SQUIRE PATTON BOGGS

Tax Update: Senate Republicans Release Tax Text

On June 16, the Senate Finance Committee released its portion of Senate Republicans' proposed multi-trillion-dollar reconciliation package. The Finance Committee's draft tax title includes significant departures from tax provisions proposed in the House-passed reconciliation bill, the *One Big Beautiful Bill Act* (H.R. 1), such as less stringent phaseouts of *Inflation Reduction Act* (IRA) clean energy tax credits, a smaller state and local tax (SALT) deduction cap, and permanent business tax reforms, among others. Additional changes to the text are expected prior to Senate floor consideration of the bill, including changes to the SALT deduction cap, which is currently subject to ongoing negotiations.

What is Included in the Draft Legislation? Notable tax provisions include:

- **TCJA Extension** – As with the House-passed bill, the legislation makes permanent or extends several expiring provisions from the 2017 *Tax Cuts and Jobs Act* (TCJA), including:
  - Individual Income Tax Rates: The bill makes permanent the individual income tax rates enacted by TCJA. As with the House bill, the Senate legislation does not include a new bracket for high-income individuals.
  - Standard Deduction: The bill makes permanent TCJA's increase to the standard deduction and further temporarily increases the standard deduction for tax year 2025. The proposed legislation also permanently reduces the deduction for personal exemptions and miscellaneous itemized deductions which were temporarily limited by TCJA. The House-passed bill includes a temporary increase in the standard deduction through 2028.
  - Section 199A Pass-Through Deduction: The bill makes permanent the 20 percent Section 199A qualified business income deduction, among several other changes. The House-passed bill includes an increase in the deduction to 23 percent.
  - Alternative Minimum Tax: The bill makes permanent TCJA's increase in the alternative minimum tax (AMT) exemption but reverts the exemption phaseout thresholds to 2018 levels. The reversion may result in additional individuals being subject to the AMT and therefore excluded from claiming the SALT deduction.
  - Estate and Gift Tax: The bill permanently increases the estate and gift tax exemption level to $15 million, beginning after December 31, 2025, and indexes the increase to inflation.
- **Business Provisions** – The bill includes several sought-after business provisions, as well as incentives for domestic manufacturing. As anticipated, the Senate proposal permanently extends several business tax provisions. The House-passed bill would extend the provisions through 2028.
  - Bonus Depreciation: The legislation permanently restores 100 percent bonus depreciation, effective January 20, 2025, allowing businesses to immediately deduct 100 percent of the cost of certain short-term investments (*e.g.*, equipment

and machinery) from their taxable income in the first year rather than over fixed intervals.

  - Interest Deductibility: The bill restores the EBITDA (*earnings before interest, taxes, depreciation, and amortization*)-based limitation on the net business interest deduction effective December 31, 2024.

  - R&D Expensing: The bill provides for immediate expensing of domestic research and development (R&D) expenditures effective after December 31, 2024. As with the House, the Senate proposal maintains current capitalization and amortization requirements for foreign R&D expenditures.

  - Special Depreciation for Manufacturing Facilities: As with the House-passed bill, the legislation includes a new 100 percent bonus depreciation allowance for certain manufacturing, production, or refining facilities.

  - Advanced Manufacturing Investment Credit (Section 48D): The bill increases the Section 48D credit rate to 30 percent (from 25 percent under current law) effective for property placed in service after December 31, 2025. The House-passed bill does not include changes to Section 48D.

- **Presidential Priorities** – As with the House-passed bill, the Senate bill contains several of President Trump's major campaign promises on tax, including:

  - No Tax on Tipped Income: The legislation includes a new deduction of up to $25,000 for "qualified tips" through 2028. Under the proposal, "qualified tips" are generally defined as "any cash tip received by an individual in an occupation which traditionally and customarily received tips," as determined by the Secretary of the Treasury. The legislation also includes several exclusions, including for highly-compensated employees, as well as Social Security Number (SSN) and reporting requirements. The deduction would be available for employees and independent contractors. The deduction would also be available for individuals claiming the standard deduction. The House-passed bill does not include a cap on the deduction.

  - No Tax on Overtime: The legislation includes a new deduction of up to $12,500 ($25,000 for joint filers) for "qualified overtime compensation" through 2028. The proposal contains exclusions for highly-compensated employees, as well as Social Security Number (SSN) and reporting requirements. The deduction would be available for individuals claiming the standard deduction. The House-passed bill does not include a cap on the deduction.

  - Tax Relief for Seniors: The legislation includes an additional standard deduction amount of $6,000 for individuals 65 and older from 2025 through 2028. The additional bonus amount begins to phase out for individuals with income over $75,000 (or $150,000 for taxpayers filing jointly). The House-passed bill includes a $4,000 increase.

  - Auto Loan Interest Deductibility: As with the House-passed bill, the Senate bill generally provides for a deduction for "qualified passenger vehicle loan interest," of up to $10,000 through 2028. "Qualified passenger vehicle loan interest," is defined as “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,” subject to several exceptions. (emphasis added). The Senate legislation would apply to new passenger vehicles. The legislation includes phase outs of the deduction for individuals exceeding income thresholds. In addition, to qualify, a vehicle’s final assembly must occur in the US.

- **Inflation Reduction Act Amendments** – As with the House-passed bill, the Senate legislation does not propose full repeal of the IRA. However, the legislation proposes to repeal, sunset, or otherwise limit several clean energy tax incentives expanded or created by the 2022 law. The Senate legislation departs from the House-passed bill in several ways. Provisions include:

    - <u>Advanced Manufacturing Production Credit (Section 45X)</u>: As with the House-passed bill, the Senate legislation makes several changes to the Section 45X Advanced Manufacturing Production Credit. The Senate legislation eliminates the credit for wind energy components after December 31, 2027, and gradually phases out the credit for critical minerals between 2031 and 2034. Unlike the House-passed bill, the Senate legislation maintains partial credit eligibility for other components sold during calendar year 2032. The bill also includes new limits on credit access for certain prohibited foreign entities. Prohibited foreign entity provisions differ from those proposed in the House-passed bill.

    - <u>Clean Electricity Credits (Sections 45Y & 48E)</u>: The Senate legislation includes varying phase outs for the Clean Electricity Production Tax Credit (45Y) and Clean Electricity Investment Tax Credit (48E) based on applicable technology type. Most notably, the legislation terminates the credits for wind and solar technologies by 2028. The legislation also imposes new prohibited foreign entity restrictions beginning after enactment and material assistance restrictions for facilities commencing constructions after December 31, 2025. The legislation also prohibits leasing arrangements for residential solar and wind projects. The House-passed bill proposes to terminate the credits for facilities beginning construction 60 days after enactment or placed in service after December 31, 2028 (with the exception of certain nuclear facilities).

    - <u>Clean Fuel Production Credit (Section 45Z)</u>: The bill extends the Section 45Z Clean Fuel Production Credit for four years through December 31, 2031. The bill also reduces the applicable credit amount by 20 percent for fuel derived from feedstocks produced or grown outside the US, effective after December 31, 2025. The legislation imposes new restrictions for prohibited foreign entities at enactment and for foreign-influenced entities beginning two years after enactment.

    - <u>Clean Hydrogen Production Credit (Section 45V)</u>: As with the House-passed bill, the Senate bill terminates the Section 45V Credit for Clean Hydrogen Production for facilitates beginning construction after December 31, 2025.

    - <u>EV Credits</u>: The Senate legislation terminates the Section 25E Previously Owned Clean Vehicle Credit for vehicles acquired more than 90 days after enactment and terminates the Section 30D Clean Vehicles Credit and the Section 45W Commercial Clean Vehicle Credit for vehicles acquired more than 180 days after enactment. The House-passed bill would terminate the credits effective on December 31, 2025. Unlike the House-passed bill, the Senate legislation does not provide for special transition rules for the Section 30D and Section 45W credits. The bill also terminates the Section 30C Alternative Fuel Vehicle Refueling Property credit with respect to property placed in service 1 year after enactment.

  - Residential Clean Energy Credits: The legislation terminates the Section 25D Residential Clean Energy Credit 180 days after enactment. The legislation also terminates the Section 45L New Energy Efficient Home Credit 1 year after enactment. The House-passed bill includes distinct termination dates.

  - Zero-Emission Nuclear Power Production Credit: The legislation includes new restrictions on the Section 45U Zero-Emission Nuclear Production Tax Credit, including restrictions on fuel produced in certain countries effective beginning in 2028, and new prohibited foreign entity restrictions. The House-passed bill proposes to accelerate the sunset of the Section 45U credit to December 31, 2031 (as compared to December 31, 2032 under current law).

  - Transferability Rules: Unlike the House-passed bill, the Senate legislation retains the transferability of several IRA credits, including the Section 45Q Credit for Carbon Oxide Sequestration (repealed two years after enactment in the House-passed bill), and Section 45Z Clean Fuel Production Credit (repealed for fuel produced after December 31, 2027, in the House-passed bill).

- **Child & Family Policies** – The legislation includes several provisions concerning children and families, including:

  - Child Tax Credit: The section makes permanent several aspects of the Child Tax Credit (CTC), including permanently extending TCJA's increase of the CTC to $2,000 per child and increase to the refundable CTC to $1,400, adjusted for inflation. The section also makes permanent income phaseout threshold amounts. The bill also permanently increases the nonrefundable CTC to $2,200 per each qualifying child, indexed for inflation. The bill also requires that the qualifying child and at least one spouse (if filing jointly) have an SSN to be eligible to claim the credit.

  - Employer-Provided Child Care Credit (Section 45F): The legislation permanently increases the employer-provided child care credit to 40 percent of qualified child care expenditures (50 percent for small businesses) and 10 percent of qualified child care resource and referral expenditures and increases the maximum credit amount to $500,000 ($600,000 for small businesses).

  - Child and Dependent Care Tax Credit: The legislation permanently increases the maximum Child and Dependent Care Tax Credit (CDCTC) rate to 50 percent from 35 percent under current law, effective for taxable years after December 31, 2025. The House-passed bill did not include CDCTC changes.

  - Dependent Care Assistance Program: The legislation increases the exclusion for dependent care assistance up to $7,500 annually from $5,000 under current law, effective for taxable years beginning after December 31, 2025. The House-passed bill did not include dependent care assistance program changes.

  - Trump Accounts: The Senate legislation includes the House proposal to create a new tax-preferred investment accounts, named "Trump Accounts," for beneficiaries under the age of eight at the time of establishment of the account. Individuals are permitted to contribute up to $5,000 per year to each account, adjusted for inflation.

- **Housing & Community Development:** The legislation proposes several changes to housing and community development incentives:

  - Opportunity Zones: The legislation establishes a permanent Opportunity Zone (OZ) incentive with ten-year rolling OZ designations beginning in 2027. The legislation includes special incentives for investment in rural areas and changes several eligibility requirements and definitions for the program. While the House-passed bill proposes a second round of OZ designations, it does not propose a permanent, rolling incentive.

  - Low-Income Housing Tax Credit: The legislation permanently increases the Low-Income Housing Tax Credit (LIHTC) state allocation ceiling by 12 percent and lower the bond-financing threshold to 25 percent for projects financed by bonds starting in 2026.

  - New Markets Tax Credit: The legislation permanently extends the New Markets Tax Credit (NMTC) program. The NMTC is set to expire on December 31, 2025 under current law. The House-passed bill did not include NMTC extension.

- **International Provisions:** The legislation proposes several changes to international tax provisions:

  - International Tax Reform: The legislation includes new limits on the deduction for "Foreign-Derived Deduction Eligible Income" (renamed from Foreign-Derived Intangible Income (FDII)) and "Net CFC Tested Income" (renamed from Global Intangible Low-taxed Income (GILTI)). The legislation also makes multiple changes to the base erosion and anti-abuse tax (BEAT).

  - Section 899: As with the House-passed bill, the Senate legislation would adopt a new Section 899 of the Internal Revenue Code that would provide a mechanism for imposing retaliatory US tax increases against residents of countries with "unfair foreign taxes." The Senate legislation makes several changes to the House proposal, including delaying implementation to 2027 and decreasing the maximum percentage point increase of applicable US taxes to 15 percentage points (from 20 percentage points).

- **State & Local Tax (SALT) Deduction Cap:** The legislation permanently extends the current cap on the state and local tax (SALT) deduction of $10,000 (compared to an increase to $40,000 in the House-passed bill). As noted by the Finance Committee, the amount of the individual SALT cap is the subject of continuing negotiations between House and Senate leaders.

- **Endowments & Private Foundations:** As with the House-passed bill, the Senate legislation includes a new tiered excise tax on the net investment income of certain private colleges and universities with large endowments. However, the Senate's applicable endowment excise tax rate ranges between 1.4 and 8 percent based on an institution's student-adjusted endowment. The House-passed bill would impose an excise tax of up to 21 percent. In addition, the Senate legislation does not include a new tiered excise tax on the net investment income of certain large tax-exempt private foundations. The House-passed bill would impose a new excise tax on certain private foundations with more than $50 million in total assets.

- **Remittance Transfers:** The legislation imposes a new 3.5 percent excise tax on certain cash remittance transfers sent to persons outside the United States, effective after December 31, 2025. The Senate legislation includes an exception for transfers funded with a US debit or credit card and transfers of funds withdrawn from certain financial institutions.

- **Debt Limit:** The legislation increases the statutory debt limit by $5 trillion. The House-passed bill includes a $4 trillion increase.

What's Next? Additional changes to the Senate's tax proposals are likely prior to Senate floor consideration of the bill, most notably further changes to the SALT deduction cap. Further modifications may also occur following review of the tax title by the Senate Parliamentarian for Byrd Rule violations.

Leader Thune is likely to initiate Senate floor consideration of H.R. 1 – with the Senate's legislative proposals substituted for the House-passed text – next week. Upon bringing the bill to the Senate floor, the Senate will begin an amendment process known as a "Vote-a-Rama," where the Senate will likely consider several hundred amendments to the bill. Following the amendment process, the Senate will vote on final passage which only requires a simple majority under reconciliation rules. Should the Senate successfully pass their version of H.R. 1, Republican leaders will be forced to reconcile differences between the House- and Senate-passed versions of the reconciliation package, either through a formal conference process, through informal negotiations, or by accepting amendments from the other chamber.

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