SQUIRE PATTON BOGGS

Tax Update: House Passes Reconciliation Package

On May 22, the House of Representatives passed Republicans' multi-trillion-dollar reconciliation package, the *One Big Beautiful Bill Act* (H.R. 1), by a vote of 215-214, with Reps. Warren Davidson (R-OH) and Thomas Massie (R-KY) joining all Democrats in opposition to the bill and Rep. Andy Harris (R-MD) voting present. In addition to significant spending cuts, the legislation includes numerous Member and presidential tax priorities, including extension of the 2017 *Tax Cuts and Jobs Act* (TCJA), limits on taxation of tipped income and overtime pay, and tax relief for seniors. The bill also reflects several days of negotiations between House leadership and Republican Members on several contentious provisions, including the state and local tax (SALT) deduction cap and changes to *Inflation Reduction Act* (IRA) clean energy tax credits.

The bill now proceeds to the Senate, where Republican Senators are expected to consider many of their own tax and spending proposals in the coming weeks. Key differences remain between House and Senate Republicans on several provisions, including early phaseouts of IRA tax credits, the size of the SALT cap, and the length of business and individual tax cuts.

What is Included in the House-passed Legislation? Notable tax provisions include:

- **TCJA Extension** – As widely anticipated, the legislation makes permanent or extends several expiring provisions from TCJA, including:

  - Individual Income Tax Rates: The bill makes permanent the individual income tax rates enacted by the 2017 *Tax Cuts and Jobs Act* (TCJA). Notably, the extension does not include a new bracket for individuals making more than $2.5 million per year, as recently proposed by President Trump.

  - Standard Deduction: The bill makes permanent TCJA's increase to the standard deduction and further temporarily increases the standard deduction by $1,000 for individuals, $1,500 for heads of households, and $2,000 for married couples through 2028. The proposed legislation also permanently repeals the deduction for personal exemptions and miscellaneous itemized deductions which were temporarily limited by TCJA.

  - Section 199A Pass-Through Deduction: The bill makes permanent the Section 199A qualified business income deduction and increases the deduction to 23 percent of qualified business income, among several other changes.

  - Alternative Minimum Tax: The bill makes permanent TCJA's increase in the alternative minimum tax (AMT) exemption and phase-out thresholds for individuals.

  - 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. While the legislation does not include a 15 percent corporate income tax rate for domestic manufacturers – as previously proposed by President Trump – the Ways and Means Committee has highlighted several additional new or enhanced business provisions which aim to reduce effective tax rates for domestic manufacturers, including provisions benefiting the construction of new manufacturing facilities.

- Bonus Depreciation: The legislation restores 100 percent bonus depreciation from January 20, 2025 through 2029, 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 between December 31, 2024 through 2029.

- R&D Expensing: The bill provides for immediate expensing of domestic research and development (R&D) expenditures after December 31, 2024 and through 2029. The proposal maintains current capitalization and amortization requirements for foreign R&D expenditures.

- **Presidential Priorities** – Adding to the overall cost of the tax package, the bill also contains several of President Trump's major campaign promises on tax, including:

  - No Tax on Tipped Income: The legislation includes a new deduction 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 individuals claiming the standard deduction.

  - No Tax on Overtime: The legislation includes a new deduction for "qualified overtime compensation" through 2028. The proposal includes exclusions for "qualified tips" and 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.

  - Tax Relief for Seniors: The legislation includes an additional standard deduction amount of $4,000 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 deduction would be available for individuals claiming the standard deduction.

  - Auto Loan Interest Deductibility: The 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 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** – While the legislation does not propose full repeal of the IRA, the legislation proposes to repeal, sunset, or otherwise limit several clean energy tax incentives expanded or created by the 2022 law:

    - Advanced Manufacturing Production Credit (Section 45X): The legislation makes several changes to the Section 45X Advanced Manufacturing Production Credit, including eliminating the credit for wind energy components after December 31, 2027 and eliminating the credit for all other components after December 31, 2031. The bill also repeals transferability provisions for Section 45X after 2027 and includes new limits on credit access for certain prohibited foreign entities.

    - Clean Electricity Credits (Sections 45Y & 48E): The legislation terminates the Clean Electricity Production Tax Credit (45Y) and Clean Electricity Investment Tax Credit (45E) for facilities beginning construction 60 days after enactment or placed in service after December 31, 2028 (with the exception of certain nuclear facilities). The legislation also accelerates the implementation of new prohibited foreign entity rules to December 31, 2025 and prohibits leasing arrangements for residential solar projects.

    - Clean Fuel Production Credit (Section 45Z): The bill extends the Section 45Z Clean Fuel Production Credit for four years through December 31, 2031. The bill also limits eligible fuel to fuel derived from feedstocks produced or grown in the US, Mexico, or Canada and imposes new restrictions for prohibited foreign entities at enactment and for foreign-influenced entities beginning two years after enactment.

    - Clean Hydrogen Production Credit (Section 45V): The bill terminates the Section 45V Credit for Clean Hydrogen Production for facilitates beginning construction after December 31, 2025.

    - EV Credits: The legislation terminates several electric vehicle (EV) credits created or expanded by the IRA effective on December 31, 2025, including the Section 25E Previously Owned Clean Vehicle Credit, the Section 30D Clean Vehicles Credit, and the Section 45W Commercial Clean Vehicle Credit. The legislation provides for special rules for certain vehicles to qualify for Section 30D through December 31, 2026 and for certain commercial clean vehicles acquired under contracts entered into before May 12, 2025, to qualify for Section 45W. The bill also terminates the Section 30C Alternative Fuel Vehicle Refueling Property credit on December 31, 2025.

    - Residential Clean Energy Credits: The legislation terminates several residential clean energy credits created or expanded by the IRA effective on December 31, 2025, including the Section 25C Energy Efficient Home Improvement Credit, the Section 25D Residential Clean Energy Credit, and the Section 45L New Energy Efficient Home Credit (with limited exceptions).

    - Zero-Emission Nuclear Power Production Credit: The legislation accelerates the termination of Section 45U Zero-Emission Nuclear Production Tax Credit to December 31, 2031 (as compared to December 31, 2032 under current law), but would preserve the full value of the credit through 2031 (as compared to a gradual phase out under the initial draft legislation). The manager's amendment would also allow for additional flexibility for new nuclear projects to begin construction under the Section 45Y and 45E credits and would preserve transferability provisions for credits for nuclear energy projects.

  - Transferability Rules: In addition to the changes discussed above, the bill modifies or eliminates the transferability of several credits including the Section 45Q Credit for Carbon Oxide Sequestration (repeals two years after enactment), and Section 45Z Clean Fuel Production Credit (repeals for fuel produced after December 31, 2027).

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

  - Child Tax Credit: The bill temporarily increases the maximum Child Tax Credit (CTC) to $2,500 per each qualifying child through 2028. The section also makes permanent several aspects of the CTC, including the maximum amount of the refundable portion of the CTC and the income phaseout threshold amounts. The bill also requires the taxpayer claiming the CTC, the taxpayer's spouse (if a married couple), and the qualifying child to have an SSN to be eligible to claim the credit.

  - Employer-Provided Child Care Credit (Section 45F): The legislation 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). The proposal also expands the definition of expenditures.

  - Trump Accounts: The legislation creates 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.

- **State & Local Tax (SALT) Deduction Cap:** The legislation increases the current cap on the state and local tax (SALT) deduction up to $40,000 (compared to $30,000 from the initial draft legislation and $10,000 under current law) for households with a modified adjusted gross income (MAGI) up to $500,000. The manager's amendment also proposes to increase the cap and income limit by 1 percent annually.

- **Endowments & Private Foundations:** The legislation includes a new tiered excise tax on the net investment income of certain private colleges and universities with large endowments. The applicable endowment excise tax rate – between 1.4 and 21 percent – is based on an institution's student-adjusted endowment. Religious colleges and universities are exempt from the excise tax. In addition, the legislation also includes a new tiered excise tax on the net investment income of certain large tax-exempt private foundations with more than $50 million in total assets.

- **International Provisions:** The legislation proposes to slightly reduce proposed increases to the deduction for foreign-derived intangible income (FDII) and global intangible lowtaxed income (GILTI) and proposes a minor increase to the base erosion minimum tax amount.

- **Debt Limit:** The legislation increases the statutory debt limit by $4 trillion.

What is <u>Not</u> Included in the House-passed Legislation? Several notable tax proposals are <u>not</u> included in the House-passed bill:

- **Business/Corporate SALT:** The legislation does not include new limits on business (or corporate) state and local tax deductions. The proposal was floated as a potentially significant offset for other tax priorities in the reconciliation package, however, stakeholders raised several concerns over the proposal, including administrability concerns.

- **Carried Interest:** The legislation does not include changes to carried interest tax rates despite calls from President Trump to close the "carried interest loophole," as part of the reconciliation process.

- **Corporate Rate Changes for Domestic Manufacturing:** The legislation does not include a 15 percent corporate income tax rate for domestic manufacturers – as proposed by President Trump. However, the Ways and Means Committee has highlighted several new or enhanced business provisions which aim to reduce effective tax rates for domestic manufacturers, as mentioned above.

- **Millionaire's Tax:** The legislation does not include a new individual income tax bracket for individuals making more than $1 million or more than $2.5 million per year nor does the legislation allow the current individual income tax rates and brackets for high-income individuals to expire, as previously raised in separate proposals.

- **Stock Buyback Excise Tax**: The legislation does not increase the stock buyback excise tax – previously raised as a potential offset.

What's Next? Following initial House passage, President Trump urged the Senate to "get to work," on the reconciliation package and advance the House bill "as soon as possible." Nevertheless, the Senate is expected to make several changes to the House-passed bill, meaning the House and Senate will likely be required to resolve differences between their legislative proposals over the coming weeks. On Thursday, House leaders expressed optimism that Congress would complete work on the reconciliation package by the Fourth of July.

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