



# Tax Provisions in Biden Administration's FY 2022 Budget Proposals

## Banking

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## Introduction

KPMG LLP on May 31, 2021, released a 117-page [report](#) [PDF 1.4 MB] containing analysis and observations of tax proposals in the Biden Administration's FY 2022 budget (the "KPMG Report on the Green Book"). For ease of reference, KPMG has compiled summaries and observations relating to certain specific industries and topics in separate reports. This report highlights selected revenue proposals that may be of interest to the banking industry, and possible implications for banks to consider. For summaries and comments on other aspects of the Biden Administration's proposals, please see our full report at the link above.

This booklet reflects developments and analysis as of August 12, 2021. For information regarding subsequent developments, see [TaxNewsFlash-Legislative Updates](#).

## Background

The Department of the Treasury ("Treasury") on May 28, 2021, released its "[General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals](#)" [PDF 884 KB]. This document, better known as the Green Book, outlines the Biden Administration's tax proposals in greater detail than seen before, including information on proposed effective dates, Treasury revenue estimates, and design choices.

During the presidential race of 2020, Biden actively campaigned on an ambitious tax plan. His campaign tax plan was in some ways centered on the idea that the major tax legislation enacted in 2017 typically called the Tax Cuts and Jobs Act ("TCJA"), championed by the Trump Administration, had cut taxes too much and in the wrong ways. Read [KPMG's detailed analysis of the TCJA](#) [PDF 6.4 MB].

As such, candidate Biden's tax plan was built around raising the corporate tax rate, raising taxes on the foreign earnings of U.S. multinationals, and raising taxes on wealthy individuals (including increases in the ordinary and capital gains tax rates). The plan proposed redirecting that tax revenue to other priorities, such as childcare, education, green energy, infrastructure, and support for middle and low-income earners.

Since becoming president, Biden has continued to champion mostly the same ideas from his campaign. He has, however, focused his legislative efforts so far on a narrower set of tax proposals than in his campaign, while introducing several new proposals.

The FY 2022 Green Book reflects the Biden Administration's tax priorities—signaling to Congress the administration's view that these ideas are of greatest importance to President Biden's current legislative agenda. With Congress gearing up to consider major tax changes as part of budget reconciliation legislation, the Green Book ideas are likely to be central to those discussions.

While the Green Book includes a great deal of information, it nevertheless leaves many questions unanswered. Those answers may be delayed pending actual legislative text from Congress, or, if legislation based on the proposals is enacted, post-enactment regulatory guidance from Treasury. But, for now, the Green Book reflects the most detailed exposition of the administration's legislative priorities for the U.S. tax system.

## KPMG observation

The Biden Administration has set forth an ambitious set of policy proposals. Congress might act on all or part of that program, or could add to it. The revenue-raising tax proposals set out in the budget are designed to offset the cost, over time, of proposed increases in spending and tax incentives. Some revenue proposals might face challenges in the legislative process and could be modified or eliminated during congressional consideration of possible legislation. Additional proposals could be included in potential legislation as well. Indeed, it would not be surprising if significant modifications were made to the Biden Administration's tax proposals when they are considered in Congress.

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## Effective dates

Congress would ultimately determine the effective dates of any tax legislation, as well as any transition and grandfathering rules it deems appropriate. In general, the Biden Administration proposes to make its tax proposals in the Green Book effective January 1, 2022. There are exceptions, however, including the proposed effective dates with respect to SHIELD (as defined below), changes to the tax rate for certain long term-capital gains and qualified dividends, and information reporting requirements, discussed in more detail below.

## Select business proposals

### Corporate tax rate

The Green Book proposes an increase to the corporate tax rate from 21% to 28%, effective for tax years beginning after December 31, 2021. A taxpayer that has a non-calendar year straddling 2021 and 2022 would need to compute taxes by applying both the 28% rate and 21% rate to taxable income on a prorated basis.<sup>1</sup>

For more information on this topic, see page 8 in the [KPMG report on the Green Book](#)

### ***Tax and accounting considerations:***

- Financial institutions may consider various planning opportunities to accelerate income prior to a potential rise in the corporate tax rates, including method of accounting changes and recognizing built-in gains on appreciated property.
  - If applicable, financial institutions may need to consider how any planning interacts with the ability to carry back 2020 net operating losses under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act).<sup>2</sup>

<sup>1</sup> In general, section 15 also provides for a “blended” tax rate in this scenario using a similar approach to the one described in the Green Book. It is not clear whether the proposal is specifically intended to provide for different results than the results that would arise under section 15.

<sup>2</sup> Pub. Law. 116-136, 134 Stat. 281. More specifically, the CARES Act generally allows taxpayers a five-year carryback for NOLs arising in tax years beginning after December 31, 2017 and before January 1, 2021 (i.e., calendar years 2018, 2019, and 2020). Thus, certain financial institutions may consider (or may have already considered) opportunities to maximize a 2020 net operating loss that can be carried back to a tax year prior to the enactment of the Tax Cuts and Job Act (TCJA) when the maximum corporate tax rate was 35%. See Pub. Law. 115-97, 131 Stat. 2054 (the official title is “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018” but is commonly referred to as the TCJA). Planning strategies deployed in response to this CARES Act provision (e.g., deferring income or accelerating deductions) would likely conflict with planning strategies deployed in response to or in anticipation of a possible rise in the corporate tax rate (e.g., accelerating

- If financial institutions are unsure whether they want to carry out planning strategies to accelerate income or defer deductions, they may still consider paying additional estimated tax payments to avoid potential underpayment penalties if they later decide to implement planning strategies.
- Banks should also consider the impact of previously filed method changes. For example, banks may have filed automatic method changes for planning opportunities associated with the TCJA or the CARES Act. Generally, taxpayers are not able to file an automatic method change within a 5-year period on the same item. However, this restriction is waived for certain types of automatic method changes (e.g., certain depreciation, research and development, and revenue recognition method changes).
- ASC 740 requires entities preparing financial statements in accordance with U.S. generally accepted accounting principles (GAAP) to reflect the impact of tax law changes, including adjustments to current and deferred taxes, along with the related disclosures, in the annual or interim financial statements that include the date of enactment. Adjustments to deferred taxes resulting from a change in tax law or rate are recorded through income tax expense (benefit) from continuing operations.
- If a bank is changing a tax accounting method that is eligible for automatic consent procedures, whether from a permissible method or from an impermissible method, the bank should generally recognize the impact of the method change in its financial statements when the entity has committed to making the change to its accounting method. An entity generally demonstrates its commitment to making an automatic change by preparing and submitting a copy of the form 3115 before the period-end financial statements are issued. If an entity is changing a tax accounting method that is not automatic, the entity should apply the recognition and measurement criteria of ASC 740-10 at the balance sheet date to determine whether it is appropriate to account for the change before receipt of a consent letter.
- Banks may need to revisit their existing judgments on valuation allowances for tax attribute carryforwards if the tax rate increases. For example, a rise in the corporate tax rate may provide banks with more capacity to utilize tax credit carryforwards (e.g., low-income housing tax credits (LIHTCs) and new markets tax credits (NMTCs)).
- A rise in the corporate tax rate may reduce a bank's expected yield with respect to an investment in a qualified opportunity fund (QOF). More specifically, banks that invested in a QOF to achieve gain deferral may not obtain their anticipated present value tax benefit since the deferred gain would be taxed at a higher corporate rate.

### ***Regulatory capital considerations:***

- An increase to the corporate tax rate would increase the value of deferred tax assets (DTAs). Thus, for banks in a net DTA position, an increase in the corporate tax rate would likely positively impact earnings in the year of enactment. The increase to earnings would initially help banks' regulatory capital; however, the increased corporate tax rate may hurt earnings in future years. Additionally, bank stress testing may be under heightened scrutiny

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income or deferring deductions). For more information on the CARES Act and its impact to the banking industry, see [Tax issues banks should CARE\(S\) about in light of COVID-19](#).

due to challenges from COVID-19, which could highlight the impact of a corporate tax rate change.

- Temporary difference DTAs are generally beneficial for regulatory capital purposes to the extent they don't exceed a certain percentage of common tier 1 equity (CET1). Thus, a bank may not receive the full regulatory capital benefit to the extent the increase pushes the bank over its threshold limitation.
- While deferred taxes are revalued, credits are not. If banks were unable to use credits under the previous (i.e., lower) rate, the increased tax rate could result in more credits being utilized. Notably, credit carryforwards (net of allocable DTLs) are generally subtracted from CET1. Thus, an increased rate would likely reduce any credit carryforwards, which would reduce any overall net DTA position and any disallowed carryforward DTAs.

### ***Operational considerations:***

- Banks may need to update their underwriting and pricing models to reflect the increased corporate tax rate, if enacted.
- The after-tax cost of borrowing may decrease as interest expense deductions become more valuable to customers if the corporate tax rate is increased.
- Certain tax-sensitive investments (e.g., LIHTC, municipal bonds) may see an increase in after-tax yield if the corporate tax rate is increased.
- Demand for tax credit investments may increase to the extent taxpayers have more capacity to utilize credits.
- If corporate tax rates increase, tax credit investment pricing would need to "re-balance" to take into account the impact of higher corporate tax rates. For LIHTCs, there may be an increase to the cost resulting from an increase in the after-tax yield. However, for NMTCs, there may be a decrease to the cost resulting from a decrease to the after-tax yield attributable to the basis decrease in the investment.

### ***State and local tax considerations:***

- While the federal tax rate change (if enacted) would not directly impact any states, any strategies or method changes to accelerate income or defer deductions would likely change the state income tax base going forward. Banks should consider state conformity to any such method changes, as well as the potential for choosing a different method in a particular state, where permitted and where such method may be preferred due to changes in apportionment or impact to net operating loss carryforwards or other state attributes.

## Minimum tax on book income

The Green Book proposes a 15% minimum tax on worldwide pre-tax book income for corporations with such income in excess of \$2 billion. Taxpayers would be able to subtract what the Green Book refers to as "book net operating loss deductions" from book income in determining the tentative minimum tax amount, and would also be able to take into account General Business Credits (including R&D, clean energy, and housing tax credits) and foreign tax credits. The minimum tax would equal the excess, if any, of the book tentative minimum tax over regular tax. Additionally, taxpayers would be allowed to claim a book tax credit (generated

by a positive book tax liability) against regular tax in future years but this credit could not reduce the tax liability below the book tentative minimum tax in that year.

For more information on this topic, see page 9 in the [KPMG report on the Green Book](#)

***Tax and accounting considerations:***

- Inbound banks frequently operate in the United States through both (i) a U.S. branch and (ii) an intermediate holding company (IHC) that owns various subsidiaries. The IHC and its subsidiaries frequently file a federal consolidated tax return. Thus, a U.S. branch and the IHC group have separate U.S. income tax return filing obligations. The proposal in the Green Book does not address how a minimum book tax would be allocated between the two filing groups in this scenario.
- Banks with significant foreign operations and relatively small U.S. operations may have worldwide book income that far exceeds U.S. taxable income. It is possible that the full weight of the proposed tax on worldwide income would not be levied against the relatively small U.S. operations, and that some set of geographically-based allocation rules would be added. However, the Green Book's description of the proposal does not mention this as an issue, and does not provide any indication of what mechanism might be utilized to ensure some degree of proportionality.
- The proposal could motivate banks to convert deductible expenses into tax credits. For example, the proposal could make certain elections to claim tax credits as opposed to tax deductions with respect to eligible expenditures (e.g., research and development (R&D), foreign taxes paid or accrued) more attractive for affected banks.
- Certain tax-exempt investments (e.g., municipal bonds, BOLI) could lose their tax benefits to the extent a taxpayer were subject to a minimum tax on book income.
- If enacted, the minimum book tax could potentially create odd results for financial institutions during a financial crisis. For example, assume there is a credit event in Year 1, and a bank must significantly increase its allowance for loan loss. However, such loans are not charged-off for book purposes until Year 2. This could result in the bank paying regular corporate tax in Year 1 and paying minimum book tax in Year 2. Further, minimum book tax carryforwards arising from Year 2 could potentially remain on the balance sheet for a significant period of time. The adverse results of this scenario could potentially be mitigated if the provision allowed for a carryforward of book net operating losses. The Green Book implies a carryforward concept with respect to book losses, however, details on such a mechanism are uncertain.

***Regulatory capital considerations:***

- Deferred tax assets arising from minimum book tax carryforwards would need to be factored into regulatory capital calculations. These carryforwards may be subject to threshold limitations in a manner similar to other carryforwards.

### **State and local tax considerations:**

- While a federal new minimum tax on book income would not directly impact state taxes, there could be future impact. For example, states could borrow this concept as they continue to explore income tax alternatives.

## SHIELD

The Green Book proposes the repeal of the Base Erosion and Anti-Abuse Tax (BEAT) and replacement with the Stopping Harmful Inversions and Ending Low-Tax Developments (SHIELD) proposal. SHIELD would apply to any financial reporting group that (i) includes at least one domestic corporation, domestic partnership, or foreign entity with a U.S. trade or business and (ii) has more than \$500 million in global annual revenues, as determined based on the group's consolidated financial statement. A financial reporting group, for these purposes, would be any group of business entities that prepares consolidated financial statements in accordance with U.S. GAAP, International Financial Reporting Standards (IFRS), or other methods authorized by regulations. Generally, under SHIELD, a deduction (whether a related or unrelated party deduction) would be disallowed to a domestic corporation or branch, in whole or in part, by reference to all gross payments made (or deemed made) to "low-taxed members" (LTMs).

An LTM is any financial reporting group member whose income is subject to (or deemed subject to) an effective tax rate that is below a "designated minimum tax rate." A designated minimum tax rate would be determined by reference to the rate agreed to under Pillar Two – a comprehensive agreement being worked on between the U.S. and the international community under the BEPS 2.0 project.<sup>3</sup> If SHIELD were in effect before a Pillar Two agreement has been reached, the designated minimum tax rate would be the U.S. global minimum tax rate (which is 21% under the proposed changes to GILTI described below). A financial reporting group member's effective tax rate is determined based on the income earned and taxes paid or accrued with respect to the income earned in that jurisdiction by financial reporting group members, as determined based on the members' separate financial statements or the financial reporting group's consolidated financial statements, as disaggregated on a jurisdiction-by-jurisdiction basis. As discussed in more detail below, it is not clear whether "taxes paid or accrued" relies on financial accounting concepts (in which case "taxes paid or accrued" could include, for example, deferred tax liabilities and taxes accrued for uncertain tax positions) or tax accounting concepts such as those found in section 901.

If a domestic corporation or branch is a member of an "in-scope" financial reporting group, SHIELD would disallow certain deductions when both the following conditions are satisfied: (i) the financial reporting group contains one or more LTMs, and (ii) the domestic corporation or branch makes any gross payment to a member of the financial reporting group. Determining the deductions that would be denied under SHIELD is a two-step process. The first step is to determine the amount of payments made (or deemed made) to an LTM. A payment made

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<sup>3</sup> BEPS 2.0 is an initiative being undertaken by the Organisation for Economic Co-operation and Development (OECD) to develop additional global tax rules.

directly to an LTM is subject to SHIELD entirely (the Direct Payments Rule). In the case of a payment to a member that is not an LTM, a portion of the payment is deemed to be made to the LTM(s), based on the ratio of the financial reporting group's low-taxed profits over the group's total profits, determined using the group's consolidated financial accounts (the Indirect Payments Rule). Importantly, for purposes of this first step (under the Direct Payments Rule and Indirect Payments Rule), "payments" are not limited to deductible payments and instead include all gross payments, including payments included in cost of goods sold (COGS) and other capitalized payments.

The second step is to deny deductions in an amount equal to the amount of payments made, or deemed to be made, to LTMs, as determined in the first step. The deductions denied are not necessarily related to the payments identified in the first step. If the payment identified in the first step is otherwise deductible, the deduction would be disallowed in its entirety. If, however, the relevant payment is not otherwise deductible (e.g., because it is included in COGS), then other deductions, including deductions associated with payments to unrelated parties, would be disallowed up to the amount of the payment.

The Green Book indicates that there would be authority for the Secretary to exempt payments to domestic and foreign members that are investment funds, pension funds, international organizations, or non-profit entities, and to take into account payments by partnerships.

SHIELD would generally apply to tax years beginning on or after January 1, 2023. This date— one year later from most of the other corporate proposals—could be intended to provide flexibility related to the ongoing BEPS 2.0 negotiations at the OECD.

In contrast to the current operation of the BEAT, SHIELD appears to target primarily non-U.S.-parented groups. U.S.-parented groups generally would be covered by GILTI, which (as modified by Biden's plan) would constitute a sufficiently strong minimum tax to turn off SHIELD.

For more information on this topic, see page 34 in the [KPMG report on the Green Book](#)

***Tax and accounting considerations:***

- The BEAT provided several special rules and exceptions for financial institutions (e.g., mark-to-market netting rule, qualified derivative payment exception). The Green Book indicates that special rules may apply to payments made to investment funds, pension funds, international organizations or non-profit entities, but there is currently no indication that special rules will apply to financial institutions.
- SHIELD could negatively impact the deductibility of interest expense on total loss absorbing capital (TLAC) instruments required to be issued to foreign parents for regulatory purposes. IRS guidance and the TLAC exception under the BEAT generally ensured that certain regulatory requirements did not result in adverse tax implications for financial institutions. SHIELD may have unfortunate consequences in limiting interest deductions on these instruments despite previous efforts to ensure such interest would be deductible. Notably, the Green Book acknowledges that the BEAT

provided an exception for TLAC securities but is silent as to whether a similar exception would be provided under SHIELD.

- SHIELD would utilize information from a financial reporting group's consolidated financial statements prepared in accordance with GAAP or IFRS to determine (i) who is a financial reporting group member (i.e., a related party), (ii) the effective tax rate of such member, and (iii) the group's low-taxed profits and total profits. Thus, the determination of whether a payment was made to an LTM is based, in part, on financial reporting rules and how such information is reported in consolidated financial statements. Thus, proper consideration would need to be given to the financial accounting treatment of related parties, information associated with the effective tax rate of a member, and profits.
  - With respect to the effective tax rate of a member, the rate is computed by dividing "taxes paid or accrued" by "income earned," determined based on financial statements. While "income earned" is defined to refer to financial statement income, rather than taxable income, it is less clear whether "taxes paid or accrued" relies on financial accounting concepts (in which case "taxes paid or accrued" could include, for example, DTLs and taxes accrued for uncertain tax positions) or tax accounting concepts such as those found in section 901. The latter interpretation appears to be the better read, given that the proposal would provide authority to develop rules to address timing differences, and such rules would not be necessary if the administration intended for "taxes paid and accrued" to include deferred tax items.
- While the proposal is not clear on this point, the language suggests that taxes paid or accrued on income earned in a jurisdiction would not only include local country net basis taxes, but also source-jurisdiction withholding taxes imposed on the income and taxes paid by a parent under an income inclusion rule<sup>4</sup> or CFC (as defined below) rule.
- SHIELD has significant cliff effects due to the fact that it does not take into account the taxes paid (or deemed paid) in a low-tax jurisdiction if the tax rate applicable to such jurisdiction is below the SHIELD's designated minimum tax rate. SHIELD's full deduction disallowance under the Direct Payments Rule would be a significant (and very taxpayer unfavorable) departure from the OECD's Pillar Two undertaxed payment rule's proposed "top-up" tax mechanism, which would deny a proportionate amount of a deduction in the payor jurisdiction by reference to the difference between the minimum rate and the Pillar Two ETR of the relevant jurisdiction. For example, assume that a domestic corporation makes a \$100x deductible payment directly to a low-taxed member payee. The payee jurisdiction's income is \$10x and the taxes paid and accrued are \$2.09x, resulting in a SHIELD ETR of 20.9%. Also assume that SHIELD's designated minimum tax rate is 21% (because no agreement is reached on an OECD Pillar Two minimum rate). As proposed, SHIELD would disallow the entire \$100x deduction regardless of the actual difference between the low-taxed member's SHIELD ETR and the designated minimum tax rate.

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<sup>4</sup> Very generally, Pillar Two proposes an income inclusion rule that would subject foreign income of controlled entities to an agreed minimum tax in the parent jurisdiction. Pillar Two also features an undertaxed payments rule that appears to be the inspiration for SHIELD and provides a backstop in cases where some jurisdictions do not adopt an income inclusion rule under Pillar Two.

- For securities that are subject to mark-to-market tax accounting, the BEAT considers the net amount of income, deduction, gain, or loss associated with such a security (the Net P&L), and if the Net P&L represents a deduction or loss, the amount is taken into account for BEAT purposes. Thus, the BEAT calculation allows a security's income items to offset deductions if recognized in the same year. SHIELD does not currently propose a similar netting rule and appears to require deductions to be determined on a gross basis.
- SHIELD could yield unfavorable results for derivative payments made to financial reporting group members if there is an LTM in the financial reporting group. More specifically, a deduction could be fully or partially disallowed for every derivative payment. This rule could have significant, negative tax consequences for multinational derivative dealers.
- Adverse tax consequences could result from banks and broker-dealers purchasing cash securities from financial reporting group members if there is an LTM in the financial reporting group. More specifically, deductions in amounts equal to the security's purchase price could be fully or partially disallowed.
- Because SHIELD could potentially apply to any payment to a member of the financial reporting group, the question has been raised as to whether SHIELD could apply to repayments of principal on debt. Although not clear, the application of SHIELD likely should be limited to payments that have tax significance (i.e., payments that could provide a tax benefit to the payor at some point).
- While SHIELD applies to a bank's interest expense deductions for payments made to an LTM, it is unclear how deemed or allocated interest for a bank's U.S. operations would be treated. For example, guidance would be necessary to determine whether interest allocated to a foreign bank's U.S. branch under Treas. Reg. section 1.882-5<sup>5</sup> should be considered for SHIELD purposes. A similar question arises for amounts allocated to a branch under the global dealing regulations.
- If the repeal of the BEAT and replacement with SHIELD has a 2023 effective date and the corporate rate increases in 2022 while the BEAT is still in effect, the BEAT may be less impactful in 2022. More specifically, an applicable taxpayer has a BEAT liability if its modified taxable income multiplied by a specified BEAT rate exceeds the taxpayer's adjusted regular tax liability.<sup>6</sup> The adjusted regular tax liability would be higher than under current law to the extent there is an increase in the corporate tax rate for 2022.

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<sup>5</sup> Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the "Code") or the applicable regulations promulgated pursuant to the Code (the "regulations").

<sup>6</sup> Modified taxable income is equal to a taxpayer's taxable income (as defined in section 63(a)), plus the gross amount of base erosion tax benefits for the year, plus the base erosion percentage of any net operating loss deduction. Section 59A(c)(1). The specified BEAT rate generally ranges from 5% to 12.5% depending on the tax year; however, for taxpayers that are banks (as defined under section 581) or registered securities dealers, the BEAT rate is increased by 1%. See section 59A(b)(2)(A) and 59A(b)(3). A taxpayer's adjusted regular tax liability is equal to a taxpayer's regular tax liability (as defined in section 26(b)) reduced (but not below zero) by certain credits. See section 59A(b)(1).

### ***Operational considerations:***

- Many financial institutions invested significant time and resources in developing systems to comply with the substantial compliance burdens imposed by the BEAT. Specifically, many financial institutions developed systems to identify the Net P&L on cash securities and derivatives, with an emphasis on contracts between U.S. entities or branches and foreign related parties. SHIELD seemingly requires financial institutions to calculate the amount of payments made to reporting group members on cash securities and derivatives; thus, financial institutions may be able to leverage previously built systems.
- For BEAT purposes, banks may be relying on the good faith reporting standard with respect to the reporting requirement for certain qualified derivative payments. Notice 2021-36 was recently released, which extends the transition period in which taxpayers can rely on the good faith reporting standard to tax years beginning before January 1, 2023.<sup>7</sup> If enacted in current form, SHIELD would be effective for tax years beginning on or after January 1, 2023. Thus, if SHIELD replaces the BEAT beginning in 2023, taxpayers may be able to rely on the good faith reporting standard for the remainder of the time in which the BEAT would be effective.
- Financial institutions (like all impacted taxpayers) would need to build solutions to properly calculate the effective tax rates for each financial reporting group member and the low-taxed profits ratio applicable for purposes of the Indirect Payments Rule.

### ***State and local tax considerations:***

- Because the BEAT is a federal level tax not imposed by states, its enactment had little state impact aside from the consequences resulting from federal BEAT planning. However, if the BEAT is replaced by SHIELD there could be state impacts. The move to SHIELD would necessitate another analysis of state conformity as it could change the federal taxable income starting point. Generally, states conform to the Code either as of a fixed date, with rolling conformity, or by specific Code section. As seen with the TCJA and the CARES Act, state conformity legislation and/or opting in or out of specific provisions will need to be followed closely by the banks as the states' legislative responses evolve.

## GILTI

The Biden Administration has proposed several changes to the existing “global intangible low-taxed income” (GILTI) regime on U.S. shareholders of controlled foreign corporations (CFCs). First, the 10% return on certain foreign tangible property (referred to as qualified business asset income, or QBAI) would be eliminated, so that a U.S. shareholder’s entire net CFC tested income would be subject to U.S. tax. Second, the section 250 deduction for GILTI inclusion would be reduced to 25%, thereby generally increasing the U.S. effective tax rate for GILTI inclusions to 21% from a rate of 10.5% or 13.125% under current law (depending on the tax

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<sup>7</sup> Previously, the transition period was effective for tax years beginning before June 7, 2021.

year).<sup>8</sup> Third, a U.S. shareholder's GILTI liability would be calculated separately for each foreign jurisdiction in which its CFCs have operations (i.e., on a jurisdiction-by-jurisdiction basis) rather than on a net basis across all jurisdictions. A separate foreign tax credit limitation would be required for each foreign jurisdiction. A similar jurisdiction-by-jurisdiction approach would also apply with respect to a U.S. taxpayer's foreign branch income. The Green Book also indicates there would be a repeal of the high tax exemption for subpart F income and GILTI.<sup>9</sup>

For more information on this topic, see page 15 in the [KPMG report on the Green Book](#)

### ***Tax and accounting considerations:***

- Banks subject to GILTI may consider planning strategies to accelerate income so it is taxed at a lower rate. Banks may also want to consider foreign tax credit capacity when deploying planning strategies, and also consider other runoff effects.
- The removal of the QBAI reduction would likely not have a significant impact on financial institutions considering banks do not typically hold material portfolios of foreign tangible assets. However, the requirement to determine GILTI inclusion on a jurisdiction-by-jurisdiction basis, as well as the reduction to the section 250 deduction and the elimination of the high tax exception, could all have a significant impact on a multinational bank's tax liability.

### ***State and local tax considerations:***

- While questions remain with respect to the state tax treatment of GILTI (e.g., constitutional issues about its taxability in some states, or appropriate apportionment representation), the proposed changes to the rate or computation of the GILTI tax base would appear to pose few new state questions. As with SHIELD, banks would need to monitor state conformity to the changes.

## FDII

The Green Book indicates that there would be a removal of the deduction for foreign-derived intangible income (FDII). Current law provides for a deduction such that there is a 13.125% (increasing to 16.406% in 2026) effective tax rate on excess returns earned directly by a U.S. corporation from foreign sales (including licenses and leases) or services. Financial services income (as defined in section 904(d)(2)(D)) is excluded from the definition of eligible income for FDII purposes. Accordingly, the repeal of the deduction for FDII is not expected to have a significant impact on financial institutions.

For more information on this topic, see page 33 in the [KPMG report on the Green Book](#)

<sup>8</sup> Under current law, the GILTI rate is effectively 10.5% through 2025, and is set to increase in 2026 to 13.125%.

<sup>9</sup> The proposal would also take into account foreign taxes paid by a foreign parent under an approach consistent with Pillar Two (if such consensus is reached), with respect to the CFC income that would otherwise be part of a domestic corporation's GILTI inclusion.

## Tax credits and incentives

The Green Book proposes the expansion of the LIHTC to include a new class of credit funding. Each year, the Code makes available to each State an inflation-adjusted finite pool of new housing credit dollar amounts (HCDAs). The proposal would create an additional type of HCDA, called an "Opportunity HCDA" (OHHCDA). State or local housing credit agencies (HCAs) would have a separate ceiling for OHCDAs from their existing allocation ceilings of HCDAs. HCAs would be required to allocate the majority of their OHCDAs to projects in tracts that are entirely in one or more difficult development areas (DDAs)<sup>10</sup> or which have low poverty or other advantages. According to the Green Book, buildings in DDAs that receive allocations of either HCDAs or OHCDAs would receive so-called "basis boosts" of up to 50% allowing investors in such a project to compute their LIHTC based on 150% of actual depreciable basis.

The Green Book proposes that the NMTC be made permanent. Under current law, no new credit allocation authority has been provided beyond 2025. The Green Book proposes that this change be effective after the date of enactment.

Additionally, the Green Book proposes many tax credits and incentives associated with clean energy. For certain clean energy credits, taxpayers would have the option to elect to receive a cash payment from the IRS in lieu of the business tax credit (i.e., a direct pay option).

The Green Book proposes that qualified School Infrastructure Bonds (QSIBs) would be created, which would be similar to Build America Bonds (BAB) under prior law. There would be a total national QSIB limitation of \$50 billion - \$16.7 billion each for 2022, 2023, and 2024. Interest on QSIBs would be taxable. Either the bondholders' interest would take the form of a tax credit equal to 100% of the interest on the QSIB, or the bondholders would receive cash from the bond issuer, and the Federal Government would make corresponding direct payments to the bond issuer.

For more information on these topics, see pages 51 - 70 in the [KPMG report on the Green Book](#)

### ***Tax and accounting considerations:***

- Financial institutions should consider how these proposed increased housing and clean energy credits and incentives could not only provide tax benefits, but also help achieve economic, social, and governance (ESG) initiatives.
- The availability of direct pay clean energy credits could increase pricing as it could potentially expand the investor base.

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<sup>10</sup> A DDA is an area designated by the Secretary of Housing and Urban Development as an area that has high construction, land, or utility costs relative to area median gross income.

## Interest limitations

According to the Green Book, interest expense limitations may apply to a member of a multinational group that prepares consolidated financial statements (financial reporting group) in accordance with GAAP, IFRS, or other methods identified by the Secretary under regulations. More specifically, a financial reporting group member's deduction for interest expense generally would be limited if the member has net interest expense for U.S. tax purposes and the member's net interest expense for financial reporting purposes (computed on a separate company basis) exceeds the member's proportionate share of the financial reporting group's net interest expense reported on the group's consolidated financial statements (excess financial statement net interest expense). A member's proportionate share of the financial reporting group's net interest expense would be determined based on the member's proportionate share of the group's earnings (computed by adding back net interest expense, tax expense, depreciation, depletion, and amortization) reflected in the financial reporting group's consolidated financial statements.

The proposal would not apply to financial services entities, and such entities would be excluded from the financial reporting group for purposes of applying the proposal to other members of the financial reporting group. The reason for this carveout is likely that financial services entities typically earn net interest income rather than incur net interest expense. The proposal also would not apply to financial reporting groups that would otherwise report less than \$5 million of net interest expense, in the aggregate, on one or more U.S. income tax returns for a tax year.

In cases where the proposal applies, when a financial reporting group member has excess financial statement net interest expense, a deduction would be disallowed for the member's excess net interest expense for U.S. tax purposes. For this purpose, the member's excess net interest expense equals the member's net interest expense for U.S. tax purposes multiplied by the ratio of the member's excess financial statement net interest expense to the member's net interest expense for financial reporting purposes. Conversely, if a member's net interest expense for financial reporting purposes is less than the member's proportionate share of the net interest expense reported on the group's consolidated financial statements, such excess limitation would be converted into a proportionate amount of excess limitation for U.S. tax purposes and carried forward. The proposal does not explicitly address the duration of excess limitation carry forwards.

Alternatively, if a financial reporting group member fails to substantiate its proportionate share of the group's net interest expense for financial reporting purposes, or a member so elects, the member's interest deduction would be limited to the member's interest income plus 10% of the member's adjusted taxable income (as defined under section 163(j)). Regardless of whether a taxpayer computes the interest limitation under the proportionate share approach or using the 10% alternative, any disallowed interest expense could be carried forward indefinitely.

A member of a financial reporting group that is subject to the proposal would continue to be subject to the application of section 163(j). Thus, the amount of interest expense disallowed for a tax year of a taxpayer that is subject to both interest expense disallowance provisions would be determined based on whichever of the two provisions imposes the lower limitation.

U.S. subgroups of a financial reporting group would be treated as a single member of the financial reporting group for purposes of applying the proposal. For this purpose, a U.S. subgroup is comprised of any U.S. entity that is not owned directly or indirectly by another U.S. entity, and all members (domestic or foreign) that are owned directly or indirectly by such entity.

For more information on this topic, see page 45 in the [KPMG report on the Green Book](#)

***Product and customer considerations:***

- Customers subject to this potential interest expense limitation would need to consider:
  - Whether to restructure current debt
  - The cost-benefit of borrowing to fund capital purchases, lease capital assets, or explore other financing structures (e.g., preferred equity, partnership structures, derivatives, prepaid contracts)

***Tax and accounting considerations:***

- Banks would be excluded from this rule to the extent they are considered financial services entities, which likely would be the case. The Green Book indicates that the Secretary would be granted authority to define financial services entities. Although banks likely would be excluded from this provision, non-financial services businesses might still be subject to the provision and might not be able to benefit from the net interest income of the financial services businesses.
- This provision, if applicable to banks, appears to only be potentially applicable to inbound banks, because U.S. headquartered banks would generally consist of a single subgroup.

***Operational considerations:***

- Banks may want to consider adjusting underwriting models for commercial borrowers to account for this potential interest expense disallowance, if applicable.

## IRS enforcement

The Green Book proposes an increase in the IRS enforcement budget for increased audits of corporations and wealthy individuals. Banks should take an inventory of their tax positions to identify potential areas of audit risk and consider ways to mitigate such risk.

For more information on this topic, see page 89 in the [KPMG report on the Green Book](#)

## Real estate

The Green Book contemplates repealing tax benefits associated with like-kind exchanges of real property held for productive use in a trade or business or for investment with gains greater

than \$500,000 (\$1 million in the case of married filing joint taxpayers), effective for exchanges completed in tax years beginning after December 31, 2021 (apparently without regard to the date upon which the exchange began). Any gains from like-kind exchanges in excess of such amount would be recognized in the year the taxpayer transfers the real property subject to the exchange.

For more information on this topic, see page 87 in the [KPMG report on the Green Book](#)

***Product and customer considerations:***

- If enacted, this proposal would likely have an impact on some bank customers who are owners of real property used in a trade or business. Customers affected by this provision would need to factor in this additional cost of operating their real estate businesses and would need to make sure they have enough cash available to satisfy increased tax obligations.

***Operational considerations:***

- Banks may want to consider changes to current underwriting models in order to account for these changes.

## Other considerations

During his presidential campaign, President Biden talked about imposing a “financial fee” on financial entities. This proposal was not included in the Green Book; however, it is possible that future iterations of Biden’s proposals could include a financial fee for financial entities or that Congress might consider such a fee.

Notably, a similar provision was introduced in Green Books released under the Obama Administration, but has not been enacted into law.<sup>11</sup> Under the Obama Administration, the fee would have applied to both U.S. and foreign banks; bank holding companies; and “nonbanks,” such as insurance companies, savings and loan holding companies, exchanges, asset managers, broker-dealers, specialty finance corporations, and financial captives. Firms with worldwide consolidated assets of less than \$50 billion would not have been subject to the fee for periods when their assets were below this threshold. The fee would have applied to “covered liabilities” of a financial entity, generally meaning, assets less equity based on financial statements with a deduction for separate accounts (primarily for insurance companies). The rate of the fee applied to covered liabilities would have been seven basis points, and the fee would have been deductible in computing corporate income tax.

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<sup>11</sup> U.S. Dep’t of the Treasury, [General Explanations of the Administration’s Fiscal Year 2016 Revenue Proposals \(2015\)](#); U.S. Dep’t of the Treasury, [General Explanations of the Administration’s Fiscal Year 2017 Revenue Proposals \(2016\)](#)

## Information reporting

The Green Book includes a proposal that financial institutions be required to report data on financial accounts in an information return. The return would report gross inflows and outflows with a breakdown for physical cash, transactions with a foreign account, and transfers to and from another account with the same owner. This would apply to all business and personal accounts from financial institutions, including bank, loan, and investment accounts, with the exception of accounts below a de minimis gross flow threshold of \$600 or fair market value of \$600.

Payment settlement entities would also be subject to this reporting regime. Such entities would collect Taxpayer Identification Numbers and file a revised Form 1099-K expanded to all payee accounts (subject to the same de minimis threshold), reporting not only gross receipts but also gross purchases, physical cash, as well as payments to and from foreign accounts, and transfer inflows and outflows.

The scope of information reporting would be expanded for brokers who report on crypto assets to include reporting on certain beneficial owners of entities holding accounts with the broker. Further, brokers transacting in crypto assets, including entities such as U.S. crypto asset exchanges and hosted wallet providers, would need to report information relating to certain passive entities and their substantial foreign owners when reporting with respect to crypto assets held by those entities in an account with the broker. A broker would be required to report gross proceeds and such other information as the Secretary may require with respect to customers' sales of crypto assets, and in the case of certain passive entities, their substantial foreign owners.

These proposals would be effective for tax years beginning after December 31, 2022.

For more information on this topic, see pages 90 and 94 in the [KPMG report on the Green Book](#)

### ***Operational considerations:***

- The information reporting requirements would likely impose a heavy compliance burden upon financial institutions. Financial institutions would likely need to invest significant resources to implement systems necessary to comply with these provisions.

## Select individual proposals

### Tax rate changes

The American Families Plan proposes to increase the top income tax bracket from 37% to 39.6%, the top individual tax rate in effect before the TCJA was enacted. The plan also

proposes modifying the “breakpoints” segregating the tax brackets. For example, the breakpoint for married filing jointly taxpayers would be lowered to \$509,300 in 2022 from \$628,300 in 2021. Combined with proposed changes to the 3.8% Medicare tax for taxpayers with adjusted gross income over \$400,000, the top tax rate could be as high as 43.4%.

For taxpayers with adjusted gross income over \$1 million, the Green Book proposes that capital gains and qualified dividend income be taxed at 39.6% rather than at preferential tax rates, as is the case under current law.<sup>12</sup> This would apply only to the extent income exceeds \$1 million (\$500,000 for married filing separately). For example, a taxpayer with \$900,000 of labor income and \$200,000 in preferential capital gain income would have \$100,000 of capital gain income taxed at the current preferential rate and \$100,000 taxed at ordinary tax rates.

According to the Green Book, the proposal to tax long-term capital gains and qualified dividends for high-income taxpayers at ordinary rates would be effective “for gains required to be recognized after the date of announcement.” It is unclear whether the applicable date would be the date of the transmittal of the budget (that is, May 28, 2021) or the date of release of the fact sheet of the American Families Plan on April 28, 2021. Either way, the proposal would be effective for future realizations, if Congress were to accept the Biden Administration’s recommendation.

Further, the plan proposes to close the “carried interest loophole” so that carried interest on a partner’s share of income on an investment services partnership interest would be taxed as ordinary income, subject to employment taxes, regardless of the character of the income at the partnership level if such partner’s taxable income (from all sources) exceeds \$400,000.<sup>13</sup>

For more information on this topic, see pages 71, 73, 80, and 86 in the [KPMG report on the Green Book](#)

***Product and customer considerations:***

- If these provisions are enacted, affected customers might change their investment and trading behavior to avoid unwanted tax consequences (e.g., holding appreciated assets longer, selling assets for a loss to minimize capital gains tax).

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<sup>12</sup> Under current law, the top tax rate for these items is 20%. See section 1. A report published by the Institute on Taxation and Economic Policy (ITEP) projects that 0.4% of taxpayers and 5.3% of the total adjusted gross income in the United States would be subject to the income tax rate increase on capital gains and qualified dividends. Steve Wamhoff & Matthew Gardner, *Effects of the President’s Capital Gains and Dividends Tax Proposals by State* (2021) (published by TaxNotes, *ITEP Estimates Effect of Raising Capital Gains Rate*, 2021 Tax Notes Today - Federal 91-24 (May 12, 2021)).

<sup>13</sup> The “carried interest loophole” would be less impactful if the capital gains tax rate is increased; however, the Green Book proposes eliminating the loophole entirely.

**Operational considerations:**

- These proposed changes can be expected to result in questions from customers. Banks should ensure that front office employees are well educated on these topics so they can communicate effectively to customers.

**Estate and gift tax**

According to the Green Book, the Biden Administration would seek to end the allowance under current law of “stepping-up” the basis for assets inherited at death on gains in excess of \$1 million (\$2 million for married couples). To accomplish this, the Green Book proposes a tax on accumulated gains of such assets upon death, if not transferred to a U.S. spouse or to a charity. The Green Book essentially proposes that a realization event would occur on date of death, regardless of what happens to the asset. There are limited exceptions for certain “family-owned and operated businesses.” The realization event at death, coupled with the increase in capital gains rates, further amplifies the impact of this potential change.

The Green Book also describes a realization event to include gifts of appreciated assets. As a result, gain on unrealized assets would need to be recognized at the time of the gift, other than gifts to U.S. spouses or to charity. The proposal also would provide that a transferred partial interest in property would be its proportional share of the fair market value of the entire property.

Gain on unrealized appreciation also would be recognized by a trust, partnership, or other non-corporate entity that is the owner of property if that property has not been the subject of a recognition event within the prior 90 years, with such testing period beginning on January 1, 1940. Therefore, the first possible recognition event for any taxpayer under this proposal would be December 31, 2030.

For more information on this topic, see page 74 in the [KPMG report on the Green Book](#)

**Product and customer considerations:**

- If enacted, customers would likely re-assess their goals and objectives regarding their gifts and estate (e.g., implement life-time gifting programs, consider philanthropic goals and its interaction with wealth transition planning, etc.).
- If enacted, these proposals would add a significant burden for taxpayers to track basis in assets, and banks would want to consider encouraging customers that are high net worth individuals to begin the process of determining their bases.

**Operational considerations:**

- Customers likely have many questions about how these proposed provisions may impact their assets. Front office employees should be prepared to discuss these topics with customers and be ready to help them navigate these changes.
- Banks should consider updating their trust account systems to track the original basis of property, if known, and subsequent changes as a result of distributions and capital

investments to support gain/loss calculations upon death. If this information is not readily available, banks should determine and document the procedures by which the cost basis information will be determined.

# Contact us

## For more information, contact a KPMG tax professional:

### Mark Price

*National Banking & Capital Markets Tax Leader*

**T:** +1 202 533 4364

**E:** mhprice@kpmg.com

### Elizabeth L'Hommedieu

*Principal, Financial Institutions & Products, Washington National Tax*

**T:** +1 614 249 1849

**E:** elhommedieu@kpmg.com

### Matthew Mosby

*Partner, Financial Institutions and Products, Washington National Tax*

**T:** +1 704 371 5265

**E:** mmosby@kpmg.com

## Contributing author

### Grant Dalbey

*Senior Manager, Financial Institutions and Products, Washington National Tax*

**T:** +1 202 533 3542

**E:** gdalbey@kpmg.com

[www.kpmg.com](http://www.kpmg.com)

[kpmg.com/socialmedia](http://kpmg.com/socialmedia)



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