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SPOTLIGHT REPORT

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The Tax Outlook Today, Tomorrow, and in 2025

What's Happening: 'Tis the (tax) season.

Why It Matters: During the tax heyday, there were 11 tax lobbyists for every member of Congress. We are not in a tax heyday like in 2017 or 2021, but there's always something going on. **Taxes can be categorized into three buckets: 1) the implementation of today; 2) the small ball of tomorrow; and 3) the armageddon of 2025.** Right now, most tax lobbying is focused on the Biden administration. The Treasury Department and Internal Revenue Service (IRS) are hard-pressed to release interim guidance and proposed regulations implementing the tax provisions from the Inflation Reduction Act (IRA). The statutory interpretation can have far-reaching implications on how clean energy tax credits are utilized and corporate minimum and buyback taxes are applied. **On the legislative horizon, there's pessimism about what tax provisions can pass in divided government this year.** That isn't stopping plenty of legislation from developing and moving through the traditional channels. But going the distance will be tough for all but a few tax provisions. **However, there is a tax heyday returning in 2025 when individual provisions in the trillions from the Tax Cuts and Jobs Act (TCJA) expire.** The taxman will cometh with a vengeance, but which taxman cometh depends on the outcome of the 2024 elections. How those elections go will have a profound impact on America's tax outlook.

What's Next: More guidance is expected to be released in the next few months from the Biden administration on the IRA's tax provisions. Interim guidance is a prelude to proposed (and then finalized) regulations. This is a process that could take years and span multiple administrations. Tax legislation is being developed and (re)introduced in Congress. Who ultimately matters is leadership in the parties and the tax committees as they look to negotiate over what, if anything, can be attached to other legislation or go to the floor. A recession later this year (as Fed economists project) could be a catalyst for a limited fiscal package depending on the depth and reaction to it. In the meantime, Democrats and Republicans are releasing tax proposals that could form the basis of negotiations, either amongst themselves through the reconciliation process or with each other through regular order, for the 2025 tax extravaganza.

Today: It's All About Implementing

The Inflation Reduction Act (IRA), enacted in August last year, was a hastily written piece of legislation among a small circle of lawmakers and aides. In the aftermath, the Treasury Department and Internal Revenue Service (IRS) have been left to put the pieces together to draft guidance for provisions beginning this year.

We published a Spotlight Report in February highlighting the implementation of the Clean Vehicle Credit (Section 30D), Advanced Manufacturing Production Tax Credit (Section 45X), Advanced Energy Project Credit (Section 48C), and the Zero-Emission Nuclear Power Production Credit (Section 45U).

Treasury and the IRS released proposed guidance on Section 30D at the end of March detailing critical mineral and battery component requirements. Proposed guidance on detailing the IRA's "foreign entities of concern" provision and its impact on the up to $7,500 credit is still in the works.

The IRS is expected to release proposed guidance with more details on implementation of the Section 45X, 48C, and 45U credits, seeking requests for comment on all three, as well as a request for comment on direct pay.

Meanwhile, guidance is ongoing for two tax offsets in the IRA.

President Biden is already proposing in his FY24 budget to quadruple the one percent corporate buyback tax that passed in the IRA. But the interim guidance issued in December is causing some problems for US subsidiaries of foreign multinational corporations. A comment letter from the American Chemistry Council noted that the guidance could subject many business transactions to treatment as funding foreign stock repurchases for purposes of the buyback tax.

Then there is the 15 percent corporate alternative minimum tax (CAMT) on adjusted financial statement income exceeding $1 billion. Interim guidance was released in December and February. Proposed regulations will come later. The provision is complicated to say the least. A previous version of a book tax in the 1980s was scrapped in part because of its complexity. Right now, it's unclear just which companies will face this new tax. Studies range from anywhere between 90 to 300 corporations will be in scope for the CAMT. As a reference, it has taken years for proposed and finalized regulations for the Tax Cuts and Jobs Act (TCJA) to be issued. **The horizon for CAMT regulations could span into a second Biden term or a Republican administration.**

For Biden and congressional Democrats, they want to run in 2024 on a successful implementation of the legislation passed last Congress. However, it's a balance of priorities. They want to make sure corporations pay their "fair share" but implementing complicated guidance and regulations could unintentionally stymie businesses and create new loopholes. On the clean energy tax credits, it's a balance between moving towards a decarbonization of the economy and promoting a domestic supply chain. Already, some reports put the price tag on these tax credits hundreds of billions higher than the initial official budget estimates. **A more costly program would make it a bigger target of Republicans for offsets if they take back control of government in 2025.**

Tomorrow: It's Small Ball Looking for a Field

Last year there were high expectations for a major tax package to pass in the lame duck session. In the end, retirement security legislation was the only thing to pass. The 2022 midterm elections did little to change the dynamics that led to an impasse on tax legislation. Democrats felt emboldened by their party's overperformance in the midterms to keep their priorities of the Child Tax Credit (CTC) and other family-oriented tax breaks. They want those tax provisions in exchange for business relief on R&D expensing, bonus depreciation, and interest deductibility limits. Republicans, however, took over the House and aren't ready to hammer out a deal.

There's a general pessimism that what was punted last year will be punted once again. But it's important to watch the dynamics that could lead to some tax legislation passing in the year ahead.

Passing tax legislation is not as simple as introducing legislation with bipartisan support. The process to watch includes the following:

1. Tax lobbyists generate interest among lawmakers for legislation;
2. The actual introduction of legislation;
3. The addition of cosponsors and whether there is a critical mass of bipartisan support;
4. The elevation of legislation to leadership levels in tax committees;
5. The holding of committee hearings and markups of relevant tax legislation and issues;
6. The elevation of legislation to party leadership;
7. The opening of tax legislation as policy riders to broader legislative vehicles; and/or
8. The opening of standalone tax legislation on the House and Senate floors

Few, if any, tax issues will get through this process this year. But it's worth keeping tabs on where things are at and how they can develop.

LIFO relief: A large, bipartisan, and bicameral effort is once again underway to give auto dealers relief from last-in, first-out (LIFO) accounting as car inventory declined during the pandemic due to the supply chain shortage. Beyond calling on the Treasury Department to take administrative action, the House and Senate reintroduced the Supply Chain Disruption Relief Act that would allow dealers to wait until 2026 for inventory to be replaced before determining income from COGS during 2020 and 2021.

- ***Outlook: Good possibility of passage this year.*** **If there's one piece of tax legislation that has the best chance of passing this year, it's LIFO relief.** There are few political constituencies more powerful than auto dealers. They give generously to politicians, are located in almost every congressional district, and are often leaders in the local community. That constituency shows in the LIFO legislation. The Senate passed this legislation at the end of last Congress, and the Senate bill this year already has 53(!) cosponsors that are close to evenly split between Democrats and Republicans. **What could hold up passage once again is if tax leaders decide to leverage its popularity for broader tax legislation. Right now, we think this legislation can be separated from the rest of the tax tussles.**

Gig economy 1099-K: The American Rescue Plan (ARP) lowered the 1099-K reporting threshold requirement from $20,000 to $600 for payment vendors to send and gig workers to fill out. It was supposed to begin for tax year 2022 (so filed this year), but the IRS last December announced a one-year delay in implementation. Rep. Carol Miller (R-WV) this year reintroduced the Saving Gig Economy Taxpayers Act with Republican support that would repeal the ARP provision.

- ***Outlook: Good possibility of passage this year.*** Late last year, the pressure was intense among Republicans and several Democrats to do something about the new reporting requirements. The idea of many gig workers getting a surprise tax report was politically treacherous enough for the IRS to delay implementation (on legally shaky grounds). Democrats last year were interested in raising the cap rather than repealing the ARP provision altogether. We'd expect some of that legislation to be reintroduced later this year. Some Democrats continue to believe the provision should remain in place. But the outside lobbying effort is only growing. The Biden administration may not want to deal with a tax headache in filing season in an election year. The campaign ad writes itself – a grandma selling some tsotchkes online to make ends meet gets hit with this new tax bill. Once again, we could see a flurry of action near year end that results in some action.

Broadband tax relief: A bipartisan group of senators and representatives reintroduced the Broadband Grant Tax Treatment Act that would exempt federal broadband grants, including those in the Infrastructure Investment and Jobs Act and ARP, from being counted as taxable income by the IRS. It has 16 cosponsors in the Senate and 10 cosponsors in the House.

- ***Outlook: Possibility of passage this year.*** Broadband access is an issue that affects the entire country, red and blue states alike, and particularly rural states that are represented by Republicans in the Senate. With House Ways and Means Committee Chair Jason Smith (R-MO) representing a rural district in Missouri, there's potentially another booster for this provision. Of course, even bipartisan and bicameral legislation often doesn't make the cut. That's what happened last year to broadband tax relief. It could once again fall by the wayside if there isn't a push for broader tax legislation.

R&D: The bipartisan fight for returning to R&D expensing is ongoing. Senators Todd Young (R-IN) and Maggie Hassan (D-NH) reintroduced the American Innovation and Jobs Act. The legislation includes retroactively returning to full R&D expensing and raising the cap and expanding the eligibility of the R&D tax credit. It already has 21 cosponsors. Ways and Means Committee Chair Smith is supportive of it in the House.

- ***Outlook: Possible this year.*** The tremendous lobbying effort by defense, tech, pharmaceutical, and manufacturing companies last year failed to break the logjam Congress had with an R&D for CTC trade. It was a connection by happenstance – both provisions were in the original Build Back Better proposal and both were stripped in the final IRA. It tied the two together in the mind of some Democratic CTC champions. This year, the R&D boosters are focusing on the impact small businesses are facing during the current tax season. **The plight of small businesses is often a more effective messaging point for action than what large corporations want. It's possible this could help prod Democrats to look for an exit ramp for an R&D trade with social policy (see housing development). But as of now, that's not the case.** Democratic leadership and key CTC champions do not appear ready to let go of the CTC.

CTC: The enhanced Child Tax Credit was the staple of the Democrats' ARP in 2021. It expanded the credit from $2,000 to $3,000 per child six years above and up and $3,600 per child under six. It also made it fully refundable and allowed for monthly payments. The enhanced CTC expired at the end of 2021 but Democrats have been fighting for its return ever since. President Biden included it in his FY24 budget proposal.

- ***Outlook: Unlikely this year.*** There's little public effort underway in Congress to reach some sort of compromise. Biden's inclusion of the enhanced CTC in his budget indicates Democrats see this as much as a messaging point for re-election than something to negotiate over. Some Republicans are open to negotiation. Chair Smith said he is "very negotiable" for increasing the size of the credit, but only if work requirements remain, something the enhanced CTC proponents oppose. The Republican sentiment in the Senate is less open to a CTC compromise. They are incredulous R&D expensing was taken hostage by Democrats for a much more expensive policy priority. There's less room to negotiate here, unless it includes broader business tax breaks. The most likely time for CTC renegotiating will come in 2025 when the TCJA's CTC expires.

Low-income housing development: In the face of continuing affordability challenges for housing, there are bipartisan efforts to address the supply-side shortage. Senators Ben Cardin (D-MD) and Young reintroduced the Neighborhood Homes Investment Act that would provide a tax credit for developers and rehabbers of homes in distressed neighborhoods. Senators Young and Maria Cantwell (D-WA) are expected to reintroduce the Affordable Housing Credit Improvement Act that would expand the Low Income Housing Tax Credit (LIHTC). Senate Finance Committee Chair Ron Wyden (D-OR) reintroduced his comprehensive housing and homelessness legislation called the DASH Act. Wyden held a committee hearing last month on tax policy's role in increasing affordable housing supply for working families. Senate Finance Committee Ranking Member Mike Crapo (R-ID) is supportive of many of the efforts underway.

- ***Outlook: Possible but not likely this year.*** In theory, the prospects for housing legislation looks good. Legislation was introduced, there is bipartisan support, including from tax leadership, and there has already been a hearing on the issue. But that support was there last year and failed to get through all the hurdles for passage. **Right now, Young is making the case that housing affordability,**

rather than the enhanced CTC, could be attached to R&D expensing. It's something Wyden hasn't dismissed out of hand, noting he's looking for a balanced package that bolsters the social safety net in exchange for business tax breaks. Still, we're pessimistic that balance can be struck for Democrats without some version of the CTC. Additionally, Wyden is a prodigious producer of policy and he may want to push for his DASH Act, even though it has no cosponsors. Crapo, while supportive of the housing efforts, may want to hold out for more business tax provisions or a more holistic approach to housing that tackles housing regulations and zoning. With limited time, it will be a challenge to reach an agreement here that could be acceptable enough in the House and Senate to attach to the few legislative vehicles available this year.

Bonus depreciation: Republicans in the House and Senate have reintroduced the ALIGN Act to make permanent full and immediate expensing from the TCJA that began to phase down this year.

- ***Outlook: Very unlikely this year.*** The 100 percent bonus depreciation provision in the TCJA is often one of the most heralded parts of the legislation by Republicans. They are keen to keep it going. However, making it permanent would cost hundreds of billions of dollars. The more feasible option is a temporary extension. It's a priority for Republicans but Democrats probably wouldn't agree to it without a real progressive priority included as a trade-off. That horse trading (and large deficit increase) probably won't cut it in the current political environment. The bonus depreciation decreases by 20 percent each year until it sunsets at the end of 2026. Republicans may decide to wait to make their push until they have greater leverage, perhaps after the 2024 election. It'll be a top priority for Republicans come 2025.

SALT Cap: Salt is still in the wound for proponents of the state and local tax (SALT) deduction. After failure to take action on the $10,000 cap from the TCJA last Congress, the SALT Caucus in the House relaunched with 32 members, including several freshmen Republicans from New York and New Jersey. Legislation has already been introduced that would remove the cap completely, remove or limit the cap for those making less than $1 million, or raise the cap to $100,000 for single filers or $200,000 for married couples.

- ***Outlook: Wait until 2025.*** The SALT caucus likes to make a lot of noise, but there's no path for any action this year, especially with a Republican House. The key will be in 2025 when the SALT cap expires and both parties will be looking for offsets.

Beyond the above legislation that was explicitly reintroduced or mentioned in Biden's budget, we could see legislation on Opportunity Zones and interest deductibility reintroduced later this year that bears watching. Some legislation that was reintroduced, like a permanent repeal of the estate tax and making permanent the individual provisions of TCJA, are a pure messaging play for 2025.

If tax legislation is getting done, it'll be attached to larger legislative vehicles, like the Federal Aviation Administration (FAA) reauthorization, the Farm Bill, or FY24 appropriations. The latter two could very well not get done this year, leaving stop-gap legislation that typically receives few, if any, policy riders. Transportation leaders in

Congress who want to get a bipartisan FAA bill done on time will have little patience for unrelated tax negotiations. **The one area where we could see a breakthrough on some of the tax impasse is if there is a recession and lawmakers try to pass a modest fiscal package.** In that case, there could be some momentum for a limited package for tax breaks for both businesses and the social safety net. But it depends on the depth and reaction of the recession. Too much partisan rancor could sidetrack any limited package.

The Day After Tomorrow: Tax Armageddon in 2025

Winter is coming. TCJA individual provisions expire at the end of 2025 and some of the business tax breaks unwind. For Democrats, the enhanced Affordable Care Act subsidies in the IRA expire at the end of 2025. Barring WWIII, this will be the biggest policy event in 2025.

The costs are substantial. The Tax Policy Center estimates extending the individual TCJA provisions would cost $3.1 trillion from FY27 to FY36. The Penn Wharton Budget Model estimates extending the expiring TCJA provisions would cost $2.8 trillion from 2023 to 2032.

The direction of policy hinges on the 2024 elections. Unified control of government means there will be a reconciliation bill. Divided government means there will be bipartisan negotiations.

Unified Republican Control: A Republican reconciliation bill will look a bit different than what the GOP passed in 2017. Back then, people like former House Speaker Paul Ryan (R-WI) were still a major force in the party. There's a more populist tilt to the party today. Several of the individual and pass-through tax breaks will be on the table. But some corporate measures, many of which were made permanent, could be tinkered with in order to help offset some of the costs. Republicans could try to roll back some of the IRA clean energy tax credits, especially if implementation is problematic and cost estimates rise. However, the GOP may not be eager to roll back the CAMT, especially since it would cost hundreds of billions. Margins matter a bit less for Republicans than Democrats, as the GOP is more unified on taxes. But a House GOP that still has a meaningful contingency of members from high-tax districts will once again face a thorny question over the SALT cap.

Unified Democratic Control: A Democratic reconciliation bill will look to extend the individual and pass-through provisions of the TCJA but limiting it to those making less than $400,000. It was what Biden included in his budget. Democrats will want to bring back several of the erstwhile provisions from Build Back Better that were cut from the IRA on both spending and offsets. Margins again will be tricky in both chambers. If Democrats have a 50-50 Senate but with no West Virginia Democrat and Rep. Ruben Gallego (D-AZ) replacing Senator Kyrsten Sinema (I-AZ), there may be some more room to maneuver compared to last Congress. House moderates would play a decisive role in culling offsets. There are more Democratic SALT defenders who would push for letting the cap lapse or at the very least create a higher cap or carveout.

Divided Government: President Obama had to work with House Republicans when the Bush tax cuts were expiring in 2010. He made a deal for a temporary extension, which was followed up by making several provisions permanent in 2012 for those making less than $400,000. Negotiations will be challenging in 2025, making the prospect of a temporary extension a real possibility. Another challenge is just how adamant both sides would be to offset any extensions. Since most of the tax cuts on the table are from the GOP's 2017 law, there may be some more latitude for deficits. But the mood for high-profile deficit spending is limited today. We will see what the mood is come 2025 (perhaps AI will generate a huge boost in productivity and grow tax revenues to reduce deficit concerns). But it could make for some painful horsetrading that leaves some tax hikes on the table in bipartisan negotiations.

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