The 2020 presidential election: Potential effects of Biden business tax proposals

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In brief

With the approach of the November election, voters are starting to examine the proposals of President Trump and former Vice President Biden on taxes and other issues.

Both candidates have laid out significantly different tax proposals as part of their 2020 campaigns agendas. Trump has proposed to make permanent individual tax cuts that were enacted as part of the 2017 tax reform act (the 2017 Act) and has indicated that he may propose further cuts to the current 21% corporate tax rate as well as lower capital gains tax rates if he is re-elected. Biden has proposed tax increases for business and higher-income individuals to offset the costs of various policies, including increased spending on infrastructure, incentives for clean energy and domestic manufacturing, expanded access to healthcare, and increased funding for education and job training.

The outlook for significant tax legislation being enacted in 2021 will depend both on which candidate wins the White House and which party controls the House and Senate. President Trump was able to achieve enactment of the 2017 federal tax reform legislation with a Republican-controlled Congress during his first two years in office, before Democrats gained control of the House following the 2018 midterm elections. A continuation of divided government control is likely to create challenges for either presidential candidate to enact their campaign tax proposals.

The analysis below examines in detail general business tax changes that have been proposed by Biden relative to provisions that were enacted as part of the 2017 tax reform act. Biden also has proposed a number of sector-specific proposals as well as tax incentives as part of his plans to address climate change and promote US infrastructure investments.

Prospects for a Biden administration instituting a significant tax overhaul will hinge on whether Democrats take control of the Senate while also retaining control of the House, as well as economic conditions next year. Assuming a Democratic-controlled Congress next year, Biden's tax proposals would be expected to be considered under 'budget reconciliation' procedures, which allow legislation to pass the Senate with a simple majority instead of the generally required 60-vote supermajority. As part of this legislative process, Biden's proposals may be modified in order to attain the majority required for passage.

In detail

In general, Biden has proposed several business income tax changes as part of his presidential campaign. The most significant change in terms of revenue involves raising the corporate income tax rate from 21% to 28%. In addition to increasing the statutory corporate income tax rate, Biden proposes doubling the tax rate on global low-taxed intangible income (GILTI) and a new 15% alternative minimum tax on global book income.

Biden also has proposed a number of sector-specific revenue-raising proposals. In addition, he has proposed several revenue-losing tax incentives as part of his plans to address climate change and promote US infrastructure investments.

While this Insight focuses on potential increases in business taxes on the corporate side, Biden also proposes increases in tax rates on pass-through businesses. On the individual side, Biden proposes increasing payroll taxes and accelerating the increase to 39.6% in the top individual income tax rate for taxpayers with more than $400,000 of taxable income that now is scheduled to occur after 2025. This would affect more than 60% of pass-through business income. As noted above, Trump has proposed to make permanent the temporary individual tax cuts that were enacted in 2017 if he is re-elected.

Corporate income tax rate

Biden would increase the corporate income tax rate from 21% to 28%, reversing half of the rate reduction enacted in 2017. At the same time, Biden does not propose to reverse the corporate base broadeners that also were enacted as part of the 2017 Act and were intended to partially offset the cost of achieving the 21% tax rate.

The top four domestic revenue raising provisions in the 2017 Act were:

- limitations on the deductibility of interest,
- modifications to the net operating loss (NOL) deduction,
- a requirement to amortize research and experimental (R&E) expenditures beginning in 2022, and
- the repeal of the deduction for income attributable to domestic production activities.

In addition, some industries were affected by sector-specific base-broadening provisions that had been proposed as part of earlier tax reform efforts. For example, several provisions affecting the tax treatment of insurance companies were adopted as part of the final 2017 Act, as discussed below.

Corporations that were more significantly affected by revenue-raising provisions of the 2017 Act could face a higher tax burden under Biden's proposed rate increase than they did under the 35% rate that prevailed prior to 2018.

***Observation*:** If a 28% Federal corporate income tax rate were enacted, the US combined federal and state rate once again would be the highest in the Organisation for Economic Co-operation and Development ("OECD"). In addition, that higher rate would be on a broader base than prior to the 2017 Act.

Interest limitations

The largest domestic revenue-raising provision in the 2017 Act is the Section 163(j) limitation on the deductibility of interest. While certain agriculture, real estate, and utilities businesses are exempt from the limitation, interest deductions are more heavily concentrated in the mining and information (including publishing and telecommunications) sectors than in other sectors that are subject to the limitation. Companies in cyclical industries with income subject to greater fluctuations also may find the limitation binding during periods of weak economic performance as their interest expense becomes a higher percentage of adjusted taxable income.

After 2021, the interest limitation is scheduled to become more restrictive for many businesses, as deductible interest will be based on taxable income before interest as opposed to taxable income before interest, depreciation, amortization, and depletion.

Observation: A higher tax rate would increase the compounding effect of the interest limitation during recessions, increasing taxes on companies suffering low profitability.

NOL deductions

The second largest domestic revenue-raising provision in the 2017 Act is the modification to the NOL deduction. The 2017 Act eliminates the ability to carry back losses for most companies but allows losses to be carried forward indefinitely. Losses may not offset more than 80% of taxable income. The CARES Act made further changes, temporarily allowing companies to carry back losses for five years and temporarily suspending the 80% limitation, such that the amount of loss carryforwards will be less than would be the case absent the CARES Act changes.

Observation: Companies whose income is more sensitive to business cycles likely could be affected more over time as a result of Biden's proposed corporate income tax rate increase relative to companies with more stable profitability.

Amortization of R&E expenditures

The 2017 Act requires the amortization of R&E expenditures for taxable years beginning after December 31, 2021.

Observation: Companies with significant R&E expenditures, which are heavily concentrated in the manufacturing sector, could be disproportionately affected by a general increase in the corporate income tax rate.

Domestic production activities deduction

The Section 199 domestic production activities deduction provided a deduction equal to 9% of qualified production activities income, resulting in a 3.15% rate reduction at a 35% corporate rate (i.e., a 31.85% effective marginal tax rate). The deduction was utilized more heavily by companies in the manufacturing and information sectors.

Observation: Some businesses may have viewed repeal of the Section 199 deduction as an acceptable offset as part of efforts to achieve a lower corporate rate. The degree to which companies that benefited from the Section 199 deduction may be affected by a 28% corporate income tax rate relative to the prior-law 35% rate may depend on how they were affected by other base-broadening provisions in combination with the loss of the deduction.

Insurance industry provisions

The 2017 Act includes several changes to the tax treatment of insurance companies that significantly broadened their tax base. Overall, the net tax reduction received by these companies was much less than the 14-percentage-point reduction in the corporate tax rate.

Observation: Insurance companies not only may be disproportionately affected by a general increase in the corporate income tax rate, but also may be more at risk relative to companies in other industries of paying more in tax under a 28% rate than they did under the prior-law tax base at a 35% rate.

Doubling the tax rate on GILTI

The 2017 Act requires US shareholders of any controlled foreign corporation to include in gross income their GILTI. A taxpayer is permitted a deduction equal to 50% (37.5% after 2025) of their GILTI, thereby subjecting GILTI of corporations to tax at 10.5% (13.125% after 2025). Increasing the corporate income tax rate from 21% to 28% would increase the tax rate on GILTI from 10.5% to 14% before 2026 and from 13.125% to 17.5% after 2025.

Biden proposes increasing the tax rate on GILTI income further to 21%, a proposal that could be implemented by reducing the Section 250 deduction from 50% to 25%. A 25% Section 250 deduction for GILTI together with a 28% corporate tax rate and an 80% limitation for foreign tax credits would result in a higher effective tax rate on all foreign income taxed at a rate less than 26.25%. The OECD average corporate tax rate, excluding the United States, is 23.4%, and 25 OECD countries have a corporate tax rate lower than 26.25%.

Observation: If the tax rate on GILTI were doubled, corporations would face residual US tax liability with respect to their operations in more jurisdictions, including more than two-thirds of developed countries. Furthermore, any increase in the GILTI tax rate might necessitate a higher tax rate on foreign-derived intangible income (FDII) to counter European Union claims that FDII is an export subsidy under World Trade Organization rules. Under present law, taxpayers are permitted a deduction on their FDII of 37.5% (21.875% after 2025), thereby subjecting it to tax at a preferential rate of 13.125% (16.406% after 2025).

Minimum tax on book income

Biden proposes an alternative minimum tax at 15% on companies' book income, potentially applicable only to companies with at least $100 million in book income. As an alternative minimum tax, a company would pay the greater of its regular tax or minimum tax liability. The proposal would provide a tax credit for income taxes paid to foreign countries and would allow companies to carry over book losses from unprofitable years. While many details of the proposal currently are unspecified, given the separate proposal for a 21% tax rate on GILTI, the greatest effect of the book minimum tax, if enacted, may be on companies with a greater share of domestic relative to foreign income.

Differences between book income and tax income may be temporary (timing) or permanent differences. Temporary differences may result in expenses being recognized *sooner* for tax purposes than for book purposes, such as with accelerated depreciation, or *later* for tax purposes than for book purposes, such as bad debt expenses. A long carryforward period may ameliorate the effect of a book minimum tax if differences are attributable to timing; however, this may depend on design features of the minimum tax. For example, the effect on companies would be less severe if extra book minimum tax would be creditable in the future against regular tax liability, similar to the credit allowed for corporate alternative minimum tax before its repeal.

Observation: Companies in industries such as manufacturing and information that take advantage of accelerated depreciation more than other industries may be more affected by a book minimum tax. The effect of the proposed tax might be less severe for companies with temporary book-tax differences if book minimum tax is creditable against future regular tax liability.

Permanent differences result when an item of income or expense is included for one system but not the other and may reflect explicit nontax policy decisions made by the government. Permanent differences include, for example, tax-exempt interest (which results in book income exceeding tax income) and limitations on deductions for certain compensation (which may result in tax income exceeding book income).

To the extent that a book minimum tax did not allow certain tax credits that are allowed to reduce regular tax liability (for example, the research credit or renewable electricity production tax credit), then these items also would create permanent differences. The Biden proposal currently does not specify any credit against the book minimum tax except for taxes paid to foreign countries.

Observation: Companies in the manufacturing sector and bank holding companies are the greatest users of business tax credits. Tax-exempt interest is prevalent among insurance and bank holding companies. Companies in these industries potentially have large permanent book-tax differences and could be most adversely affected by the proposed book minimum tax.

Sector specific proposals

In addition to general business tax proposals, Biden has proposed revenue-raising proposals that directly affect certain business sectors. These include proposals to:

- Eliminate tax preferences for fossil fuels.
- Eliminate the deduction for prescription drug advertising.
- Eliminate certain tax preferences for the real estate industry
- Tighten rules for independent contractors and increase penalties for misclassification.
- Institute a financial fee on certain liabilities of large financial institutions with over $50 billion in assets.

Tax incentives

Biden also has proposed several tax incentives as part of his plans to address climate change and promote US infrastructure investments. The following individual and business proposals would:

- Restore and expand the electric vehicle tax credit, with a focus on promoting consumer purchases of American-made vehicles.
- Reinstate the solar investment tax credit.
- Reinstate residential energy efficiency tax credits.
- Expand tax deductions for energy technology upgrades, smart metering, and other emissions-reducing investments in commercial buildings.
- Enhance tax incentives for carbon capture, use, and storage.

Economic effects

The most significant Biden business tax proposals would increase tax rates on both domestic and foreign income. Companies that have been affected most significantly by the tax base broadeners in the 2017 Act likely would be impacted the most by the proposed tax rate increases. A new book minimum tax also could reduce the benefits of many of the incentives enacted by Congress and new incentives proposed by Biden to encourage certain activities by providing those activities favorable tax treatment. The effects on investment and employment would vary by sector, with the ultimate effects dependent on policy design features that have yet to be specified.

The takeaway

The outlook for legislative action in 2021 on business tax proposals will depend on who is elected president and which party controls the House and Senate. The status of the pandemic and the US economy also likely will influence legislative priorities next year. If Biden is elected, chances of a significant tax overhaul will depend on whether Democrats retain control of the House and take control of the Senate, and what policies current and newly elected members would support. A continuation of divided government control is likely to create challenges for either presidential candidate to see their campaign tax proposals be enacted.

Additional material

For a PwC Insight on individual tax considerations for the 2020 elections, click here.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

Tax Policy Services

Pat Brown
(203) 550-5783
pat.brown@pwc.com

Rohit Kumar
(202) 841-8300
rohit.kumar@pwc.com

Kevin Levingston
(678) 592-5159
kevin.levingston@pwc.com

Pam Olson
(703) 627-8925
pam.olson@pwc.com

David Camp
(989) 488-8807
david.l.camp@pwc.com

Scott McCandless
(202) 748-4760
scott.mccandless@pwc.com

Todd Metcalf
(202) 304-5383
todd.metcalf@pwc.com

Larry Campbell
(202) 251-6666
larry.campbell@pwc.com

Don Carlson
(301) 520-4115
donald.g.carlson@pwc.com

Janice Mays
(202) 603-0641
janice.a.mays@pwc.com

Mark Prater
(202) 826-9014
mark.a.prater@pwc.com

Andrew Prior
(703) 980-4520
andrew.prior@pwc.com

David Lewis
(317) 358-9293
david.p.lewis@pwc.com

National Economics & Statistics

Drew Lyon
(202) 431-5629
drew.lyon@pwc.com

Karl Russo
(202) 431-9566
karl.russo@pwc.com