January 18, 2023

2023 Tax Legislative and Regulatory Outlook

The November elections brought a new reality to Washington for 2023 - Democrats and Republicans will need to reach bipartisan agreements to pass tax and other legislation this Congress. Unlike the previous Congress in which reconciliation was twice used as a legislative vehicle and only a portion of Senate Republicans was needed to support larger items such as appropriations bills or other efforts, any negotiations for must-pass bills will need to involve House and Senate Republicans as reconciliation will likely not be an option this Congress.

As evidenced by the four-day House Speaker vote and subsequent House Rules changes, such as a single-Member motion to vacate, Speaker Kevin McCarthy (R-CA) will need to ensure that all factions of the House Republican party agree on any paths forward. Due to that challenge, House Republicans will focus the early part of the Congress on oversight and policy development.

The headwinds that come with a new House majority will not prevent all legislation, however, as there are several must-pass items with deadlines later this year. The most notable items include the debt limit, which will need to be addressed this Spring or Summer, as well as government funding, a farm bill, and Federal Aviation Agency reauthorization, each with September 30 deadlines. The scope of the potential agreements on passing these three major items is unclear, but they could include tax legislation. Several tax items were left out of last year's omnibus bill and there will be an effort to complete those items in any available vehicle this year. As is often discussed in our legislative outlooks, there is always risk of an unforeseen occurrence (UFO) that will shift Congress away from its anticipated path – this year some of these items could include an economic recession, natural disasters, or escalation of global security tensions.

Although Congress could face difficulties this year in moving tax legislation in the divided government, the Treasury Department and IRS will be busy continuing to issue guidance implementing last year's Inflation Reduction Act. The key areas of guidance will implement the two new taxes – the corporate alternative minimum tax and stock buyback excise tax – and the robust package of energy tax incentives.

The Treasury Department will also continue its work at the OECD to develop the implementation framework for the "Two Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy." With other countries moving forward with a 15 percent global minimum tax, the debate about whether and how the United States should respond will continue, potentially setting the stage for future legislative action.

The following outlook provides background of last year's legislative efforts and an overview of the relevant legislative and regulatory items that may arise this year. Please reach out to us if you have any questions or comments.

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2022 Year in Review

Inflation Reduction Act

In what turned out to be one of the best-kept secrets in recent Washington memory, the months-long impasse between Senate Majority Leader Chuck Schumer (D-NY) and Senator Joe Manchin (D-WV) broke quickly and they announced in July that an agreement had been reached on a budget reconciliation bill, paving the way for legislation that provides over $270 billion of energy tax credits, reforms health care and drug pricing, and increases tax revenues through three business tax provisions and increased IRS funding.[1] The July 27 announcement set off a flurry of activity leading to the bill's enactment on August 16.

The energy tax incentives in the Inflation Reduction Act (IRA)[2] represent the largest single energy investment in U.S. history.[3] The bill provided long-term tax incentives in five key areas: (1) clean energy generation; (2) clean fuels; (3) energy efficiency; (4) clean transportation; and (5) clean energy manufacturing. President Joe Biden said the IRA is "the most significant legislation in history to tackle the climate crisis and improve our energy security."[4] Congressional Democrats focused their policy efforts primarily on providing incentives to promote certain activities intended to address climate change rather than disincentivizing disfavored activities. This led to broad interest across the energy sector in utilizing and supporting the credits. Further, to ameliorate tax equity market limitations, the IRA provides for transferability for most credits, as well as a direct pay mechanism available to certain entities, such as municipal utilities or electric cooperatives. The direct pay mechanism is accessible more broadly by all taxpayers in the case of certain credits, such as the energy manufacturing, carbon sequestration, and hydrogen credits. While the tax equity markets will still play a significant role in the monetization of energy credits, transferability and direct pay offer new tools that will shape the equity markets and expand the utilization and interest in the credits.

Importantly, the energy tax credits included many incentives, and in some cases requirements, designed to increase investments in high-paying jobs, domestic supply chains, low-income communities, and regions directly impacted by the shrinking coal industry. Most of the energy generation credits now require taxpayers to meet certain prevailing wage and apprenticeship requirements (collectively referred to as the "labor provisions") to receive the full value of the credits.[5] For some generation, taxpayers may receive bonus credits if the materials are sourced domestically (referred to as the "domestic content" requirements) or if the project is located in

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[1] "Manchin Supports Inflation Reduction Act of 2022," Press Release, July 27, 2022, https://www.manchin.senate.gov/newsroom/press-releases/manchin-supports-inflation-reduction-act-of-2022.
[2] P.L. 117-169, August 16, 2022, H.R. 5376. The IRA passed Congress with unanimous Democratic support and no Republican votes.
[3] See JCT, "Estimated Budget Effects of the Revenue Provisions of [the Inflation Reduction Act]," JCX-18-22, August 9, 2022, https://www.jct.gov/publications/2022/jcx-18-22/.
[4] Remarks by President Biden on the Inflation Reduction Act of 2022, July 28, 2022, https://www.whitehouse.gov/briefing-room/speeches-remarks/2022/07/28/remarks-by-president-biden-on-the-inflation-reduction-act-of-2022/.
[5] Credits with the labor requirements are structured so that the credit increases by a multiple of five if the requirements are met. For example, the base investment tax credit would be six percent but multiplied by five if the taxpayer meets the labor requirements to make it a 30 percent investment tax credit.

certain low-income or coal communities. These provisions are all designed to increase domestic production of key components and materials as well as ensure that the jobs associated with construction, operation, and maintenance are higher paying and supported through apprenticeship programs.

The IRA also included tax revenue raisers to both offset the energy incentives costs and reduce the deficit. The $400 billion of tax revenue-raising provisions of the IRA include:[6]

- A 15-percent corporate alternative minimum tax (CAMT) based on financial statement income for companies with greater than an average of $1 billion in profits over a three-year period. The provision is effective for taxable years beginning after December 31, 2022. This provision was estimated by the staff of the Joint Committee on Taxation (JCT) to increase revenues by an estimated $222 billion over the ten-year budget window.
- A one-percent excise tax on stock buybacks that is effective for any repurchases occurring after December 31, 2022. JCT estimated that the provision would increase revenues by $73 billion over ten years.
- A two-year extension of the limitation on excess business losses by noncorporate taxpayers. The $250,000 limitation ($500,000 for a joint return) will now sunset for taxable years beginning after December 31, 2028.[7] JCT estimated that the extension of this provision would raise $52.8 billion over ten years.
- Almost $80 billion appropriated to the IRS for the FY2023 year and made available through 2031 for tax enforcement, increased customer service, and technological upgrades, among other items. The Congressional Budget Office (CBO) estimated that the provision of this money would increase revenues by about $200 billion over ten years.

Although the bill moved quickly, and without significant revision from the July 27 version, there were some material changes to generate the support of all Democratic Senators.[8] For example, a change to the treatment of carried interest was dropped and replaced with the stock buyback excise tax. Similarly, some Senators were concerned about the effect that the CAMT would have on the benefits of section 168 expensing, particularly with respect to the manufacturing and energy sectors, and secured the ability for taxpayers to use section 168 tax depreciation instead of book depreciation in determining the CAMT before the bill passed the Senate.

Since the IRA's passage, Treasury and the IRS have been engaged in a robust guidance development process, with an initial focus on developing key issues lists – a process guided in part from requesting stakeholder comments, and issuing guidance on key "day one" issues.[9]

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[6] For a detailed summary of all the tax provisions included in the IRA, see the "Capitol Tax Partners Summary of Tax Provisions in the Inflation Reduction Act of 2022," August 12, 2022, https://www.capitoltax.com/blog-collection/inflation-reduction-act-of-2022-summary.

[7] The excess business loss extension was added as an amendment on the Senate floor that made changes to the corporate alternative minimum tax fixing the common control rules to ensure that certain smaller firms are not aggregated causing them to be subject to it.

[8] The House passed the bill on partisan lines without changes to the Senate-passed version.

[9] The IRA regulatory process is discussed more fully in the Regulatory Agenda section below.

CHIPS

To promote U.S. technology leadership in the semiconductor sector, as well as address ongoing concerns about competition with China and the national security implications of fragile supply chains, last year Congress passed the Creating Helpful Incentives to Produce Semiconductors (CHIPS) and Science Act.[10] This legislation brought together elements from the United States Innovation and Competition Act (USICA),[11] which passed the Senate in July 2021, and the America Creating Opportunities for Manufacturing, Pre-Eminence in Technology, and Economic Strength (COMPETES) Act,[12] which the House passed in February 2022. Notably, the law created the Advanced Manufacturing and Investment Credit (AMIC), which provides a refundable 25-percent credit for qualified investment in a facility that manufactures semiconductors, or the equipment used to manufacture semiconductors. The credit, which expires at the end of 2026, is intended to help create additional domestic capacity for semiconductor manufacturing.

Lame Duck

The 2022 lame duck session, which was headlined by an omnibus appropriations bill and the National Defense Authorization Act, provided a final opportunity in 2022 to enact tax legislation. As outlined in the Capitol Tax Partners Post-Election Outlook,[13] there were many tax items that were in play for inclusion in an end-of-year package. However, a broader agreement could not be reached as Democrats wanted certain child tax credit (CTC) changes to be included in any tax title providing business relief, while Republicans opposed including any CTC changes. Consequently, many items that were potentially on the table during negotiations were left unresolved, including the requested retroactive delays of two 2017 Tax Cuts and Jobs Act (TCJA) revenue raisers (section 174 research and experimentation expensing and section 163(j) business interest expense limitation), and delaying the beginning of the phase-out of full expensing in 2023. Other non-TCJA extenders (such as the limited business meals deduction and the temporary above-the-line charitable deduction), disaster tax relief, and other miscellaneous tax items were also left out of the package.

Some tax items made it into the omnibus bill, however, even in the absence of a larger agreement on tax; the legislative package included a retirement reform package that was the subject of ongoing bipartisan and bicameral negotiations throughout the 117th Congress.[14] Some of the retirement provisions include:

- 401(k) and 403(b) plans automatically enroll participants upon becoming eligible (the employees may opt out of coverage) effective in 2025. The initial automatic enrollment amount is at least three percent but not more than ten percent (percentage increases in subsequent years). All current 401(k) and 403(b) plans are exempted;

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[10] P.L. 117-167, August 9, 2022.
[11] S. 1260, 117th Congress.
[12] H.R. 4521, 117th Congress.
[13] https://www.capitoltax.com/blog-collection/2022-post-election-legislative-outlook.
[14] The retirement legislation centered on separate House and Senate bills: the House-passed SECURE 2.0 (H.R. 2954, 117th Congress) and the Senate EARN Act (S. 4808, 117th Congress) and Retirement Improvement and Savings Enhancement to Supplement Healthy Investments for the Nest Egg Act (S. 4353, 117th Congress).

- Employers are permitted to offer de minimis financial incentives, not paid for with plan assets, such as low-dollar gift cards, to boost employee participation in workplace retirement plans;
- Employers have the option of offering employees to receive matching/nonelective contributions as Roth contributions;
- Employers may make matching contributions to 401(k) plans on behalf of employees who make student loan payments instead of contributing to their retirement account, effective for 2024;
- The cap for transferring former employees' retirement funds to an IRA is increased from $5,000 to $7,000, effective 2024;
- All catch-up contributions from older retirement savers who are high earners (over $145,000) are required to be made as Roth contributions, effective for 2024;
- The overall 25-percent cap for a qualified longevity annuity contract (QLAC) is eliminated, which is intended to improve access to QLACs;
- The rules for recoupment of inadvertent plan overpayments to innocent participants were clarified;
- The time period over which part-time employees can become eligible for 401(k) participation is shortened, effective 2025;
- The ages and limits for catch-up contributions are adjusted, effective 2025;
- Penalty-free early withdrawals for emergencies, certain illnesses, or federally declared disasters are now permitted;
- Repeals the saver's tax credit and replaces it with a 50 percent Federal match of retirement plan contributions, up to $2,000 per employee, for low and moderate-income taxpayers;
- The ability to use of certain plan assets to pay retiree health and life insurance benefits is expanded;
- The required minimum distribution age is increased to 73 (and in 2033, raised to age 75), along with reducing the penalty for failure to take a required minimum distribution; and
- Lost and found directories to locate missing participants are now required.

The omnibus package also included a provision intended to address the abuse of syndicated conservation easement transactions, which was included in the Enhancing American Retirement Now Act when it was marked up by the Senate Finance Committee in June. The original legislation was sponsored by Sens. Debbie Stabenow (D-MI) and Steve Daines (R-MT) and Reps. Mike Thompson (D-CA) and Mike Kelly (R-PA). The conservation easement change only applies to conservation easements that occur after the law's enactment. The new rules will deny a deduction in instances where the claimed value of the deduction exceeds 2.5 times the investment. The new limits do not apply to family partnerships or in instances where the property has been held for more than three years before the donation.

As a final order of business, the Democratically-controlled Ways and Means Committee approved the release of President Trump's tax returns on a party-line basis, which was accompanied by a Ways and Means Committee report[15] and a separate JCT report on the former

[15] CNN, "READ: House Ways and Means Committee report finding Trump was not properly audited by IRS as president," December 20, 2022, https://www.cnn.com/2022/12/20/politics/trump-tax-summary-ways-and-means-committee/index.html.

President's tax returns and mandatory audits while he was President.[16] Committee Democrats defended the investigation by issuing a detailed report showing that the IRS failed to perform a mandatory audit of the President until then-Ways and Means Chairman Richard Neal (D-MA) requested information on the audits. Democrats also cited an interest in requiring transparency of Presidential tax returns. Republicans, however, were concerned about the precedent the release of the tax returns set and the impact on taxpayer expectations of privacy. "I am deeply concerned by recent erosions of taxpayer confidentiality and dangerous precedent today's release sets, which undermines confidence in both our tax laws and legislature," Senate Finance Committee Ranking Member Mike Crapo (R-ID) said in a statement released shortly after the Ways and Means Committee voted to release the tax returns.

[16] CNN, "READ: Joint Committee on Taxation's report on Trump's taxes," December 21, 2022, https://www.cnn.com/2022/12/20/politics/read-irs-mandatory-audit-program-report/index.html.

2023 Outlook

Overview and Important Dates

With divided government returning to Washington, the prospects for tax legislation during this Congress depends on whether Republicans and Democrats can reach compromises on tax issues to pursue as part of only a few expected legislative vehicles. With the recently enacted omnibus package, the next date-certain legislative deadline for bills that could carry tax provisions is September 30: the expiration date for FY2024 government funding, a farm bill, and the airport and airway trust fund excise tax expiration. Another must-pass item that could possibly carry tax will be a debt limit deal, which will need to be addressed later this year.[17]

The following is a list of important dates during the upcoming Congress that may impact the legislative agenda and schedule (*italicized* dates are not legislative deadlines, but rather key dates for the upcoming Congress):

January 19, 2023	*Treasury estimates Federal debt limit reached, beginning extraordinary measures*
February 7, 2023	*President Joe Biden will deliver State of the Union*
February 2023	*CBO chair expected to testify on budget baselines and projections*
March 2023	*Administration budget and Treasury Greenbook release (generally, the Treasury Secretary will testify at the tax-writing committees after the Administration releases its budget)*[18]
Spring/Summer 2023	Debt limit expiration based on the Treasury Department's estimate of when extraordinary measures will be exhausted
September 30, 2023	FY2023 government funding expires, farm bill, airport and airway trust fund excise tax expiration
December 31, 2023	Medicare doc fix
January 2024	*2024 Presidential primaries expected to begin*

[17] Secretary Yellen released a statement informing Congress that the country will reach its statutory debt limit and the Treasury Department will start using extraordinary measures on January 19, 2023. Treasury does not expect the extraordinary measures to be exhausted before June 2023. The exact timing of the debt limit expiration is uncertain and dependent on a variety of factors including, but not limited to, tax receipts. Congress extended the debt ceiling in December 2021 by increasing the dollar cap rather than setting a date certain.
[18] The Treasury Greenbook, which contains tax legislative proposals, generally accompanies the President's budget proposal. For last year's Greenbook, see Treasury Department, "General Explanations of the Administration's Fiscal Year 2023 Revenue Proposals," March 2022, https://home.treasury.gov/system/files/131/General-Explanations-FY2023.pdf.

The outlook for the scope of any of the above vehicles is very uncertain. All legislation will require compromise with the split government, but both sides also have different demands that muddy the outlook. Many House Republicans are committed to reigning in spending and the deficit, and tax cuts without spending offsets may be unpalatable in the current environment in which there is a heightened focus on government debt and deficits and some Democrats may be unwilling to support spending reductions. Business tax cuts without robust individual and family relief may also be difficult to achieve due to the need to reach a bipartisan agreement. Because Republicans only have a 222-212 margin,[19] House conservatives with concerns about the deficit and government spending may impede progress on some of the above-mentioned bills. Because of that dynamic, it is possible that House moderate Republicans and Democrats may be positioned to work deals to secure the necessary votes to pass key bills through the House. In the 51-49 Senate (and with reconciliation likely off the table), all tax legislation will have to be bipartisan to garner 60 votes.

Further impeding efforts for major bipartisan tax legislation early in the year, House Republicans will spend the first few months refining and developing their tax legislative priorities, which will largely center around oversight of the IRS, supporting and improving upon the TCJA, and reversing the increased IRS funding provided by the IRA.

One caveat to the general expectations for the upcoming Congress is, if economic conditions worsen, emergency stimulus relief legislation could be considered. In that event, a tax title may be added to provide relief to families and businesses, but subject to a backdrop of debate about the debt limit and government spending.

Unfinished Tax Items

There are several legislative priorities that were left unresolved in the previous Congress that will likely be pursued in any available tax vehicle. The following is a list of some of those items:

- **Section 174 R&D expensing** – The TCJA required that research and experimentation expenses be capitalized and amortized over five years (15 years for foreign expenses), beginning in 2022. There was bipartisan support last Congress for a retroactive delay in requiring amortization.
- **Section 163(j) extension** – Section 163(j) as passed in the TCJA transitioned the business interest deduction limitation from being based on a company's earnings before interest, taxes, and amortization (EBITDA) to earnings before interest and taxes (EBIT) beginning in 2022. The business community will seek to extend the more favorable EBITDA-based limitation.
- **Full expensing/bonus depreciation extension** – This year, 100 percent bonus depreciation (or "full expensing"), which was included in the TCJA, begins to phase out ratably over a five-year period.
- **Child tax credit** – As a condition to agreeing to business tax changes in the lame duck, Congressional Democrats prioritized child tax credit enhancements. The 2021 American Rescue Plan Act (ARPA) legislation made several temporary changes to the existing

[19] There is currently one vacancy in the House, with Rep. Donald McEachin (D-VA) passing away after November's election. There will be a special election to fill the seat on February 21, 2023.

CTC, including: (1) expanded the value to $3,600 for children under six and $3,000 for children up to 17 years old; (2) phased out the enhanced CTC at lower income thresholds; (3) made the credit fully refundable; and (4) made the credit advanced refundable for the second half of 2021. Those changes expired at the end of 2021. Democrats sought to include extension of some of these changes in a year-end lame duck package. Some Republicans have indicated an interest in making modest changes to the CTC, creating the potential for compromise in 2023. For example, newly-selected Ways and Means Chairman Smith said in December that he believes that there is room for compromise on the CTC and welfare reform, specifically noting the need to address work requirements for the CTC.[20]

- **1099-K reporting thresholds** – ARPA included a provision that expanded third-party settlement organization information reporting to cover anyone receiving $600 or more in a tax year; the previous reporting threshold was $20,000 and 200 transactions in a year. Certain stakeholders and taxpayer advocacy groups have argued that the lower reporting threshold will cause confusion to taxpayers who used a variety of mostly online marketplace resources, and the burden will fall mostly on lower-income individuals who rely on such services for their personal financial activity. Responding to the concerns raised over the new reporting provision, the Treasury Department in December delayed the reporting requirement for one year, easing some of the initial pressure that would have been raised if the forms were to be released in January.[21] There was also a glitch on backup withholding related to this provision that would require withholding at the first dollar rather than at the $600 reporting threshold. The Notice did not address this issue and a technical correction may be considered this year.
- **Other expired tax provisions** – There are several non-TCJA expired provisions, including racehorse depreciation and the cover-over of the rum excise tax.[22] Recent tax extender legislation provided permanent or long-term extensions of several items that traditionally drove consensus on reaching an extenders deal; there were not extenders on the FY2023 omnibus package. Other items adopted as part of COVID relief, such as the 100-percent deductibility of business meals and the charitable deduction for non-itemizers, could be considered as well.
- **Car dealer LIFO** – After passing the omnibus last December, the Senate passed by unanimous consent the Supply Chain Disruptions Relief Act,[23] which would provide relief to car dealerships that use the LIFO inventory method. The measure was not considered in the House. Advocates are expected to continue efforts to advance this legislation in the new Congress.

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[20] Rep. Jason Smith interview with Punchbowl News, December 7, 2022. On CTC and work requirements, see also Jason Smith Press Release, "J. Smith Statement on Selection as Next Chairman of the House Ways and Means Committee," January 9, 2023 ("Domestically, we cannot expect our labor force to recover if Congress makes work less valuable than a government check, as Democrats did when they dismantled the Child Tax Credit in 2021").

[21] Notice 2023-10. See also, IRS Fact Sheet, "Frequently asked questions about Form 1099-K," FS-2022-41, December 2022.

[22] For a comprehensive list of expired and expiring provisions, see the JCT "List of Expiring Federal Tax Provisions, 2021-2031," JCX-1-22, https://www.jct.gov/publications/2022/jcx-1-22/.

[23] S. 4105, 117th Congress, Introduced by Sen. Sherrod Brown (D-OH) and cosponsored by 23 Democratic and 35 Republican Senators.

House Outlook

The challenges of a tight House Republican majority, evidenced during the Speaker vote that took 15 rounds and four days, and the inclination to look toward the 2024 election, may impair the prospects for developing bipartisan tax legislation. The general expectation is that House Republicans will focus their efforts instead on oversight, challenging legislation that was passed during the previous Congress, and developing their own legislative priorities, which will include extending and improving upon the TCJA. Conversely, House Democrats generally are expected to defend their legislative record and push back on the Republican oversight agenda.

Oversight Priorities. House Republican commitment to a robust oversight agenda begins with the recently-passed House Rules package requiring standing committees to submit an oversight plan no later than March 1. Within the Ways and Means Committee, oversight will primarily focus on the current Administration's implementation of ARPA, IRA, and Covid-relief funds. In part, the oversight efforts are expected to continue last year's work when Republicans filed dozens of Resolutions of Inquiry. Several resolutions of inquiry were within Ways and Means' jurisdiction, including directing the Treasury Secretary to provide the House with information relating to the decision-making process for the destruction of approximately 30 million paper information returns in 2021,[24] the impact of the OECD Pillar One agreement on the United States,[25] the role of the Small Business Administration in determining taxes for small businesses,[26] and recovery rebates under section 6428B (also referred to as "stimulus checks").[27] The Ways and Means Committee also may focus some oversight efforts on items related to environmental, social, and governance standards in the business community and their impact on energy independence, security, jobs, and rates of returns on retirement accounts. House Ways and Means Chairman Jason Smith (R-MO) has also stated he intends to "examine whether it is in the best interest of the American people to continue showering tax benefits on corporations that have shed their American identity in favor of a relationship with China."[28]

Pushing Back on Legislation from Last Congress. As part of House Republicans' plans to push back against legislation that was passed under recent Democratic control, the House passed as its first legislation this Congress a bill repealing most of the $80 billion of additional IRS funding from the IRA.[29] The IRS funding bill is political and will not pass the Senate. It is an important reminder of the Republican House agenda to clawback Democratic bills and enhance oversight. Specifically, the bill would rescind the IRA increased funding for enforcement, operations support, the direct e-file program, the Treasury Inspector General for Tax Administration, Treasury Office of Tax Policy, U.S. Tax Court, and IRA implementation. The bill would keep almost $8 billion for customer service and business systems modernization.

In an August 17 letter to then-IRS Commissioner Chuck Rettig, Treasury Secretary Janet Yellen directed the IRS to produce an operation plan detailing how the IRA's $80 billion IRS funding

[24] H.Res. 1283, 117th Congress.
[25] H.Res. 1269, 117th Congress.
[26] H.Res. 1281, 117th Congress.
[27] H.Res. 1246, 117th Congress.
[28] See Jason Smith Press Release, "J. Smith Statement on Selection as Next Chairman of the House Ways and Means Committee," January 9, 2023.
[29] H.R. 23, Family and Small Business Taxpayer Protection Act, Passed the House on January 9.

should be used over the next decade. In the letter, Secretary Yellen said that the "operational plan is key to ensuring the public and Congress are able to hold the agency accountable as it pursues needed improvements."[30] Secretary Yellen also directed the IRS to not use the new resources to increase audit rates relative to historical levels for households earning $400,000 or less or small businesses. A public operational plan will be scrutinized by Congressional Republicans.

Develop Legislative Priorities. Leading up to the 2022 election, Speaker McCarthy released the Commitment to America policy package, which was a set of priorities for the incoming Republican House majority developed through a committee process focusing on four pillars: (1) strong economy – inflation, energy independence, and supply chains; (2) security – border, crime, and national security; (3) freedom – parental rights, health care, and big tech; and (4) government accountability – constitutional freedoms, Washington oversight, and election security.[31] On tax, the Commitment to America package includes support for an extension and refinement of the TCJA, expanding retirement savings and 529 plans, additional middle-class tax relief, expanding research and development tax credits, and small business and innovation tax incentives.[32]

Because extending and improving the TCJA will be a top priority for House Republicans and the Ways and Means Committee majority, Republican efforts early in the Congress will be to educate the Members about the TCJA and other areas of tax policy. While a primary goal of these efforts will be to establish a record of success related to the TCJA, they will also involve determining whether changes should be made. Chairman Smith has indicated that part of his agenda will include hearings (including possible field hearings) to determine what parts of the TCJA worked, or did not work. Education will be important because only five Ways and Means Republican members were on the Committee during TCJA. With many important individual and business provisions expiring after 2025, Members will need to identify and develop their priorities. These efforts will be viewed as critical when examining opportunities to extend the TCJA during this Congress or the following Congress. These TCJA-related efforts may also intersect with the agenda items Chairman Smith laid out in a January 9 statement, such as (1) "utilizing the tax code to increase jobs, grow wages, and build financial and healthcare security for families," (2) using both trade policy and our tax code to re-shore and strengthen our supply chains," and (3) "examin[ing] whether it is in the best interests of the American people to continue showering tax benefits on corporations that have shed their American identity in favor of a relationship with China."[33]

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[30] Secretary of the Treasury, Memorandum for Commissioner Rettig, "IRS Operational Plan," August 17, 2022. See The Hill, Tobias Burns, "Yellen eyes $80B boost as 'monumental opportunity' to 'transform' IRS," August 17, 2022, https://thehill.com/homenews/3605215-yellen-eyes-80b-boost-as-monumental-opportunity-to-transform-irs/.
[31] Commitment to America, Speaker McCarthy, https://www.speaker.gov/commitment/.
[32] "Growth Through Innovation," Jobs & the Economy Task Force, https://www.republicanleader.gov/wp-content/uploads/2022/09/JETF-Growth-Through-Innovation-3-pager-v.2.pdf.
[33] See Jason Smith Press Release, January 9, 2023.

House Rules Changes. The House Republicans made a series of rules changes that could impact tax policy this Congress. Some of those changes include:

- Replacing the previous Congress's pay-as-you-go (PAYGO) rule[34] with a cut-as-you-go (CUTGO) rule, which only requires spending offsets if there are increases to mandatory spending.[35] The CUTGO rule allows the House to pass tax cuts without corresponding offsets.
- Requiring a three-fifths supermajority vote for Federal income tax rate increases. Note that a "Federal income tax rate increase" is defined under the rule as any amendment increasing the rates under Internal Revenue Code sections 1(a)-(e) (individual and estate/trust tax rates), 11(b) (corporate tax rate) or 55 (alternative minimum tax rates).
- Restoring the requirement that the CBO and JCT incorporate macroeconomic effects of major legislation into the official cost estimates, including a qualitative assessment of long-term budgetary and macroeconomic effects of major legislation. The Chair or Vice Chair of the JCT may designate major legislation for these purposes. This rule was in place when Republicans last controlled the House.

Possible Bipartisanship. If it becomes challenging to reach consensus among 218 House Republicans, moderate Democrats and Republicans may seek to legislate from the middle by compromising on must-pass legislation and other areas in which they can agree. Beyond finding consensus opportunities with House Republicans, House Democrats will also focus their efforts on ensuring recently-passed legislation, such as the IRA and CHIPS Act, are implemented by the Administration in the manner intended by Congress.

Another area of possible bipartisan agreement this Congress could be developing policies to make the United States more competitive with China. The House on a bipartisan basis established a Select Committee on the Strategic Competition Between the United States and the Chinese Communist Party.[36] The Committee has the authority to conduct investigations, hold hearings, and submit policy recommendations. Although the Committee hasn't been populated, some tax-writers may be part of the 16-Member panel developing policies on U.S. competitiveness.

Senate Outlook

The House is not the only chamber undergoing a significant transition this Congress. After a two-year majority only through the Vice President's tie-breaking vote, Senate Democrats now control the chamber 51-49,[37] which means they will have full control over the committees and less deference to the minority party when scheduling hearings, using subpoenas, or otherwise

[34] The previous House PAYGO rule required legislation adding to the deficit to be offset with tax increases or spending cuts.
[35] House rules can be waived in legislation, leaving open the procedural possibility for mandatory spending increases without spending reductions or tax increases.
[36] H.Res.11, Introduced by Speaker McCarthy, Passed the House by a 365-65 margin, with all Republicans and 146 Democrats supporting the Select Committee.
[37] Sen. Ben Sasse (R-NE) resigned from the Senate on January 8, 2023. His replacement is former Nebraska Republican governor, Pete Ricketts, who was selected by recently-elected Republican governor, Jim Pillen. Ricketts will serve until a 2024 special election.

setting the committee agenda. Senate Finance Committee Chair Ron Wyden (D-OR) is expected to have an active committee agenda carrying on the work of previous Congresses on both policy and oversight.

While Chairman Wyden has not yet outlined a specific agenda for 2023, we anticipate that he will focus on continuing ongoing investigations,[38] protecting the new funding for the IRS included in the IRA, and highlighting the successes of IRA. Chair Wyden is expected to continue work on his partnership proposals that would drastically reform subchapter K and other passthrough-related provisions,[39] mark-to-market proposals for wealthy and high-earning individuals and certain financial products,[40] and housing reform proposals.[41]

As currently comprised, several Finance Committee Senators are up for reelection in 2024, which may have an impact on the committee's agenda this Congress. The mostly Democratic slate includes:

- Maria Cantwell (D-WA)
- Bob Menendez (D-NJ)
- Tom Carper (D-DE)
- Ben Cardin (D-MD)
- Sherrod Brown (D-OH)
- Bob Casey (D-PA)
- Sheldon Whitehouse (D-RI)
- Elizabeth Warren (D-MA)
- John Barrasso (R-WY)

Sen. Debbie Stabenow (D-MI) recently announced that she will not run for reelection in 2024.

As described above, because of the split government, tax legislation will require bipartisan consensus. Sen. Crapo remains as the ranking member of the Finance Committee and will serve as a key member when developing bipartisan consensus on tax legislation. His priorities will include extending and enhancing the TCJA, developing policies to battle inflation, and continuing oversight of the OECD negotiations and the Biden Administration's implementation of recently enacted legislation.

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[38] For example, last year Sen. Wyden initiated an investigation of a U.S. pharmaceutical companies regarding the impact of the TCJA on their tax profiles. Sen. Wyden most recently sent additional letters in December following up on responses offered earlier in the year.

[39] See "Wyden Unveils Proposal To Close Loopholes Allowing Wealthy Investors, Mega-Corporations To Use Partnerships To Avoid Paying Tax," September 10, 2021, https://www.finance.senate.gov/chairmans-news/wyden-unveils-proposal-to-close-loopholes-allowing-wealthy-investors-mega-corporations-to-use-partnerships-to-avoid-paying-tax.

[40] See "Wyden Unveils Billionaires Income Tax," October 27, 2021, https://www.finance.senate.gov/chairmans-news/wyden-unveils-billionaires-income-tax. See also, S. 2621 of the 117th Congress, Modernization of Derivatives Act, Introduced August 5, 2021.

[41] See "Wyden Announces New Bill to End Homelessness and Ensure Affordable Housing for All," August 18, 2021, https://www.finance.senate.gov/chairmans-news/wyden-announces-new-bill-to-end-homelessness-and-ensure-affordable-housing-for-all.

IRS Commissioner Nomination

On January 3, President Biden resubmitted the nomination of Daniel Werfel to serve as the next IRS Commissioner. The previous IRS Commissioner Chuck Rettig vacated the position at the end of his five-year term in November, and Doug O'Donnell, a long-time IRS employee who most recently served as the IRS Deputy Commissioner for Services and Enforcement, has been serving as the Acting IRS Commissioner in the interim. Senate Democrats will likely seek to process Werfel's nomination early this year.[42] Werfel recently worked as a Managing Director at Boston Consulting Group. Previously, he served as IRS Acting Commissioner in 2013 and Controller of OMB from 2009 to 2013. He began his career at OMB in the Office of Information and Regulatory Affairs (OIRA).

The IRS is also operating with an acting Chief Counsel, William Paul. The Biden Administration has not yet nominated an IRS Chief Counsel.

Joint Committee on Taxation Bluebook

The JCT generally releases a technical explanation, referred to as the "Bluebook," of all tax legislation enacted during each Congress. The Bluebook for the 117th Congress may be released as early as the first few months of 2023. While the Bluebook always serves as an important document for purposes of supplementing the legislative record and identifying potential technical corrections, given there were no committee reports and very few colloquies establishing legislative intent for the IRA (particularly with regard to the CAMT and stock buyback tax), the Bluebook will be particularly important and could provide added clarity to various IRA provisions.

Energy

As part of his agreement to support the reconciliation bill this summer, Sen. Manchin secured a promise that there would be an opportunity to vote on a permitting reform bill that he developed as chairman of the Senate Committee on Energy and Natural Resources. That effort failed during the lame duck session but could be resuscitated in 2023. The bill would streamline the permit process for energy infrastructure projects such as natural gas pipelines and electricity transmission lines. Energy bills often include a tax title. Although the scope of energy tax provisions in IRA was historic, a few provisions were not included in the final bill, including an investment tax credit for electricity transmission and an expansion of master limited partnerships. Republicans likely would want to add incentives for domestic fossil fuel production.

As described above, Congressional Democrats and Republicans will continue to monitor IRA implementation and weigh in where they deem necessary. For Democrats, there will be an interest in ensuring that the provisions are being implemented in a manner consistent with their legislative intent. Republicans, however, will likely conduct oversight on the projects and

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[42] On January 11 Finance Chair Wyden's office said that scheduling a hearing for the IRS Commissioner nomination is "very high on the list of hearing priorities" once the Senate organizes and committee assignments are finalized. Politico Pro Morning Tax, Bernie Becker, January 11, 2023.

products being supported by the IRA and develop policies that support domestic energy production while keeping costs low.

Digital Assets

Incoming House Financial Service Committee Chair Patrick McHenry (R-NC) said that he will make digital asset legislation a priority. In November, Rep. McHenry said, "for years, I have advocated for Congress to develop a clear regulatory framework for the digital asset ecosystem…it's imperative that Congress establish a framework that ensures Americans have adequate protections while also allowing innovation to thrive here in the U.S."[43] Chairman McHenry unveiled plans to establish a subcommittee on digital assets, financial technology, and inclusion, making clear that digital asset regulation is a top priority for the Committee.[44]

Though tax is outside the Financial Services Committee's jurisdiction, a large digital asset legislative package could include tax provisions impacting these assets.[45] For example, the Ways and Means version of the Build Back Better Act included several provisions impacting digital assets, such as expanding the wash sale and constructive sale rules to cover digital assets. Later in 2022, there was some interest by several Senators in continuing to develop tax policies centered around expanding current tax provisions to cover digital asset investment and use. While those efforts were not included in the lame duck legislation, the work will likely continue in the next Congress. Also, proposed regulations implementing the 2021 bipartisan infrastructure bill's digital asset broker reporting provisions are expected to be released soon, which will likely generate interest among tax-writers with an interest in digital asset policy.[46]

Tax-Writing Committee Membership

House Ways and Means Committee

Rep. Smith won a highly contested election to be Ways and Means Committee Chairman. In a written statement released shortly after being selected, Chairman Smith (MO) said the Republican majority has a "commitment to the American people to build a stronger economy that gives everyone – not just the wealthy and politically-connected – greater opportunity to build a more prosperous future for themselves and their families."[47] He added that the way to build a strong economy is to "prioritize….the American worker" and to "build on the success of the Tax Cuts and Jobs Act and examine how our policies can reward working families with a tax code that delivers better jobs, higher wages, and more investment in America."

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[43] November 8, 2022 Press Release, "McHenry Statement on Recent Events Involving Digital Assets Trading Platforms FTX and Binance."
[44] Politico, Zachary Warmbrodt and Eleanor Mueller, "House Republicans plan crypto panel in first move to oversee troubled industry," January 12, 2023.
[45] Note that in September, Sens. Cynthia Lummis (R-WY) and Kristen Gillibrand (D-NY) introduced the Lummis-Gillibrand Responsible Financial Innovation Act, S. 4356, which would broadly reform digital asset regulation. The proposal contained a tax title with many proposals impacting digital assets. They are expected to continue refining that legislative package, including the tax provisions.
[46] P.L. 117-70, Section 80603, Became law on November 15, 2021, H.R. 3684.
[47] January 9, 2023 Press Release, "J. Smith Statement on Selection as Next Chairman of the House Ways and Means Committee."

Some additional priorities outlined by Chairman Smith include investigating politically-motivated leaks of taxpayer information by the IRS, reshoring supply chains, and "unleashing American energy production" that lowers costs.

For a more detailed review of Chairman Smith's priorities and history, see the Capitol Tax Partners "Profile of House Ways and Means Committee Chairman-Select Jason Smith."[48]

Chairman Smith's change in role left a vacancy at the Budget Committee, which he previously led for the Republicans. Rep. Jodey Arrington (R-TX), a member of the Ways and Means Committee, will replace him as the Budget Committee Chairman.

On January 11, the House GOP Steering Committee has recommended the following members (listed in alphabetical order) to serve on the Ways and Means Committee:

- Rep. Mike Carey (R-OH)
- Rep. Randy Feenstra (R-IA)
- Rep. Michelle Fischbach (R-MN)
- Rep. Brian Fitzpatrick (R-PA)
- Rep. Nicole Malliotakis (R-NY)
- Rep. Blake Moore (R-UT)
- Rep. Michelle Steel (R-CA)
- Rep. Greg Steube (R-FL)
- Rep. Claudia Tenney (R-NY)
- Rep. Beth Van Duyne (R-TX)

For a comprehensive summary of the new members' background and priorities, see the Capitol Tax Partners "Profiles of New House Ways and Means Committee Members."[49]

Because Republicans won the House majority and committee ratios will adjust, three Democratic Ways and Means members are expected to have to vacate their Committee positions: Reps. Jimmy Gomez (D-CA), Steven Horsford (D-NV), and Stacey Plaskett (D-VI).[50] Rep. Brendan Boyle also temporarily left the committee to be the Budget Committee Ranking Member.

Senate Finance Committee

Four Republican Finance Committee Members left Congress since last year. As of publication, Finance Committee ratios have not been finalized. Republicans likely will add as few as two and as many as four new Senators to the Committee, depending on whether Democrats have a one or two seat majority on the Committee and whether Democrats add a new Member.

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[48] See attached, Capitol Tax Partners, January 9, 2023, https://www.capitoltax.com/blog-collection/house-ways-and-means-republican-chairman-and-new-member-profiles.
[49] See attached, Capitol Tax Partners, January 11, 2023, https://www.capitoltax.com/blog-collection/house-ways-and-means-republican-chairman-and-new-member-profiles.
[50] Note that as of publication, there has not been an official announcement, and this is subject to change.

Regulatory Agenda

IRA Implementation

The IRA created a litany of issues for which regulatory guidance is needed. As described more fully below, Treasury and the IRS quickly put out nine notices requesting comments on the major energy provisions and have already begun putting out initial guidance addressing the most pressing issues.

Similarly, several unresolved issues exist with respect to the two major revenue offsets in IRA: the CAMT and the stock buyback excise tax. In contrast to the energy provisions, rather than asking for preliminary comments on various issues, Treasury and the IRS moved directly to issuing initial guidance addressing time sensitive issues arising under the two provisions, and including in that guidance requests for comments on several issues. The guidance process on both of these provisions will continue at least through 2023.

In Notice 2023-2, Treasury and IRS provided interim guidance addressing several important issues that arise under the stock buyback excise tax. The Notice provides timing rules for determining when stock is repurchased or issued, and valuation rules for determining the fair market value of the stock upon repurchase or issuance. Also, relief from the excise tax is provided for many types of reorganizations, splitoffs, and certain liquidations (including SPACs), but not for redemptions of preferred stock.

The guidance also clarified the application of the netting rule to fiscal year corporations by following the statutory language, which allows them to net stock issued before the effective date (even though stock repurchases are only taken into account after the effective date). Finally, because of the annual netting rule, IRS and Treasury clarified that reporting for the excise tax will be required only once per year (on the Form 720 filed for the first calendar quarter after the end of the taxpayer's taxable year).

In addition to the guidance, Treasury and the IRS requested comments on several issues - some of which were covered by the Notice and others which were not - indicating that additional guidance will be forthcoming. Questions regarding issues covered by the Notice include:

- Should there be special rules for redeemable preferred stock or other special classes of stock or debt (including convertible debt) and if so, what criteria should be used to provide certainty for taxpayers and the IRS?
- Should the fair market value of stock repurchased or issued be an amount other than the market price of such stock?
- Should the definition of an employer-sponsored retirement plan be broader than just plans that are qualified under section 401(a) and what additional examples should be provided regarding such plans?

On the same day, Treasury and IRS provided interim guidance with respect to the new CAMT, which is effective for tax years beginning after December 31, 2022.[51] The notice describes proposed regulations Treasury and IRS intend to issue on certain issues related to the scope of corporations subject to the tax and the calculation of applicable financial statement income (AFSI) for CAMT liability purposes.

With respect to scoping issues, the notice provides (1) limited relief with a simplified safe harbor method to determine applicable corporation status, (2) guidance on the impact of acquisitions and dispositions ("Covered Transactions") on applicable corporation status, (3) guidance on the treatment of tax consolidated groups, and (4) guidance on applying the rule that disregards the adjustment for a corporate partner's distributive share of partnership income for scoping purposes.

- Safe harbor. In general, the safe harbor is a modified AFSI test (using a $500 million threshold rather than $1 billion), and a modified foreign-parented AFSI test (using a $50 million threshold rather than $100 million), in each case with AFSI determined without making most of the adjustments to AFSI that are otherwise required.
- Covered Transactions. The notice provides rules for determining the AFSI of a party to a Covered Transaction during the three-year period for purposes of the AFSI test.
- Tax consolidated groups. The notice provides that a tax consolidated group is treated as a single entity for purposes of calculating AFSI for scope purposes (as well as CAMT liability purposes).
- Distributive share rule. The notice provides that the distributive share adjustment is disregarded in all circumstances, i.e., whether or not the taxpayer and the partnership are aggregated under section 52(b).

With respect to the AFSI tax base, the notice provides rules for (1) "covered nonrecognition transactions" (2) transactions that give rise to cancelation of indebtedness income (CODI) that is excluded from taxable income, (3) the tax depreciation adjustment, and (4) amounts received under tax credit monetization provisions.

- Covered Nonrecognition Transactions. In general, financial statement gain or loss arising directly from nonrecognition transactions under sections 332, 337, 351, 354, 355, 357, 361, 721, 731, and 1032 is excluded from AFSI. In addition, any resulting asset basis increase or decrease is not taken into account for AFSI purposes. Notably, both spinoff and splitoff transactions under section 355 are eligible for this treatment, but transactions that do not qualify for full nonrecognition are not.
- Cancellation of indebtedness income. In general, financial statement gain attributable to debt discharge transactions is excluded from AFSI to the extent of the amount of CODI exclusion under section 108(a) (discharge in bankruptcy). Principles similar to the attribute reduction rules under sections 108(b) and 1017 apply to reduce financial statement attributes.
- Tax depreciation adjustment. In general, adjustments are made to AFSI to take into account tax depreciation deductions and depreciation recovered as part of cost of goods sold (COGS), and to disregard such amounts (as well as impairment loss or impairment loss reversal), reflected in the applicable financial statement. The adjustment only

[51] Notice 2023-7.

applies to property depreciated under section 168, regardless of when placed in service (i.e., it includes property placed in service prior to 2023), and does not include amounts deducted as repairs, but capitalized for book purposes. Corresponding basis adjustments are also required.

- Tax credit monetization payments. To the extent not otherwise excluded from AFSI, the notice disregards any amount (1) treated as a payment of tax pursuant to a direct pay election under sections 48D(d) or 6417, (2) received from a credit transfer and excluded from taxable income under section 6418(b), and (3) treated as tax-exempt income pursuant to a partnership's elections under sections 48D, 6417, or 6418.

The notice includes requests for comments on several aspects of the CAMT, including issues addressed in the notice and issues not addressed in the notice. The notice also indicates areas where future guidance is planned. In particular, the notice indicated that subsequent interim guidance would address mark-to-market issues, the treatment items reported in other comprehensive income (OCI), and the treatment of embedded derivatives arising from certain reinsurance contracts. The notice does not include any guidance, or request any specific comments, on the myriad international tax related issues. Based on comments made by Treasury and IRS officials last year, a notice that is dedicated to such issues is expected in the near future.

IRA Energy Implementation

As described above, the IRA drastically reformed the energy tax credits available, requirements and incentives for receiving them, and the ways in which taxpayers will monetize the credits. Given the breadth of the legislation and its importance to the Biden Administration and Congressional Democrats, Treasury, and IRS, with the support of the White House and other Federal agencies, are prioritizing issuing guidance on energy tax. Treasury began issuing guidance shortly after the IRA became law and will continue issuing regulations and other sub-regulatory guidance over the next two years.

The process of issuing IRA energy tax guidance is complicated due to various factors, including the need to combine the tax expertise of Treasury and IRS staff with the energy and other expertise from other agencies. Treasury and the IRS have committed full staffing resources to IRA implementation since its passage, including hiring staff to manage various aspects of implementation. An example of the cross-agency efforts, initial prevailing wage and apprenticeship guidance, which was published in the Federal Register on November 30, directs taxpayers to Labor Department rules on meeting the prevailing wage requirements that will be effective for projects beginning construction after January 30.[52] Similarly, the Energy Department is involved and talking with stakeholders about how to determine lifecycle emissions for various fuels credits, and the Commerce Department will provide input on how to best implement the domestic content rules.

Despite the challenges described above, Treasury and the IRS were active in beginning the implementation process. In October, Treasury issued six notices requesting comments on issues relating to the energy generation credits, bonus credits, prevailing wage and apprenticeship requirements, direct pay and transferability, electric vehicle credits, manufacturing credits, and

[52] Notice 2022-61.

energy efficiency credits.[53] Stakeholders submitted thousands of comment letters during that first round of comments. In November, Treasury issued an additional tranche of three notices requesting feedback on the clean hydrogen and fuels credits, carbon sequestration credits, and commercial clean vehicle credits.[54] In December, Treasury issued a notice providing limited definitions and outlining the regulations it intends to release with respect to electric vehicles. Treasury did not meet the IRA December 31, 2022 statutory deadline for issuing guidance on several key areas, including how the critical minerals rules work, so the effective date of those are delayed.[55]

During the upcoming year, Treasury will work to release guidance in an order that accelerates the deployment of clean energy and provides certainty to consumers seeking to claim credits. On energy generation, Treasury will likely seek to issue guidance on the bonus credits, including for domestic content and investments in certain low-income communities. Additionally, the IRA required Treasury to issue regulations on the allocable section 48C advanced manufacturing tax credit 180 days after the IRA's enactment, which requires rules by mid-February. That guidance will outline the process for applying for the $10 billion of manufacturing investment tax credits. Other areas of guidance that will likely be issued this year include rules on direct pay and credit transferability, the clean hydrogen and fuels credits, and the prevailing wage and apprenticeship requirements.

Treasury continues to encourage stakeholders to issue written comments on areas guidance is needed.

CHIPS Implementation

Treasury is working on implementing the AMIC (also referred to as the "CHIPS ITC") in consultation with the Commerce Department. No formal guidance has been issued yet on issues specific to the AMIC, but the Commerce Department published a request for information in October seeking feedback from stakeholders on semiconductor manufacturing incentives. Some of those comments will instruct Treasury as they develop AMIC guidance. There will likely be guidance this year on issues related to the AMIC, including the interaction between grants for domestic chip manufacturing and the AMIC.

[53] See Notices 2022-46 through 2022-51.
[54] See Notices 2022-56 through 2022-58.
[55] Notice 2023-1. See also FS-2022-42.

Global Tax Outlook

2022 Review

During 2022, the OECD's project to address the digital economy continued to confront challenges resulting from the complexity of the required technical work and the political environments in the United States and abroad. As a result, while technical work and public consultations have proceeded in earnest, the future of widespread implementation of Pillars One and Two remains uncertain.

In December 2021, the OECD released its Pillar Two model rules for implementation of a 15-percent global minimum tax. The Model Rules introduced several new issues that stakeholders and policymakers would spend much of 2022 seeking to understand and address. Perhaps most notably, the Model Rules created the new concept of a qualified domestic minimum top-up tax (QDMTT), which would provide a mechanism for countries to top-up their own companies' taxes to meet the 15-percent threshold before the operation of the income inclusion rule (IIR), thereby potentially significantly reducing the revenue available to be collected under an IIR. Additionally, the Model Rules spurred concern related to the treatment of qualified refundable tax credits (including grants), compared with the treatment of nonrefundable credits. While qualified refundable tax credits are included in the Pillar Two income base, they do not reduce covered taxes for purposes of calculating a jurisdiction's ETR, as opposed to nonrefundable tax credits, which do reduce covered taxes and thus increase the likelihood that companies utilizing those nonrefundable credits would fall below the minimum tax threshold to be subject to additional top-up taxes. This concerns U.S. policymakers given the nonrefundable nature of the United States's R&D tax credit, as well as the lack of refundability of most tax credits for clean energy generation, which would disadvantage U.S.-based companies as compared to the refundable R&D credits provided by other nations and their more generous industrial policies in the form of grants.

At the time that the Pillar Two model rules were released, U.S. implementation of Pillar Two already presented an additional question mark. With Senator Manchin walking away from the Build Back Better Act negotiations in December 2021, it was not clear whether there was a path in the near term for the United States to implement changes to GILTI that would bring the United States closer to the structure laid out in Pillar Two, including converting GILTI to a country-by-country calculation and increasing the minimum tax rate to 15 percent.

Despite uncertainty surrounding implementation of Pillar Two in the United States – seen by many as the easier of the pillars to bring into force – the OECD continued its technical work on both pillars throughout 2022. On Amount A, a key portion of Pillar One, the OECD published a total of six public consultation documents between February and May. Topics on which the OECD specifically sought public comment included draft rules for nexus and revenue sourcing, tax base determinations, scope, the extractives and financial services exclusions, and tax certainty. These consultations culminated in a public consultation on the Progress Report on Amount A of Pillar One, released in July, along with a Progress Report on the Administration and Tax Certainty Aspects of Amount A of Pillar One, released in October. Technical work on Pillar One closed out the year with the release of two long-awaited public consultation

documents: the main design elements of Amount B under Pillar One, and Draft Multilateral Convention (MLC) Provisions on Digital Services Taxes (DSTs) and other Relevant Similar Measures of Amount A of Pillar One.

The technical work underlying Pillar Two also advanced, with publication of the Commentary on Pillar Two in March, which included a solicitation for comments on issues that should be addressed in the forthcoming Implementation Framework. The Pillar Two Commentary did not answer questions, however, about treatment of U.S. tax credits, including for credits for renewable energy, the Low Income Housing Tax Credit, and the R&D tax credit. In the final days of 2022, the OECD released several additional documents related to Pillar Two, including guidance on Safe Harbors and Penalty Relief, which includes agreed terms of a Transitional Safe Harbor based on county-by-country reporting and a framework for the development of a Permanent Safe Harbor; a public consultation document on the GloBE Information Return; and a public consultation document on Tax Certainty for the GloBE Rules. Responses to those consultations are due on February 3, 2023.

Notably, although 137 countries joined the October 2021 political agreement on Pillars One and Two and some countries have either expressed commitment to implementing Pillar Two in the future or begun a consultation process, securing actual implementation of the rules in countries has been a challenge. Outside the United States, meaningful progress was made when efforts to pass an EU directive implementing Pillar Two finally succeeded on December 15th after months of being bogged down by objections of individual countries, including Poland and Hungary. EU member-states now must transpose the EU directive into their own legislation by December 31, 2023, with the legislation effective for fiscal years starting on or after December 31st, 2023 for the IIR and December 31, 2024 for the UTPR. This breakthrough came almost one year after the original draft EU directive was published on December 22, 2021.

Pressure on the international tax system resulting from an increasing number of unilateral measures also continues. Some countries have continued to implement or discuss implementing French-style DSTs, while others like Australia and Colombia have pursued more novel approaches. While the OECD consultation on unilateral measures released in December provides a working document outlining the structure and operation of the provisions on the standstill and withdrawal commitment for DSTs and other relevant similar measures, the document noted that it was released without prejudice to a final agreement, did not represent the consensus views of the Inclusive Framework, and explicitly acknowledged that further changes may be made. Comments to that document are due no later than January 20, 2023.

Looking Ahead to 2023

The outlook for implementation of the agreement on Pillars One and Two remains unclear. Technical work should continue on the remaining components of the Pillar Two Implementation Framework—including guidance on GILTI co-existence, QDMTTs, rule ordering, and further detail on treatment of certain credits – and those documents are anticipated to be out in early 2023, with guidance on the Subject-to-Tax Rule is expected in the near term as well.

However, ongoing concerns by Congressional Republicans over the agreement's substance and Treasury's limited consultation with Congress in its development place the project's future in the United States in doubt. In December, all Congressional Republican tax-writers wrote to Secretary Yellen claiming that the undertaxed profits rule (UTPR) likely violates bilateral tax treaties, asserting the model rules warrant renegotiation, and urging Treasury to begin working with Congress on a bipartisan basis to defend U.S. interests in the negotiations.[56] It is also uncertain how the United States will respond if other countries implement Pillar Two and levy UTPR top-up taxes on U.S.-based companies, as well as how the United States will use their policy tools to react to continued enactment of unilateral DSTs and other similar measures by other governments.

The U.S.'s involvement in the OECD project is likely to be a continued topic of bipartisan Congressional interest and a House Republican oversight focus the coming year. Ongoing staff changes at the OECD – including Pascal Saint-Amans's, Director of the OECD's Centre for Tax Policy and Administration, departure in October, as well as at the U.S. Treasury Department – including Itai Grinberg's, Treasury Deputy Assistant Secretary (Multinational Negotiations), departure earlier this month - may complicate, but also create opportunities for change in, negotiating positions. On January 14, the OECD named Manal Corwin to replace Saint-Amans, beginning in April 2023, while it is anticipated that Michael Plowgian, Deputy Assistant Secretary (International Tax Affairs) at U.S. Treasury, will be leading Treasury's tax negotiations with the OECD. With other countries ready to move forward with Pillar Two implementation, the debate about whether and how the United States should respond will continue, potentially setting the stage for future legislative action.

Treaties

In 2019, the Senate approved protocols to U.S. tax treaties with Japan, Luxembourg, Spain, and Switzerland. Those approvals were notable, as it had been nearly a decade since the Senate had ratified any treaties or protocols, in large part related to Sen. Rand Paul's (R-KY) privacy-related objections. While those four protocols sailed through the Senate once receiving floor time, other pending tax treaties—with Chile, Hungary, Poland, and Vietnam—have stalled over the need for targeted reservations resulting from the enactment of TCJA. For similar reasons, treaties under negotiation with Norway and Romania have yet to be signed.

Developments in 2022 include the following:

- On March 29, the Senate Foreign Relations Committee approved the Chile treaty, which included a reservation with respect to the base erosion and anti-abuse tax and revised language on the elimination of double taxation.
- On July 8, the U.S. Treasury Department announced that Hungary was notified that the United States would terminate the 1979 treaty with Hungary. Termination generally is effective on January 8, 2023, except with respect to withholding taxes, termination is

[56] See Senate Finance Committee Republican Press Release, "Congressional Republicans: Administration Neglected U.S. Interests in OECD Deal, Invited Extraterritorial Tax on U.S. Companies" (December 15, 2022), https://www.finance.senate.gov/ranking-members-news/congressional-republicans-administration-neglected-us-interests-in-oecd-deal-invited-extraterritorial-tax-on-us-companies.

effective on January 1, 2024. In announcing the termination, Treasury also indicated they no longer support the new treaty signed in 2010.

- On December 7, a tax treaty with Croatia was signed.
- Treasury officials have stated that treaty update negotiations are underway with Israel and Switzerland.

State Tax Outlook

State Legislative Activity

As state legislative sessions open in all 50 states, the outlook for many states is likely to shift from the budget surpluses enjoyed the last few years to more challenging scenarios. Following the trend of 2022, when ten states enacted individual income tax cuts and six states enacted corporate income tax cuts, states that have healthy budget forecasts may continue to pursue either income tax cuts or sales tax cuts for essential services. Other states, however, will need to focus on new sources of revenue.

The IRA impacts some states because many state income tax regimes conform to varying degrees with federal tax law. Some states may consider whether to decouple from the CAMT, for example. In addition, because many states have decoupled from recent changes to federal law which are scheduled to expire (e.g., provisions in TCJA), federal legislation extending temporary federal tax provisions may also impact state budgets. Litigation is ongoing with respect to the provision included in Federal law which prohibited using the ARPA relief funds for certain purposes, with most cases in Federal appellate courts being decided in favor of the states.[57]

As states look for additional revenue, many are likely to continue considering new taxes on a broad range of digital services. The Multistate Tax Commission (MTC) has a uniformity project focusing on digital products and intends to release a white paper that would serve as a road map for states seeking to expand their tax base to new digital products and services. Although many states introduced bills proposing taxes on digital services in prior years, most states refrained from imposing new taxes on digital services while the litigation in Maryland was ongoing. A Maryland state court judge recently found the state digital tax law to be unconstitutional and in violation of the Internet Tax Freedom Act (ITFA).[58]

Litigation continues to grow with respect to challenges to state tax laws that violate federal law, often resulting in inconsistent decisions between state courts; in recent years, the Supreme Court has declined review of these state tax conflicts.[59] With ongoing litigation in Louisiana,

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[57] States prevailed in lawsuits against the Treasury Department in five of the six circuits (4th, 5th, 6th, 9th, and 11th circuits), where the courts found the ARPA "Tax Mandate" to be unconstitutional. The eighth circuit held that Missouri lacked standing – Missouri recently filed a cert petition seeking review by the U.S. Supreme Court.

[58] *Comcast et al v. Comptroller of the Treasury of Maryland*, Case No. C-02-CV-21-000509 (Md. Cir. Ct. Anne Arundel County, 10/20/2022). The federal case, *Chamber of Commerce of the United States et al v. Franchot*, 588 F. Supp. 3d 633 (U.S. Dist. Ct. Md. N. Div., 2022), is on appeal to the 4th Circuit.

[59] E.g., The U.S. Supreme Court declined to reconcile inconsistent decisions by the Ohio Supreme Court, *City of Cincinnati, Ohio et al v. Lamar Advantage GP Co. LLC* and the Maryland Court of Appeals, *Clear Channel Outdoor LLC v. Henry J. Raymond, Director, Department of Finance of Baltimore City*.

California, and Pennsylvania, uncertainty regarding the scope of the U.S. Supreme Court's decision in *Wayfair* has also increased. As a result of recently revised guidance issued by the MTC,[60] in which the MTC recommends limiting the scope of Public Law 86-272's long-standing protections with respect to Internet commerce, there is increasing concern that states will aggressively expand their business income taxation of small online (out-of-state) businesses that lack an in-state physical presence, thereby exporting their tax burdens across state borders and increasing the likelihood of double taxation. The Senate Finance Committee held a hearing on June 14, *Examining the Impact of South Dakota v. Wayfair on Small Businesses and Remote Sales*. In addition, the GAO released a report in November discussing the substantial uncertainty that resulted from the Supreme Court's decision in *Wayfair* and recommending Congressional action to establish nationwide parameters.[61]

Remote Work

The taxation of remote work continues to be a contentious issue. Litigation is ongoing in numerous states and a few states have introduced legislation to clarify treatment where neighboring states have inconsistent policies.[62] As employees continue to work remotely, the issues of whether employees create business nexus and the impact of remote work on income tax apportionment are a growing concern for businesses. Bills have been introduced in previous Congresses to address this issue, and there will likely be bills and efforts to address the issue during this Congress.[63]

Tax Injunction Act

There is increasing concern that cases involving state tax violations of Federal law are not reviewed by federal courts.[64] In the *Wayfair* hearing last June, Sen. Daines identified the Tax Injunction Act, which limits access to federal courts, as an additional burden on taxpayers. As more conflicts arise regarding the taxation of interstate commerce, access to Federal courts to resolve questions of federal law would ensure consistency and help reconcile inconsistent state tax policies. With split control of the House and Senate, Congress will need bipartisan support to address this issue.

SALT Workarounds

Since the $10,000 state and local tax deduction limitation was enacted in 2017, 29 states have enacted pass-through entity (PTE) tax workaround regimes using a variety of approaches. Significant complications remain due to a lack of uniformity between the methods adopted by different states and uncertainty regarding how these regimes apply to multistate PTEs. With the

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[60] Statement of Information concerning practices of the MTC and supporting states under P.L. 86-272 (Aug. 4, 2021).
[61] U.S. Government Accountability Office, *Remote Tax: Federal Legislation Could Resolve Uncertainties and Improve the Overall System* (November 14, 2022).
[62] For example, See New Jersey Senate bill, S. 3128, introduced by Sens. Joseph Lagana (D) and Jon Bramick (R).
[63] See, S. 1274, 117th Congress, Remote and Mobile Worker Relief Act of 2021, Sen. Thune; and S. 1887, 117th Congress, Multi-State Worker Tax Fairness Act of 2021, Sen. Blumenthal.
[64] Council On State Taxation Policy Position, *The Federal Tax Injunction Act Is a Bar to Fair Litigation in State Tax Controversies* (5/10/22).

SALT cap expiring in 2025, and a lack of clarity regarding how Congress will address it, this issue will remain a concern among states and policy makers.