Ways and Means tax proposals relating to infrastructure, energy, housing, retirement, and social safety net

NOTE: This report does not address revenue raisers and other proposals released on September 13. KPMG LLP will provide further analysis of these proposals in a subsequent report.

This report reflects developments as of 9:00 AM EDT on September 14.
This report provides a summary and analysis of many of the legislative tax proposals released by the Chairman of the House Ways and Means Committee on Friday, September 10, as well as retirement tax savings proposals approved by the Ways and Means Committee on September 9. These proposals are part of a larger legislative effort by the Ways and Means Committee to contribute to the Build Back Better Act moving through the House. This report does not include the tax increase proposals released by the Chairman on Monday, September 13, which will be included in a later summary and analysis.

The proposals released on September 10 are primarily tax incentives and tax benefits for various taxpayers. Those incentives and benefits, for green energy investment, housing, infrastructure, and for various social programs, are the subject of this report.

### Background

The Ways and Means Committee has responsibility in the House of Representatives for producing, among other things, recommendations for the tax provisions of proposed budget reconciliation legislation, the Build Back Better Act. The Committee began consideration—“mark up”—of the legislation within its jurisdiction on September 9 with spending items, such as paid family leave, Medicare expansion, trade adjustment assistance, and the like as well as some items related to retirement savings. Several tax proposals were approved as part of this markup.

The Committee is continuing consideration of the legislation, including the tax provisions, this week—the week of September 13.

The Chairman released late on Friday, September 10, additional tax proposals to be considered by the Committee beginning on September 14. This tranche of tax proposals consists almost exclusively of revenue-losing tax incentives and tax benefits, such as an extension of the refundable child credit and tax incentives to support clean energy.

The remaining tax proposals—most of the proposed revenue raisers—were released on September 13. KPMG will provide analysis and observations regarding those proposed revenue raisers and other proposals in a later report.

### Tax incentives and tax benefits provisions

The tax proposals that Ways and Means already has approved include proposals relating to automatic contribution plans and to a “saver’s match” refundable tax credit.

The tax provisions released on September 10 propose tax credits and incentives for infrastructure financing, green energy, the social safety net, and drug pricing. According to the Committee’s press release, the proposals are intended to:

- Support clean energy investment and deployment, and the creation of good, well-paying jobs
- Extend the American Rescue Plan expansion of the child tax credit, and make permanent the American Rescue Plan expansions of the earned income tax credit and the child and dependent care tax credit
- Reinstate Build America Bonds and advanced refunding bonds to provide financing to state and local
governments and spur investment in the private sector

• Expand tax credit programs that encourage economic and affordable housing investments in our communities that are most in need
• Lower prescription costs for Americans by allowing the HHS Secretary to negotiate for lower drug prices
• Provide immediate coverage for Americans in the Medicaid coverage gap
• Extend the American Rescue Plan’s expanded premium tax credits to help lower health insurance costs

These proposals fall into three main categories:

• **Infrastructure financing.** The mark includes: New Markets Tax Credit permanency, expansion of the Rehabilitation and Low-Income Housing Tax Credits, a new Neighborhood Homes credit, and infrastructure financing.

• **Green energy.** The mark would extend and modify the credits for renewable electricity production and for renewable fuels, extend and modify green energy and efficiency incentives for individuals, and extend and modify incentives for electric and alternative fuel vehicles.

• **Social safety net.** The mark would extend and expand the refundable child credit, modify the Child and Dependent Care Credit and Earned Income Tax Credit, and create tax credits to support child care providers and caregivers.

The mark would also establish an excise tax in connection with drug pricing.

The revenue cost of this tranche of tax proposals for markup, according to the Joint Committee on Taxation (JCT), would be almost $1.2 trillion, not including the non-tax health care provisions.

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**Budget reconciliation**

Adoption of the Senate-passed budget resolution by the House on August 11, 2021 initiated the Congressional budget reconciliation process. That process, among other things, would permit passage of a budget reconciliation bill in the Senate by a simple majority, effectively avoiding the usual requirement there for 60 votes to end debate, i.e., a filibuster. Congressional Democrats have initiated the process with the expectation of nearly universal Republican opposition to proposed tax increases, as well as many of the spending proposals and potential increases in deficits.

Limitations on the budget reconciliation process may affect some of the proposals being considered. In particular, Senate rules require that every provision in a budget reconciliation bill must have more than an incidental effect on spending and revenue. Provisions that create new policy may not satisfy that requirement.

In addition, the narrow Democratic majorities in the House, the “50-50” Senate, and the resulting need for near unanimous Democratic support for a reconciliation bill could complicate passage.

The budget resolution approved by the House and Senate provides for up to $3.5 trillion in new spending. It provides instructions to the various Congressional committees setting net spending limits within their jurisdictions. Their charge is to produce conforming legislation, which is to be reported to the House.
Budget Committee; the Budget Committee then assembles the various pieces of legislation into the reconciliation bill. The budget resolution directs the committees to report their legislation to the Budget Committee by September 15, although that direction is not binding.

The instruction to the House Ways and Means Committee is to produce legislation that raises at least $1 billion in revenue over 10 years. The Committee is therefore required to offset the cost of the spending provisions it has already approved, as well as any tax incentive and benefit provisions in the pending portions of the mark. Beyond that, the Committee can approve legislation that raises $1 billion or more to offset spending approved by other House committees.

The Committee is expected to continue to its consideration of revenue-raising provisions this week in an attempt to comply with the budget resolution directing House Committees to approve legislation by September 15.

This report addresses both the tax-related retirement savings proposals approved by the Ways and Means Committee on September 9, as well as many of the tax incentive, credit, and other proposals released on September 10.

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Infrastructure financing

New Markets Tax Credit made permanent

The proposal would make the new markets tax credit (NMTC) permanent. In addition, for NMTC allocation limitations in calendar years 2022 and 2023, there would be additional allocation amounts of $2 billion (for a total of $7 billion in 2022) and $1 billion (for a total of $6 billion in 2023). Allocation amounts would be set at $5 billion for 2024 and all years thereafter. Beginning in 2024, the proposal would index the annual allocation amount to inflation. These proposal amendments would be effective for NMTC allocation limitations determined for calendar years after 2021.

The proposal would add the NMTC as a specified credit under the general business credit provisions that can be used against the alternative minimum tax (AMT) but only with respect to credits relating to qualified equity investments made after December 31, 2021.

The JCT has estimated that the proposal would lose approximately $2.316 billion over a 10-year period. For calendar years after 2021, in addition to the above increased NMTC allocation limitations, the proposal would create a new, permanent, annual $175 million NMTC allocation for low-income communities in tribal statistical areas and broadens the definition of low-income community to include an area used for a project which services a significant population of Tribal or Alaska Native Village members who are residents of a low-income community.
The JCT has estimated that the proposal would lose approximately $226 million over a 10-year period.

Also, a new, permanent, annual $100 million NMTC allocation would be created for low-income communities in U.S. territories. 80% of the such allocation would be directed towards projects in Puerto Rico, and 20% directed towards projects in Guam, the Commonwealth of the Northern Marian Islands, the U.S. Virgin Islands, or American Samoa. The new tribal and U.S. territories allocation amounts would be indexed for inflation beginning in 2024. These proposal amendments would be effective for NMTC determined for calendar years after December 31, 2021.

The JCT has estimated that the proposal would lose approximately $2.3 billion over a 10-year period.

**KPMG observation**

Making the NMTC permanent would be the foremost enhancement to the credit and would provide greater assurance to investors considering investing in riskier low-income communities. Increasing the annual credit limitation and indexing such amounts for inflation would increase the amount of investment dollars available for projects seeking NMTC financing in underserved economic areas across the United States and its territories. Increasing NMTC allocation authority for tribal statistical areas, Puerto Rico, and the other U.S. territories would drive more investment in such areas and allow qualified businesses in those areas greater participation in the NMTC program.

**Rehabilitation tax credit**

Under current law, a 20% tax credit is provided for qualified rehabilitation expenditures (the HTC) with respect to a certified historic structure. The HTC is generally allowable ratably in each tax year over the five-year period beginning in the tax year in which the qualified rehabilitated building is placed in service, for amounts paid or incurred after December 31, 2017.

The proposal would modify the HTC by replacing the current 20% with an applicable percentage applied for tax years beginning before 2020 equal to 20% and 30% for tax years 2020 through 2025. The applicable percentage would be phased down to 26% in 2026, 23% in 2027, and returns to 20% in 2028 and thereafter. The temporary credit rate increase would be effective for property placed in service after March 31, 2021.

For certain smaller projects, the proposal would provide an applicable percentage of 30% for qualified rehabilitation expenditures (QREs) capped at $2,500,000. A smaller project is defined generally as a qualified rehabilitated building for which the QREs do not exceed $3,750,000, and for which no rehabilitation credit was allowed for the two tax years preceding the first year for which such expenditures are paid or incurred. Taxpayers may elect between the regular HTC and the small project credit. The elective credit rate increase for smaller projects is effective for tax years beginning after December 31, 2021.

The proposal would modify the substantial rehabilitation requirement so that QREs must exceed the greater of (1) 50% (instead of the current 100%) of the adjusted basis of the building (and its structural components), or (2) $5,000. The modification of the substantial rehabilitation requirement would be effective for 24-month (or 60-month) periods ending after December 31, 2021.

The proposal would also remove the requirement that the QREs be reduced by the amount of the HTC
and; in the case of a lease passthrough arrangement in which the HTC is passed through to the lessee, the proposal would eliminate the requirement that the lessee must include ratably in gross income over the shortest recovery period with respect to such property an amount equal to 100% of the HTC. These proposal amendments would be for QREs placed in service after December 31, 2022.

The proposal would modify the tax-exempt use property rules for the HTC by amending the disqualified lease rules, making such rules only applicable in the case of a government entity and would be effective for leases entered into after December 31, 2021.

Also, the tax-exempt use rules would not apply in the case of the rehabilitation of any building that was used as a qualified public educational facility as defined under section 142(k)(1) at any time during the five-year period ending on the date that such rehabilitation begins and which is used as such a facility immediately after such rehabilitation. The proposal amendment would be effective for property placed in service after December 31, 2021.

The JCT has estimated that the proposal would lose approximately $26.476 billion over a 10-year period.

KPMG observation

The proposal would temporarily increase HTC percentage and eliminate HTC basis reduction which would increase the depreciable basis of QREs. Also, the proposal would eliminate the “phantom income” that requires lessees to include in income an amount equal to 100% of the HTC ratably over recovery life of the building. The elimination of the basis reduction (or income inclusion for lessees) would be a noteworthy change to the HTC. From a policy perspective, the basis reduction is viewed as the tool by which the taxpayer pays back the government for the credit over time through decreased depreciation deductions. The 2017 U.S. tax law, commonly referred to as the “Tax Cuts and Jobs Act” (TCJA) (Pub. L. No. 115-97) amended the HTC so that the credit is taken over five years instead of all in one year. As such, the proposed elimination of the basis reduction rule may be an effort to restore some of the incentive value of the credit that was lost in the TCJA change.

Also, according to the Ways and Means Committee summary, by limiting the application of the disqualified lease rules to government entities, the proposed amendments would make the HTCs easier to access by non-profits and other tax-exempt entities and make projects like health care centers, arts organizations, community services, workforce training providers, and others better able to use the HTC.

Disaster and resiliency

Exclusion of amounts received from state-based catastrophe loss mitigation programs

The proposal would provide an exclusion from gross income for certain state-based grants made to homeowners that support mitigation efforts for earthquakes, fires, windstorms, and other disasters.

The exclusion would apply to tax years beginning after December 31, 2020.

The JCT estimated that the provision would decrease revenues by approximately $122 million over 10 years.
Repeal of temporary limitation on personal casualty losses

The proposal would repeal the TCJA’s temporary limitation on personal casualty losses and extend the period of time individuals have to claim losses attributable to damages resulting from deteriorating concrete foundations containing pyrrhotite.

The TCJA limited the deduction that could be claimed for personal casualty and theft losses not compensated by insurance or otherwise to personal casualty and theft losses incurred in a federally declared disaster for tax years 2018 through 2025.

The proposed repeal of the TCJA’s temporary limitation on personal casualty and theft losses would apply to losses incurred in tax years beginning after December 31, 2017, meaning individual taxpayers may be eligible to amend their tax returns for tax years 2018 through 2020 to claim previously disallowed losses.

The proposal would also extend the period of time individuals have to make a claim for credit or refund attributable to a casualty loss deduction for amounts paid to repair damage to their personal residences caused by deteriorating concrete foundations containing pyrrhotite. Under the proposal, the statute of limitations for making a claim of credit or refund for this type of casualty loss arising in tax years beginning after December 31, 2016 would expire no earlier than one year after the date of the enactment of this proposal.

The JCT estimated that the provision would decrease revenues by approximately $2 billion over 10 years.

KPMG observation

The proposed repeal of the TCJA provision limiting personal casualty and theft loss deductions solely to those incurred in a federally declared disaster would expand the scope of personal property loss deductions available to individual taxpayers. Under the broader pre-TCJA definition, such losses could include personal casualty losses resulting from fires, floods, or storms that occur in areas not subject to a federal disaster declaration or other sudden or unexpected events such as theft or an automobile collision.

Credit for qualified wildfire mitigation expenditures

The proposal would create a tax credit equal to 30% of qualified expenditures for individuals and businesses who participate in a qualified state-based wildfire resiliency program.

The provision would apply to expenditures paid or incurred after the date of enactment, in tax years ending after that date.

The JCT estimated that the provision would decrease revenues by approximately $387 million over 10 years.

Housing

Low-income housing tax credit

The proposal would make several changes to the low-income housing credit (LIHTC).
**Increases in state housing credit ceilings**

The proposal would modify the population component of the State housing credit ceiling. For 2022, the population component of the state housing credit ceiling would be equal the greater of (1) $3.22 multiplied by the state population, or (2) $3,711,575. For 2023, the population component of the State housing credit ceiling would equal the greater of (1) $3.70 multiplied by the state population, or (2) $4,269,471. For 2024, the population component of the State housing credit ceiling would be equal to the greater of (1) $4.25 multiplied by the state population, or (2) $4,901,620. For 2025, the population component of the state housing credit ceiling would be equal to the greater of (1) $4.88 multiplied by the state population, or (2) $5,632,880. These amounts are adjusted for inflation in calendar years 2026, 2027, and 2028.

The proposal would be effective for calendar years after December 31, 2021.

The JCT has estimated that the proposal would lose approximately $11.04 billion over a 10-year period.

**Tax-exempt bond financing requirement**

Currently, the 4% housing credit provides a credit from the state private activity bond volume cap where 50% or more of the building and land is financed by tax-exempt bonds. The proposal would temporarily reduce the 50% requirement to 25% for buildings financed by the proceeds of tax-exempt bonds issued in any calendar year 2022-2028 (and not by any obligation taken into account during any tax year beginning in 2019-2021) effective for buildings placed in service in tax years after December 31, 2021. (See further discussion below in bond financing discussion.)

The JCT has estimated that the proposal would lose approximately $9.498 billion over a 10-year period.

**Buildings designated to serve extremely low-income households**

The proposal would add a new state housing allocation set-aside requirement for certain buildings with extremely low-income households requiring that at least 10% of the state housing credit ceiling be allocated to certain buildings with extremely low-income households.

A building with extremely low-income households is a building where 20% or more of the residential units are rent-restricted (determined as if the imputed income limitation applicable to such units were 30% of area median gross income), which have been designated by the taxpayer for occupancy by households the aggregate household income of which does not exceed the greater of (1) 30% of area median gross income, or (2) 100% of an amount equal to the Federal poverty (“extremely low-income buildings”). The requirements of the new set-aside would not apply to allocations after December 31, 2031.

The proposal also makes certain extremely low-income buildings eligible for enhanced low-income housing tax credit. For any extremely low-income building which is designated by the state housing credit agency as requiring an increase in credit in order for the building to be financially feasible, such building’s eligible basis would be increased to 150% of the otherwise applicable eligible basis. The enhanced credit would not available for allocations made after December 31, 2031

The JCT has estimated that the proposal would lose approximately $2.603 billion over a 10-year period.
Inclusion of rural areas as difficult development areas

The proposal would allow states the ability to provide an enhanced credit of up to 130% for projects in rural areas if needed for financial feasibility, by qualifying rural areas as difficult development areas. Rural areas are defined as any non-metropolitan area or any open country, place, town, village, or city which is not part of or associated with an urban area and either has low population or is not contained within a standard metropolitan statistical area and has a serious lack of mortgage credit for lower and moderate income families, as determined by the Secretary of Agriculture and the Secretary of Housing and Urban Development and which is identified by the qualified allocation plan of the housing credit agency. The proposal would apply to buildings placed in service after December 31, 2021.

The JCT has estimated that the proposal would lose approximately $2.654 billion over a 10-year period.

Repeal of qualified contract option

The proposal would eliminate the qualified contract exception for buildings receiving allocations after January 1, 2022. The qualified contract exception allows an owner of a qualified low-income building to submit a written request beginning on the date after the 14th year in the compliance period, that the state housing agency find a qualified buyer to acquire the owner’s building within a one-year period from the date of such request. If the State is unable to find a qualified buyer, the building’s extended use period terminates, and the housing affordability restrictions are removed.

Specifically, the proposal would limit the use of the exception to (1) buildings that received housing credit allocations before January 1, 2022, or (2) with respect to buildings financed with tax-exempt bonds, buildings that received housing credit allocations before January 1, 2022, a determination from the issuer of the tax-exempt bonds or the housing credit agency that the building has satisfied the qualified allocation plan requirements and the financial feasibility determination.

In addition, for buildings that may still make use of the qualified contract exception, the proposal would modify the specified statutory price. The price for any non-low-income portion remains the fair market value. The price for the low-income portion is the fair market value, determined by the housing credit agency taking into account the rent restrictions required to continue to satisfy the minimum set aside requirements. The Secretary is directed to prescribe regulations necessary or appropriate to the determination of the specified statutory price. The proposal would generally be effective on the date of enactment. The proposal to modify the specified statutory price would apply to buildings with respect to which the building owner submits, after the date of enactment, a written request to find a buyer that agrees to acquire the owner’s interest in the low-income portion of the building.

The JCT has estimated that the proposal would raise approximately $466 million over a 10-year period.

Modification and clarification of rights relating to building purchase

Currently, no federal income tax benefit shall fail to be allowable to the taxpayer with respect to any qualified low-income building merely by reason of a right of first refusal held by the tenants or resident management corporation of such building or by a qualified nonprofit organization or government agency to purchase the property after the close of the compliance period for a price which is not less than a certain purchase price.

The proposal would modify this right of first refusal safe harbor into an option safe harbor. In addition, for existing agreements, the provision clarifies, for purposes of the safe harbor, that the right to acquire the property includes the right to acquire the property or all the partnership interests relating to the building. It also clarifies that the right to acquire the building includes the right to acquire assets held for the
development, operation, or maintenance of the building. Thus, agreements which provide for the right to acquire these partnership interests or building assets would satisfy the safe harbor.

The proposal also would clarify that, for existing agreements, the right of first refusal safe harbor may be satisfied by the grant of an option. A right of first refusal may be exercised in response to an offer by a related party; a bona fide third-party offer is not needed. A right of first refusal may be exercised without the approval of any owner of a credit project.

Finally, the proposal would amend the minimum purchase price to exclude exit taxes. The new definition of the minimum purchase price would be the principal amount of outstanding indebtedness secured by the building (other than indebtedness incurred within the 5-year period ending on the date of the sale to the tenants). In the case of a purchase of a partnership interest, the minimum purchase price would be an amount not less than such interest’s ratable share of the principal amount of outstanding indebtedness secured by the building (other than indebtedness incurred within the 5-year period ending on the date of the sale to the tenants). Thus, agreements that do not include exit taxes as part of the minimum purchase price do not fail to satisfy the safe harbor.

The proposal that would change the right of first refusal safe harbor into an option safe harbor is effective for agreements entered into or amended after the date of enactment. The other provisions of the proposal would be effective for agreements entered into before, on, or after the date of enactment.

The JCT has estimated that the proposal would raise approximately $751 million over a 10-year period.

**Increase in credit for bond-financed projects designated by housing credit agency**

The proposal would modify the rule which treats as difficult development areas those buildings designated by state housing agencies as requiring an increase in credit. Under the proposal, buildings so designated and financed with the proceeds of tax-exempt bonds would be treated as located in difficult development areas for purposes of determining eligible basis provided the determinations of housing credit dollar amounts are not made after December 31, 2028. The proposal would apply to buildings that receive a determination of housing credit dollar amount pursuant to section 42(m)(2)(D) after the date of enactment.

The JCT has estimated that the proposal would lose approximately $4.66 billion over a 10-year period.

**KPMG observation**

The proposal would be a significant expansion of the LIHTC, increasing the amount of the current credit available to support and expand affordable housing. The proposal also would provide enhanced credits that specifically target and encourage more affordable housing for certain groups or areas such as Indian tribes, extremely low-income households, and rural areas. (See further discussion below in investments in tribal infrastructure discussion.)

The proposal would also make it easier to qualify projects for the 4% credit by reducing the percentage of land and building required for the tax-exempt bond volume cap and also increase the amount of credit for such projects by allowing state housing agencies to designate bond-financed projects as being located in a difficult development area. In addition, the proposal would repeal the qualified contract option thereby preserving the affordability of the low-income project rather than allowing the project to become market rate at the end of the compliance period.
Neighborhood homes investment tax credit

The proposal would provide a new general business credit to (1) taxpayers that develop or rehabilitate property that will be sold to an eligible purchaser who will use the property as the purchaser’s principal residence, or (2) taxpayers that rehabilitate certain owner-occupied property. The proposal would also provide that each State create a new agency (or identify a pre-existing agency) to serve as the Neighborhood Homes Credit Agency (NHCA), with authority to allocate potential Neighborhood Homes Credits (NHCs) to project sponsors. States would receive authority to administer and allocate credits on a competitive basis. NHCs would be allocated to the 50 states, the District of Columbia, and U.S. possessions (State).

Credit for property sold to an eligible purchaser

Specifically, the proposal would provide a tax credit, with respect to a qualified residence sold by a taxpayer in an affordable sale, in an amount which is the lesser of (1) the excess (if any) of (i) reasonable development costs paid or incurred by the taxpayer with respect to the qualified residence, over (ii) the sales price of the qualified residence (reduced by any reasonable expenses paid or incurred by the taxpayer in connection with the sale), or (2) 35% of the lesser of (i) eligible development costs paid or incurred by the taxpayer with respect to the qualified residence or (ii) 80% of the national median sales price for new homes.

The proposal would provide that “reasonable development costs” mean amounts paid or incurred for the acquisition of buildings and land, construction, substantial rehabilitation, demolition of structures, or environmental remediation, to the extent the amounts meet the standards of the NHCA and are necessary to ensure the financial feasibility of the qualified residence.

“Eligible development costs” mean amounts which would be reasonable development costs if the amounts taken into account as paid or incurred for the acquisition of buildings and land did not exceed 75% of the costs determined without regard to any amount paid or incurred for the acquisition of buildings and land.

The proposal would provide that a “qualified residence” must be (1) real property affixed on a permanent foundation; (2) a single-family home (including homes with up to four dwelling units), a condominium, or a residence in a housing cooperative; (3) part of a qualified project which has received an allocation from a NHCA; and (4) located in a qualified census tract (meeting requirements with elevated poverty rates, lower incomes, and modest home values; certain rural areas with lower incomes; or disaster areas). Qualified homeowners would generally include individuals who own and use a qualified residence as their principal residence and whose family income is 140% or less of the median family income for the area.

Rehabilitations of owner-occupied residences

The proposal also would provide a credit to a taxpayer that rehabilitates certain owner-occupied residences. For these rehabilitations, the credit would be allowed in the tax year in which the qualified rehabilitation is completed, and the credit amount would be the lesser of (1) the excess (if any) of (i) amounts paid or incurred by the taxpayer for the qualified rehabilitation of the qualified residence, to the extent the amounts meet the standards of the NHCA, over (ii) any amounts paid to the taxpayer for the rehabilitation; (2) 50% of amounts paid or incurred by the taxpayer for the qualified rehabilitation of the qualified residence, to the extent the amounts meet the standards of the NHCA; or (ii) $50,000.

The proposal would provide that “qualified rehabilitation” means a rehabilitation performed pursuant to a written binding contract between the taxpayer and the qualified homeowner, if the amount paid or
incurred by the taxpayer in the performance of the rehabilitation exceeds $20,000. Qualified homeowners for owner-occupied rehabilitations would generally include individuals who own and use a qualified residence as their principal residence as of the date of the written binding contract and whose family income does not exceed the median family income for the area.

**NHCA credit ceiling**

The proposal would provide that, for any calendar year, the aggregate amount allocated to qualified projects by the NHCA may not exceed the credit ceiling. Further, the credit allocated to any qualified project may not exceed the amount that the NHCA determines is necessary to ensure the financial feasibility of the qualified project. The credit ceiling for a calendar year for each state for 2022 would be the greater of $8 million or $6 multiplied by the state population, plus certain unallocated credits. This amount would be indexed for inflation for years after 2022.

**Responsibilities of NHCA**

Sponsors seeking potential NHCA would apply on a competitive basis by providing candidate plans for construction or rehabilitation to the NHCA. Each NHCA would establish a qualified allocation plan (QAP) to guide it in allocating potential NHCA among competing proposals. The NHCA would also be responsible for promulgating certain standards, monitoring compliance with all provisions governing NHCA, and for reporting certain information and noncompliance to the Internal Revenue Service (IRS).

The proposal would apply to tax years beginning after December 31, 2021.

The JCT has estimated that the proposal would lose approximately $17.736 billion over a 10-year period.

**KPMG observation**

The proposal would provide a new federal tax credit that supports building or renovating owner-occupied housing. The NHCA would be allocated and administered under rules similar to the allocation and administration of the low-income housing credit.

**Bonds**

**Credit to issuer for certain infrastructure bonds**

**Current law**

*In general*

Under current law, interest paid on bonds issued by state and local governments generally is excluded from gross income. As an alternative to tax-exempt interest, various tax credit and direct pay bonds have been authorized to lower borrowing costs on certain bonds issued by state and local governments. With direct pay bonds, the issuer of the bond receives a payment from the federal government to offset a portion of the interest expense on the bonds.

State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental functions or which are repaid with governmental funds. Private activity bonds are bonds in which the state or local government serves as a conduit providing financing to nongovernmental persons (e.g.,
private businesses or individuals). A private activity bond is any bond that satisfies (1) the private business test\(^1\) or (2) the private loan financing test.\(^2\)

**Arbitrage requirements**

The exclusion from income for interest on state and local bonds does not apply to any arbitrage bond. An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments. Subject to limited exceptions, arbitrage profits that are earned during these periods or on such investments must be rebated to the federal government.

**The proposal**

**In general**

The proposal would create a new direct pay bond called a “qualified infrastructure bond.” Under the proposal, an issuer could elect to have an otherwise tax-exempt bond treated as a qualified infrastructure bond, subject to satisfaction of additional requirements. A “qualified infrastructure bond” is any obligation (other than a private activity bond) if:

- The interest on such obligation would be (but for the bond being a qualified infrastructure bond) excludable from gross income under section 103,
- The issuer makes an irrevocable election to have the provision apply, and
- Certain additional requirements are satisfied.

In determining if an obligation would be tax-exempt under section 103, the credit allowed to the issuer (discussed below) would not be treated as a federal guarantee. For arbitrage purposes, the yield on a qualified infrastructure bond is reduced by the credit allowed to the issuer (the reduction does not apply in determining the amount of gross proceeds of an issue that qualifies as a reasonably required reserve or replacement fund). A qualified infrastructure bond would not include any bond if the issue price has more than a de minimis amount of premium over the stated principal amount of the bond.

**Taxable interest and credit payment to issuer**

The interest on a qualified infrastructure bond would be taxable to the bondholder, and the issuer of the bond would be allowed a credit equal to the applicable percentage of each interest payment made under such bond, subject to the limitation on the applicable percentage discussed below. The applicable percentage for a qualified infrastructure bond (other than current refunding bonds, as discussed below) would depend on the calendar year in which the bond is issued as follows:

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1 Under the private business test, a bond is a private activity bond if it is part of an issue in which:

- More than 10% of the proceeds of the issue are to be used in the trade or business of any person other than a governmental unit (“private business use”); and
- More than 10% of the payment of principal or interest on the issue is:
  - Secured by property used or to be used for a private business use or payments in respect of such property, or
  - To be derived from payments in respect of property, or borrowed money, used or to be used for a private business use.

2 A bond issue satisfies the private loan financing test if proceeds exceeding the lesser of $5 million or 5% of such proceeds are used directly or indirectly to finance loans to one or more nongovernmental persons.
• 2022 through 2024 ................................................................. 35%
• 2025 ..................................................................................... 32%
• 2026 ..................................................................................... 30%
• 2027 and thereafter (and current refunding bonds) .............. 28%

For example, if an issuer of a qualified infrastructure bond issued in 2022 pays a $1,000 coupon payment, unless the limitation described in the following paragraph applies, the taxpayer who holds such a bond would include $1,000 of interest in their income and the issuer would receive a payment of 35% of each $1,000 coupon paid to bondholders. (The net interest cost to the issuer would be $650.) The payment by the federal government to the issuer is to be made contemporaneously with the interest payment made by the issuer and may be made either in advance or as reimbursement. In lieu of payment to the issuer, the payment may (at the direction of the issuer) be made to a person making interest payments on behalf of the issuer.

For purposes of calculating the issuer’s allowed credit, the amount of any interest payment taken into account with respect to a bond for any payment date could not exceed the amount of interest which would have been payable under such bond for such payment date if interest were determined at the “applicable credit rate” multiplied by the “applicable amount” for such bond for such payment date.

• The “applicable credit rate” is the rate which the Secretary estimates would permit the issuance of qualified infrastructure bonds with a specified maturity or redemption date without discount and without additional interest cost to the issuer. The applicable credit rate with respect to any qualified infrastructure bond would be determined as of the first day on which there is a binding, written contract for the sale or exchange of the bond.

• The “applicable amount” for a bond for any payment date would be:
  o In the case of any bond that has more than a de minimis amount of original issue discount (determined under the rules of section 1273(a)(3)), the issue price of such bond (within the meaning of section 148), as adjusted for any principal payments made prior to such date, and
  o In the case of any other bond, the outstanding principal amount of such bond on such payment date (determined without taking into account any principal payment on such bond on such date).

Regarding sequestration (pursuant to the Balanced Budget and Emergency Deficit Control Act of 1985 or the Statutory Pay-As-You-Go Act of 2010), the proposal would provide that in the case of any payment of the credit to or at the direction of the issuer of a qualified infrastructure bond to which sequestration applies, the amount of such payment is increased to an amount equal to (1) such payment (determined before such sequestration), multiplied by (2) the quotient obtained by dividing 1 by the amount by which 1 exceeds the percentage reduction in such payment pursuant to such sequestration.

Additional provisions for qualified infrastructure bonds

To qualify as a “qualified infrastructure bond,” 100% of the excess of available project proceeds of the issue of which the bond is a part over the amounts in a reasonably required reserve (within the meaning of section 150(a)(3)) with respect to such issue would have to be used for:

• Capital expenditures or operations and maintenance expenditures in connection with property the acquisition, construction, or improvement of which would be a capital expenditure, or
• Payments made by a state or political subdivision of a state to a custodian of a rail corridor for purposes of the transfer, lease, sale, or acquisition of an established railroad right-of-way consistent with section 8(d) of the National Trails Act of 1968, but only if the Surface Transportation Board has issued a certificate of interim trail use or notice of interim trail use for purposes of authorizing such transfer, lease, sale, or acquisition.

A bond issued to currently refund a qualified infrastructure bond would not be a qualified infrastructure bond unless:

• The average maturity date (determined in accordance with section 147(b)(2)(A)) of the issue of which the refunding bond is a part is not later than the average maturity date of the bonds to be refunded by such issue,
• The amount of the refunding bond does not exceed the outstanding amount of the refunded bond,
• The refunded bond is redeemed not later than 90 days after the date of the issuance of the refunding bond, and
• The refunded bond was issued more than 30 days after the date of the enactment.

The applicable percentage with respect to any qualified infrastructure bond issued to currently refund another qualified infrastructure bond would be 28%. The proposal also would provide authority for certain advance refunding bonds (when the refunded bond is redeemed more than 90 days after the date of issuance of the refunding bond) to be issued as tax-exempt bonds, subject to applicable requirements. Bonds issued to advance refund qualified infrastructure bonds would not be qualified infrastructure bonds.

The requirements of the Davis-Bacon Act in Subchapter IV of chapter 31 of title 40, United States Code would apply to projects financed with the proceeds of qualified infrastructure bonds.

The JCT estimated that the provision would decrease revenues by approximately $22.5 billion over 10 years.

The proposal would be effective for bonds issued after December 31, 2021.

KPMG observation
The proposal would create a new direct pay bond for qualified infrastructure. The proposal does not allow for a tax credit alternative. The proposal does not have an expiration date, however it does scale back the direct pay credit in later years.

Advance Refunding Bonds

Under current law, section 103 generally provides that gross income does not include interest received on state or local bonds. The exclusion from income for interest on state and local bonds applies to refunding bonds subject to certain limits. A refunding bond is defined as any bond used to pay principal, interest, or redemption price on a prior bond issue (the refunded bond).

A bond is classified as an advance refunding bond if it is issued more than 90 days before the redemption of the refunded bond. Prior to the TCJA, the exclusion from gross income for state and local bonds applied, in certain limited circumstances, to advance refundings. The TCJA amended section 149 to
repeal the exclusion from gross income for interest on a bond issued to advance refund another tax-
exempt bond, effective for refunding bonds issued after December 31, 2017.

The proposal would amend section 149 of the Code to allow the exclusion from gross income for interest 
on a bond issued to advance refund another tax-exempt bond, subject to limitations similar to those 
applicable to tax-exempt advance refunding bonds issued prior December 31, 2017.

The JCT estimated that the provision would decrease revenues by approximately $14.9 billion over 10 
years.

The proposal would be effective for advance refunding bonds issued more than 30 days after the date of 
enactment.

KPMG observation

This provision would reinstate the rules for advance refunding bonds that were in effect prior to 
their repeal in the TCJA.

**Permanent modification of small issuer exception to tax-exempt interest expense allocation rules for financial institutions**

**Current law**

Present law disallows a deduction for interest on indebtedness incurred or continued to purchase or carry 
obligations the interest on which is exempt from tax. In the case of a financial institution, the Code 
generally disallows a deduction for that portion of the taxpayer’s interest expense that is allocable to tax-
exempt interest. This general rule (in section 265(b) of the Code) does not apply to “qualified tax-exempt 
obligations.” Instead, as discussed below, only 20% of the interest expense allocable to “qualified tax-
exempt obligations” is disallowed.

A “qualified tax-exempt obligation” is a tax-exempt obligation that:

- Is issued after August 7, 1986, by a “qualified small issuer,“
- Is not a private activity bond, and
- Is designated by the issuer as qualifying for the exception from the general rule of section 265(b).

A “qualified small issuer” is an issuer that reasonably anticipates that the amount of tax-exempt 
obligations that it will issue during the calendar year will be $10 million or less (in certain circumstances, 
an issuer and all subordinate entities are aggregated).

Section 291(a)(3) reduces by 20% the amount allowable as a deduction with respect to any financial 
institution preference item. Financial institution preference items include interest on debt to acquire tax-
exempt obligations acquired after December 31, 1982, and before August 8, 1986. Section 265(b)(3) 
treats qualified tax-exempt obligations as if they were acquired on August 7, 1986. As a result, the 
amount allowable as a deduction by a financial institution with respect to interest incurred to carry a 
qualified tax-exempt obligation is reduced by 20%.

The American Recovery and Reinvestment Act of 2009 (ARRA) made certain adjustments to section 265 
for tax-exempt obligations issued during 2009 and 2010, including increasing from $10 million to $30
million the annual limit for qualified small issuers, treating qualified 501(c)(3) bonds as if they were issued by the 501(c)(3) organization for whose benefit they were issued (and not by the actual issuer of such bonds), and, for certain qualifying issues, applying the annual volume limitation at the borrower level (rather than at the level of the pooled financing issuer).

**The proposal**

The proposal would increase from $10 million to $30 million the annual limit for qualified small issuers and would index the annual limit for inflation after 2021.

A “qualified financing issue” is any composite, pooled or other conduit financing issue the proceeds of which are used directly or indirectly to make or finance loans to one or more ultimate borrowers each of whom is a qualified borrower.

For “qualified financing issues,” the proposal would apply the annual volume limitation at the borrower level (rather than at the level of the pooled financing issuer). Thus, for the purpose of applying the requirements of the section 265(b)(3) qualified small issuer exception, the portion of the proceeds of a qualified financing issue that are loaned to a “qualified borrower” that participates in the issue would be treated as a separate issue with respect to which the qualified borrower is deemed to be the issuer.

A “qualified borrower” means (1) a state or political subdivision of a state, or (2) an organization described in section 501(c)(3) and exempt from tax under section 501(a). Thus, for example, a $100 million pooled financing issue could qualify for the section 265(b)(3) exception if the proceeds of such issue were used to make four equal loans of $25 million to four qualified borrowers. However, if:

- More than $30 million (or such increased annual limit as may be applicable under the adjustment for inflation) was loaned to any qualified borrower,
- Any borrower was not a qualified borrower, or
- Any borrower would, if it were the issuer of a separate issue in an amount equal to the amount loaned to such borrower, fail to meet any of the other requirements of section 265(b)(3),

then the entire $100 million pooled financing issue would fail to qualify for the exception.

Additionally, for purposes of determining whether an obligation is a qualified tax-exempt obligation under section 265(b)(3), the proposal would treat qualified 501(c)(3) bonds as if they were issued by the 501(c)(3) organization for whose benefit they were issued (and not by the actual issuer of such bonds). The JCT estimated that the provision would decrease revenues by approximately $3.97 billion over 10 years.

The proposal generally would be effective for obligations issued after the date of enactment.

**KPMG observation**

Section 265(b) generally disallows 100% of the interest expense of banks that is allocable to tax-exempt interest. The proposal would increase the size of a tax-exempt bond issuance that would be excluded from this rule and that would instead be taken into account under the 20% disallowance of interest in section 291.
Modifications to qualified small issue bonds

Current law

Qualified private activity bonds are tax-exempt private activity bonds issued to provide financing for specified privately used facilities. Generally, qualified private activity bonds are subject to a number of eligibility restrictions. For example, the aggregate volume of most qualified private activity bonds is restricted by annual state volume limitations (the “state volume cap”). For calendar year 2021, the state volume cap, which is indexed for inflation, equals $110 per resident of the state, or $324,995,000, if greater. Qualified small issue bonds (discussed next) are subject to state volume cap.

Qualified small issue bonds (commonly referred to as “industrial development bonds” or “small issue IDBs”) are tax-exempt qualified private activity bonds issued by state and local governments to finance private business manufacturing facilities or the acquisition of land and equipment by certain farmers.

Qualified small issue bonds are subject to limits on the amount of financing that may be provided. In general, no more than $1 million of small issue bond financing may be outstanding at any time for property of a business (including related parties) located in the same municipality or county. Generally, this $1 million limit may be increased to $10 million if, in addition to outstanding bonds, all other capital expenditures of the business (including related parties) in the same municipality or county are counted toward the limit over a six-year period that begins three years before the issue date of the bonds and ends three years after such date. Outstanding aggregate borrowing is limited to $40 million per borrower (including related parties) regardless of where the property is located. The Code permits up to $10 million of capital expenditures to be disregarded, in effect increasing from $10 million to $20 million the maximum allowable amount of total capital expenditures by an eligible business in the same municipality or county.

The ARRA made certain temporary adjustments to section 144(a) that expanded the availability of qualified small issue bonds to facilities creating intangible property and modified the related facilities eligible for treatment as part of a manufacturing facility. These changes include expanding the definition of manufacturing facilities to mean any facility that is used in the manufacturing, creation, or production of tangible property or intangible property (within the meaning of section 197(d)(1)(C)(iii)).

The proposal

The proposal would increase the limit on qualified small issue bonds that may be outstanding at any time for property of a business (including related parties) located in the same municipality or county from $10 million to $30 million and indexes the limit for inflation after 2021. The issuer could elect to have this limit apply (instead of the generally applicable $1 million limit) if, in addition to outstanding bonds, all other capital expenditures of the business (including related parties) in the same municipality or county are counted toward the limit over a six-year period that begins three years before the issue date of the bonds and ends three years after such date.

Additionally, the proposal would expand the availability of qualified small issue bonds to manufacturing facilities creating intangible property and adds to the related facilities treated as part a manufacturing facility. The definition of manufacturing facility would be expanded to include intangible property (within the meaning of section 197(d)(1)(C)(iii)). For this purpose, intangible property means any patent, copyright, formula, process, design, pattern, knowhow, format, or other similar item. It is intended to include among other items, the creation of computer software, and intellectual property associated bio-tech and pharmaceuticals. The proposal would add facilities that are functionally related and subordinate to a manufacturing facility as part of the manufacturing facility for purposes of eligible uses of qualified small issue bonds. Functionally related and subordinate facilities must be located on the same site as the
manufacturing facility. Directly related and ancillary facilities that are not functionally related and subordinate to a manufacturing facility would be eligible for financing by qualified small issue bonds if (1) such facilities are located on the same site as the manufacturing facility and (2) not more than 25% of the net proceeds of the issue are used to provide such directly related and ancillary facilities.

The proposal includes a limitation that would preclude the issuance of qualified small issue bonds to refund qualified small issue bonds (refunded bonds) issued prior to the date of enactment for manufacturing facilities for intangible property or functionally related and subordinate facilities, unless such refunded bonds financed such facilities pursuant to the temporary rule applicable pursuant to the ARRA, either directly or in a series of refundings.

The JCT estimated that the provision would decrease revenues by approximately $161 million over 10 years.

The proposal generally would be effective for obligations issued after the date of enactment.

Expansion of certain exceptions to the private activity bond rules for first-time farmers

Current law

Qualified private activity bonds are tax-exempt private activity bonds issued to provide financing for specified privately used facilities. Qualified private activity bonds are subject to a number of eligibility restrictions. For example, the aggregate volume of most qualified private activity bonds is restricted by annual state volume limitations (the “state volume cap”). For calendar year 2021, the state volume cap, which is indexed for inflation, equals $110 per resident of the state, or $324,995,000, if greater. Qualified small issue bonds (discussed next) are subject to state volume cap.

Qualified small issue bonds (commonly referred to as “industrial development bonds” or “small issue IDBs”) are tax-exempt qualified private activity bonds issued by state and local governments to finance private business manufacturing facilities (including certain directly related and ancillary facilities) or the acquisition of land and equipment by certain farmers.

In general, qualified private activity bonds, including qualified small issue bonds, may not be issued for the acquisition of land to be used for farming purposes or for the acquisition of used property. Under exceptions to these general rules, qualified small issue bonds can be used for the acquisition of land and used property by first-time farmers for farming purposes, subject to certain limitations. The amount of proceeds that can be used for the acquisition of land by a first-time farmer is limited to a specified amount of $450,000, indexed for inflation for calendar years after 2008. The limit is $558,000 for 2021. Used equipment to be used for farming purposes on any land satisfying the requirements for acquisition by a first-time farmer is also eligible for a qualified small issue bond up to a limit of $62,500. Additionally, there is a $250,000 limit on the amount of net proceeds of a qualified small issue bond used to provide depreciable farm property.

“First-time farmer” means any individual if such individual (including their spouse and minor children) has
not at any time had any direct or indirect ownership interest in substantial farmland (any parcel of land unless such parcel is smaller than 30% of the median size of a farm in the county in which such parcel is located) in the operation of which such individual materially participated and has not received financing under the exception permitting the acquisition of land by a first-time farmer in an amount which, when added to the financing to be provided, exceeds the applicable annual limit ($558,000 for calendar year 2021).

The proposal

The proposal would increase the dollar limitations applicable to the use of qualified small issue bonds for the acquisition of land to be used for farming purposes, prior to indexing for inflation, from $450,000 (which was increased after indexing for inflation in calendar year 2021 to $558,000) to $552,500 for bonds issued after the date of enactment and in calendar year 2021, and indexes such limit for inflation after 2021. The proposal would eliminate the lower dollar limitation on used farm equipment, increases the dollar limitation on acquisition of depreciable farm property from $250,000 to $552,500, and indexes such limit for inflation after 2021. Additionally, for purposes of determining if an individual is a first time farmer, the 30% size limit used to determine if a parcel of land is substantial farmland would be based on the average, rather than the median, size of a farm in the county in which such parcel is located.

The JCT estimated that the provision would decrease revenues by approximately $2 million over 10 years.

The proposal would be effective for bonds issued after the date of enactment.

KPMG observation

This provision appears to propose to increase the amount of private activity bond proceeds that can used by first-time farmers to acquire land and to repeal the limitation for used farm equipment.

Certain water and sewage facility bonds exempt from volume cap on private activity bonds

Current law

Qualified private activity bonds are tax-exempt private activity bonds issued to provide financing for specified privately used facilities. The definition of a qualified private activity bond includes an exempt facility bond.

Exempt facility bonds are often used to finance infrastructure projects. To qualify as an exempt facility bond, 95% of the net proceeds must be used to finance an eligible facility. Facilities eligible include, among others, facilities for the furnishing of water and sewage facilities that, generally, may be privately owned. A facility for the furnishing of water must meet the following two requirements:

• The water is or will be made available to the public (including electric utility, industrial, agricultural, or commercial users); and

• Either the facility is operated by a governmental unit or the rates for the furnishing or sale of the water have been established or approved by a state or political subdivision thereof, by an agency or instrumentality of the United States, or by a public service or public utility commission or other
similar body of any state or political subdivision thereof.

Generally, qualified private activity bonds are subject to a number of eligibility restrictions. For example, the aggregate volume of most qualified private activity bonds is restricted by annual state volume limitations (the “state volume cap”). For calendar year 2021, the state volume cap, which is indexed for inflation, equals $110 per resident of the state, or $324,995,000, if greater. Exempt facility bonds issued to provide facilities for the furnishing of water and sewage facilities are subject to the state volume cap requirement.

The proposal

The proposal would provide an exception to the state volume cap requirement for exempt facility bonds issued to provide facilities for the furnishing of water and sewage facilities if 95% or more of the net proceeds of the bonds are used to provide facilities which will be used:

• By a person who was, as of July 1, 2020, engaged in operation of a facility of the type provided, and

• To provide service within the area served by such person on such date (or within a county or city any portion of which is within such area), or by a successor in interest to such person for the same use and within the same service area.

The JCT estimated that the proposal would decrease revenues by approximately $79 million over 10 years.

The proposal would be effective for bonds issued after the date of enactment.

KPMG observation

This proposal would exempt certain exempt facility bonds issued after the date of enactment from the state volume cap; however, it would only apply to bonds that finance existing water and sewage facilities in operation as of July 1, 2020.

Exempt facility bonds for zero-emission vehicle infrastructure

Under current law, qualified private activity bonds are tax-exempt private activity bonds issued to provide financing for specified privately used facilities. The definition of a qualified private activity bond includes an exempt facility bonds. Exempt facility bonds are often used to finance infrastructure projects. To qualify as an exempt facility bond, 95% of the net proceeds must be used to finance an eligible facility. Eligible facilities include airports, ports (docks and wharves), mass commuting facilities, sewage facilities, qualified residential rental projects, high-speed intercity rail facilities, environmental enhancements of hydro-electric generating facilities, and qualified green building and sustainable design projects.

Generally, qualified private activity bonds are subject to a number of eligibility restrictions. For example, the aggregate volume of most qualified private activity bonds is restricted by annual state volume limitations (the “state volume cap”). For calendar year 2021, the state volume cap, which is indexed for inflation, equals $110 per resident of the state, or $324,995,000, if greater.

The proposal would add a new category of exempt facility bonds for zero-emission vehicle infrastructure. “Zero-emission vehicle infrastructure” means any property (not including a building and its structural components) if such property is part of a unit which
• Is used to charge or fuel zero emissions vehicles,
• Is located where the vehicles are charged or fueled,
• Is of a character subject to the allowance for depreciation (or amortization in lieu of depreciation),
• Is made available for use by members of the general public,
• Accepts payment via a credit card reader (including a credit card reader that uses contactless technology), and
• Is capable of charging or fueling vehicles produced by more than one manufacturer (within the meaning of section 30D(d)(3)).

For property which is part of a unit which is used exclusively by fleets of commercial or governmental vehicles, the last three requirements listed would not apply. “Zero-emission vehicle infrastructure” also would include any utility service connections, utility panel upgrades, line extensions and conduit, transformer upgrades, or similar property, in connection with property meeting the applicable requirements.

The term “zero-emissions vehicle” means either a zero-emission vehicle as defined in section 88.102–94 of title 40, Code of Federal Regulations, or a vehicle that produces zero exhaust emissions of any criteria pollutant (or precursor pollutant) or greenhouse gas under any possible operational modes and conditions.

Any zero-emission vehicle infrastructure located within another type of facility or project eligible for financing by exempt facility bonds, or an area adjacent to such a facility or project that primarily serves vehicles traveling to or from such facility or project, would be treated as that type of facility or project for purposes of eligibility restrictions applicable to exempt facility bonds.

Except to the extent not applicable due to the treatment described in the preceding paragraph, the state volume cap would apply to exempt facility bonds issued for zero-emission vehicle infrastructure.

The JCT estimated that the proposal would decrease revenues by approximately $116 million over 10 years.

The proposal would be effective for obligations issued after December 31, 2021.

KPMG observation

The proposal would add zero-emission vehicle infrastructure as an additional facility eligible to be funded through private activity bonds; however, it does not include an overall increase in the volume cap for private activity bonds.

Unlike the other proposals expanding the scope of tax-exempt bonds, this proposal would be effective for obligations issued after December 31, 2021.

Application of Davis-Bacon Act requirements with respect to certain exempt facility bonds

Under current law, qualified private activity bonds are tax-exempt private activity bonds issued to provide financing for specified privately used facilities. The definition of a qualified private activity bond includes an exempt facility bond. Exempt facility bonds are often used to finance infrastructure projects. To qualify
as an exempt facility bond, 95% of the net proceeds must be used to finance an eligible facility. Eligible facilities include airports, ports (docks and wharves), mass commuting facilities, sewage facilities, qualified residential rental projects, high-speed intercity rail facilities, environmental enhancements of hydro-electric generating facilities, and qualified green building and sustainable design projects.

Generally, qualified private activity bonds are subject to a number of eligibility restrictions that do not apply to governmental bonds. For example, the aggregate volume of most qualified private activity bonds is restricted by annual state volume limitations (the “state volume cap”). For calendar year 2021, the state volume cap, which is indexed for inflation, equals $110 per resident of the state, or $324,995,000, if greater.

The proposal would add a new requirement for exempt facility bonds issued to provide facilities for the furnishing of water, sewage facilities, and qualified highway or surface freight transfer facilities, and for such bonds issued to provide zero-emission vehicle infrastructure under section 135107 of this proposal. These facilities would only be eligible for financing with exempt facility bonds if each entity that receives bond proceeds to conduct construction, alteration, or repair of such facilities agrees to comply with the provisions of subchapter IV of chapter 31 of title 40, United States Code (the “Davis-Bacon Act”) with respect to such construction, alteration, or repair. The Davis-Bacon Act generally provides that contractors and subcontractors on certain federally funded or assisted contracts must pay their laborers and mechanics employed under the contract no less than the locally prevailing wages and fringe benefits for corresponding work on similar projects in the area.

The JCT estimated that the provision would no effect on revenues over a 10-year period.

The proposal would be effective for bonds issued after the date of enactment.

KPMG observation

David-Bacon labor standards already applied to section 54A tax credit bonds.

**Tax-exempt bond financing requirement**

**Current law**

*In general*

A taxpayer may claim the low-income housing tax credit annually over a 10-year period for the costs of building or rehabilitating rental housing occupied by low-income tenants. The amount of credit that may be claimed each year is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building.

*Credit calculations*

The applicable percentage for non-federally subsidized newly constructed housing and non-federally subsidized substantial rehabilitation is calculated such that the present value of the credit amounts is at least 70% of a building’s qualified basis (“nine-percent credits”). The applicable percentage for federally subsidized newly constructed housing, federally subsidized substantial rehabilitation, and certain housing acquisition costs, is calculated such that the present value of the credit amounts is at least 30% of a building’s qualified basis (“four-percent credits”). The applicable percentage is fixed at no less than 9% for non-federally subsidized new buildings placed in service after July 30, 2008. For bond financed projects for bonds issued after 12/31/2020 or acquisitions of existing properties that receive allocations
and are placed in service after 12/31/2020, the applicable percentage is fixed at no less than 4%.

Credit allocations

A low-income housing tax credit is generally allowable only if the building owner receives a housing credit allocation from a state or local housing credit agency. The amount of housing credit allocated by a state to a low-income building reduces the state housing credit ceiling only once, in the year the housing credit is allocated.

Special rule for buildings financed by tax-exempt bonds

If 50% or more of the aggregate basis of the building and the land on which the building is located is financed by the proceeds of tax-exempt bonds, a low-income housing tax credit is allowable with respect to the entire eligible basis of the project without an allocation from the state or local housing credit agency and at no charge to the states’ housing tax credit cap. If less than 50% of the aggregate basis is so financed, this exception only applies to the low-income housing tax credit with respect to the portion financed by the proceeds of tax-exempt bonds. The tax-exempt bonds must be subject to the volume cap for private activity bonds and, once bond proceeds are used to finance a project, principal payments on such financing must be applied within a reasonable period to redeem the bonds.

The proposal

The proposal would modify the special rule that allows a low-income housing tax credit on the entire eligible basis of a building without an allocation from the state or local housing credit agency and at no charge to the states’ housing tax credit cap as long as 50% or more of the aggregate basis is financed with certain tax-exempt bonds. The percent limitation would be lowered from 50% to 25% for buildings that are financed by the proceeds of certain tax-exempt bonds issued in calendar year 2022, 2023, 2024, 2025, 2026, 2027, or 2028 (and not by any obligation taken into account during any taxable year beginning during calendar year 2019, 2020, or 2021). See previous discussion of low-income housing tax credit proposals.

The JCT estimated that the provision would decrease revenues by approximately $9.5 billion over 10 years.

The proposal would apply to buildings placed in service in taxable years beginning after December 31, 2021.

KPMG observation

The proposal would reduce the amount of tax-exempt financing required to exclude a project from the state allocation and tax credit cap. Eligible tax-exempt financing is subject to the volume caps on private activity bonds. By lowering the percentage of financing required from tax-exempt bonds, the proposal would allow developers to undertake projects with less tax-exempt financing, potentially allowing for more projects to qualify for the low-income housing tax credit.
Investments in tribal infrastructure

Treatment of Indian tribes as states with respect to bond issuance

Current law

Treatments of Indian tribal governments as states for certain purposes

Section 7871 expressly provides that Indian tribal governments are treated as states for certain tax purposes. Special treatment relating to excise taxes is available to tribal governments only for transactions involving the exercise of an essential governmental function by the Indian tribal government. Indian tribal governments are also treated as states in that they may issue tax-exempt bonds, subject to certain conditions described further below.

Tax-exempt bonds

Under present law, gross income does not include interest on state or local bonds. State and local bonds are classified generally as either governmental bonds or private activity bonds. Private activity bonds are bonds in which the state or local government serves as a conduit providing financing to nongovernmental persons. For these purposes, the term “nongovernmental person” includes the Federal government and all other individuals and entities other than states or local governments.

States may issue tax-exempt private activity bonds subject to a per-state volume cap. For calendar year 2021, the state volume cap, which is indexed for inflation, equals $110 per resident of the state, or $324,995,000, if greater.

Issuance of tax-exempt bonds by Indian tribal governments

Indian tribal governments may issue tax-exempt bonds in several circumstances if they meet requirements applicable to bonds issued by states and local governments as well as certain other rules applicable only to Indian tribal governments. Indian tribal governments may issue tax-exempt bonds for governmental purposes, subject to the requirement that substantially all of the proceeds of the issue are used in an essential governmental function. Indian tribal governments also may issue private activity bonds but only for the purpose of financing manufacturing facilities.

Indian tribal governments may also issue a third type of tax-exempt bond called “tribal economic development bonds” to finance projects and facilities (but not certain gambling facilities) if the bonds would be tax-exempt if issued by a state or local government. The restriction of essential government function and the limitation on private activity bonds to certain manufacturing facilities do not apply. This Code provision is subject to an allocation limit of $2 billion.

Governmental bonds

Like states and local governments, Indian tribal governments may issue so-called “governmental bonds.” Indian tribal governments must meet an additional requirement to issue governmental bonds. Specifically, all bond proceeds must be used in an essential governmental function, and such function must be customarily performed by state and local governments with general taxing powers.

Private activity bonds for tribal manufacturing facilities

As with governmental bonds, Indian tribal governments are more restricted than states and local governments in their ability to issue private activity bonds. Section 7871(c)(3) permits tribal governments
to issue private activity bonds so long as the bond proceeds are used for manufacturing facilities that are owned and operated by the tribal government on “qualified Indian lands,” and that employ tribal members. A project financed by manufacturing facility bonds must meet requirements as to use, location and ownership, and employment.

Tribal economic development bonds

Indian tribal governments are also permitted to issue “tribal economic development bonds.” A tribal economic development bond is any bond issued by an Indian tribal government (1) the interest on which would be tax-exempt if issued by a state or local government, and (2) that is designated by the Indian tribal government as a tribal economic development bond.

The aggregate face amount of bonds that may be designated by any Indian tribal government cannot exceed the amount of national tribal economic development bond limitation allocated to such government. There is a national bond limitation of $2 billion, allocated as the Secretary determines appropriate, in consultation with the Secretary of the Interior.

Under the tribal economic development bond program, Indian tribal governments have the authority to issue bonds to finance projects and facilities owned by Indian tribes and located on Indian reservations, but outside the scope of “essential governmental function” bonds, such as convention centers, golf courses, hotels, restaurants, certain entertainment facilities, etc. In addition, Indian tribal governments have the authority to issue private activity bonds for any one of the seven types of “qualified bonds” used for purposes that Congress has permitted and are not limited to financing tribal manufacturing facilities.

Tribal economic development bonds cannot be used to finance any portion of a building in which class II or class III gaming (as defined in section 4 of the Indian Gaming Regulatory Act) is conducted, or housed, or any other property used in the conduct of such gaming. Nor can tribal economic development bonds be used to finance any facility located outside of the Indian reservation.

The proposal

The proposal would allow Indian tribal governments to issue governmental bonds and private activity bonds on a basis similar to state and local governments, but with certain location and gambling facility restrictions applicable to private activity bonds.

First, under the proposal, the essential governmental function standard would not apply to the issuance of tax-exempt bonds by Indian tribal governments.

Second, for private activity bonds, the proposal would require the Treasury Secretary annually to establish a national Tribal private activity bond volume cap for all Indian tribes based on the greater of:

- The state population formula approach in section 146(d)(1)(A) (using national tribal population estimates supplied annually by the Department of the Interior in consultation with the Census Bureau), and
- The minimum state ceiling amount in section 146(d)(1)(B) (as adjusted for the cost of living).

The Treasury Secretary also would be required annually to allocate the national bond volume cap among Indian tribal governments seeking an allocation in a particular year under regulations prescribed by the Secretary. The present-law limits on using state volume cap to finance a facility located outside of the state (section 146(k)(1)) would not apply to volume cap allocated under the proposal to the extent that such cap is used with respect to financing for a facility located on qualified Indian lands.
No portion of volume cap allocated to an Indian tribal government under the proposal could be used with respect to the financing of any portion of a building in which class II or class III gaming (as defined in section 4 of the Indian Gaming Regulatory Act) is conducted or housed or any property actually used in the conduct of such gaming.

There would be no volume cap for governmental bonds issued by an Indian tribal government.

The proposal would include a special rule for situations where an Indian tribal government has authorized an intertribal consortium, a Tribal organization, or an Alaska Native regional or village corporation to plan for, coordinate, or otherwise administer services, finances, functions, or activities on its behalf. In such cases, the authorized entity would have the rights and responsibilities of the authorizing Indian tribal government only to the extent provided in the authorizing resolution.

The JCT estimated that the provision would decrease revenues by approximately $77 million over 10 years.

The proposal would be effective for obligations issued in calendar years beginning after the date of enactment.

KPMG observation

This proposal generally would expand the ability of Indian Tribal Governments to issue tax-exempt bonds. Current law generally limits Indian Tribal Governments to using tax-exempt bonds for essential government functions and private activity bonds for manufacturing facilities. Section 7871(f) limited the Tribal Economic Development Bonds, which provide greater flexibility for Indian Tribal Governments, to a one-time limitation of $2 billion, of which only $58.7 million of limitation remains. The proposal would generally put Indian Tribal Governments on a similar treatment as state and local governments by eliminating the “essential government function” restriction for government bonds and allowing Indian Tribal Governments generally to issue all types of private activity bonds, subject to an annual national volume limitation and a restriction on using the proceeds to finance certain gaming facilities.

NMTC for tribal statistical areas

A proposal relating to the NMTC and tribal statistical areas is referenced in the NMTC discussion above.

Inclusion of Indian areas as difficult development areas

The proposal would modify the definition of a difficult development area to automatically include projects located in an Indian area, making these projects eligible for up to a 130% increase in eligible basis. The difficult development area inclusion is limited to buildings that were assisted or financed under the Native American Housing Assistance and Self Determination Act of 1996, or, the project sponsor is a qualifying Indian tribe. The proposal would apply to buildings placed in service after December 31, 2021.

The JCT has estimated that the proposal would lose approximately $114 million over a 10-year period.
KPMG observation

The proposal would provide enhanced credits that specifically target and encourage more affordable housing for Indian tribes, provided the building is financed under the Native American Housing Assistance and Self Determination Act of 1996, sponsored by an Indian tribe or a tribally designated housing entity, or wholly owned or controlled by an Indian tribe or a tribally designated housing entity.

Investments in the territories

Possessions economic activity credit

This proposal would create a new economic activity credit related to active businesses conducted in U.S. territories or possessions. The new credit would be a general business credit equal to 20% of the sum of the qualified possession wages and allocable employee fringe benefit expenses paid or incurred by a qualified domestic corporation for the tax year up to $50,000 with respect to each full-time employee.

A qualified domestic corporation encompasses both U.S. corporations and a U.S. shareholder of a foreign qualified corporation that is wholly owned by the same US group if they meet both source of income and active conduct of trade or business tests.

For purposes of the credit, “possessions” would include the five fiscally autonomous territories of American Samoa, Guam, Commonwealth of Northern Marianas, Commonwealth of Puerto Rico, and the U.S. Virgin Islands.

This proposal would apply to tax years beginning after the date of the enactment of this Act, and in the case of a qualified corporation that is a foreign corporation, to tax years beginning after the date of enactment and to tax years of United States shareholders in which or with which such tax years of foreign corporations end.

The JCT has estimated that the proposal would lose approximately $10.6 billion over a 10-year period.

Additional NMTC allocations for the territories

See NMTC discussion above.

Green energy

Renewable electricity and reducing carbon emissions

Extension of credit for electricity produced from certain renewable resources and extension and modification of the energy tax credit

Wind energy

Under current law, a taxpayer must begin construction on an onshore wind facility by December 31, 2021
to qualify for the production tax credit (PTC). The credit rate for onshore wind facilities is in the process of phasing down and the full PTC rate is only available for projects that began construction prior to 2017. Projects that begin construction in 2017 are eligible for 80% of the otherwise eligible PTC rate. Projects that begin construction in 2018 are eligible for 60% of the otherwise eligible PTC rate. Projects that begin construction in 2019 are eligible for 40% of the otherwise eligible PTC rate. Projects that begin construction in 2020 or 2021 are eligible for 60% of the otherwise eligible rate.

A taxpayer may elect the investment tax credit (ITC) in lieu of the PTC for wind facilities, but the ITC rate phases down on a schedule comparable to the PTC.

A taxpayer that begins construction on an offshore wind farm after 2016 and before 2026 is eligible to claim an ITC at the full statutory credit rate or 30%.

**Solar energy**

Under current law, a taxpayer that begins construction of a solar energy facility in 2020-2022 is eligible for a 26% ITC. Further, a taxpayer that begins construction of a solar energy facility in 2023 is eligible for a 22% ITC. Projects that begin construction after 2023 are eligible for a 10% ITC. Finally, any project placed in service after 2025, no matter when construction began, is eligible for a 10% ITC.

**Other renewables**

The PTC is available for geothermal, biomass, trash combustion, landfill gas, hydropower and wave, and tide power if construction of the project begins prior to 2022.

As with wind facilities, taxpayers may elect the ITC in lieu of the PTC.

Further, fuel cell powerplants, fiber optic solar property, waste energy recovery property and small wind projects qualify for a 26% ITC rate if construction begins in 2021 or 2022, and a 22% ITC rate if construction begins in 2023. No credit is available for projects that are not placed in service by the end of 2025 or that begin construction after 2023.

Finally, there is a 10% ITC for combined heat and power property, microturbines and geothermal heat pumps that applies if construction begins prior to 2024.

**Proposed PTC modifications**

In the proposal, the PTC would be extended and modified in various ways. The proposal would include a base credit rate of 0.5 cents/kilowatt hour, and alternatively, a bonus credit rate of 2.5 cents per kilowatt/hour.

In order to claim the PTC at the bonus credit rate the taxpayer would have to satisfy:

1) A prevailing wage requirement for the full construction period and for the duration of the 10-year PTC credit period, and
2) Apprenticeship requirements during the construction of the project

For purposes of the PTC, and for other energy credit provisions in the proposal, the prevailing wage requirement means that taxpayers must ensure that any laborers and mechanics employed by contractors and subcontractors are paid prevailing wages during construction and, in some cases, for the alteration and repair of such project for a period of time after the project is placed into service. If a taxpayer fails to satisfy these requirements, the taxpayer may cure the failure by compensating each
worker the difference between wages paid and the prevailing wage, plus interest, in addition to paying a $5,000 penalty to the Treasury for each worker paid below the prevailing wage during the tax year.

Again, for purposes of the PTC and other energy credit provisions in the proposal, the apprenticeship requirement requires taxpayers to ensure that no fewer than the applicable percentage of total labor hours are performed by qualified apprentices. The applicable percentage for purposes of this requirement would be 5% for projects for which construction begins in 2022. This rate would be increased to 10% in 2023, and 15% thereafter. In the event a taxpayer fails to satisfy these requirements, the taxpayer may cure the failure by paying a $500 penalty for each labor hour for which the requirement is not satisfied. There is also an exemption process in the event there is a lack of available qualified apprentices.

Projects that commenced construction before the date of enactment or that have a maximum net output of less than one megawatt would be treated as eligible for the bonus rate.

The proposal also makes solar energy facilities eligible for the PTC.

The proposal would make the 100% of the (base and bonus) PTC credit rate available for facilities that commence construction by the end of 2031, 80% available for facilities that commence construction by the end of 2032, and 60% for facilities that commence construction in 2033, and no credit for facilities that commence construction in 2034 and later.

The proposal would allow taxpayers to claim an increased credit for facilities placed into service after December 31, 2021 if the facilities meet certain domestic content requirements. The proposal would provide a base credit increase of 2% of the amount otherwise allowable, or a bonus credit increase of 10% of the amount otherwise allowable with respect to such facility. These values are not subject to phasedown in 2032 and 2033.

For purposes of the PTC, and for other energy credit provisions in the proposal, the domestic content rule requires taxpayers to ensure that facilities are composed of steel, iron, or products manufactured in the United States. For purposes of these requirements, a manufactured product is deemed to have been manufactured in the United States if not less than 55% of the total cost of the components of such product is attributable to components that are mined, produced, or manufactured in the United States. Such rules are to be applied in a manner consistent with the United States’ obligations under international rules.

Proposed ITC modifications

The proposal would extend the ITC, which allows taxpayers to claim a tax credit for the cost of qualified energy property. In most cases, the provision would extend the credit for property for which construction begins by the end of 2032, and then would phase down the credit value over two years.

The proposal would provide a base credit rate of 6% of the basis of qualified energy property or a bonus credit rate of 30% of the basis of qualified energy property. These credit rates would apply with respect to facilities placed into service after December 31, 2021. The base credit rate would phase down to 5.2% for facilities that commence construction in 2032 and 4.4% for facilities that commence construction in 2033. The bonus credit rate would phase down to 26% in 2032 and 22% in 2033. And then for 2034 and thereafter, for solar and geothermal property, the base rate would be 2% and the bonus rate would be 10%. For other ITC eligible property, no credit would be allowed for projects that begin construction after 2033 or not placed in service before 2036.

In order to claim the ITC at the bonus credit rate, the taxpayer would have to satisfy:
1) A prevailing wage requirement for the full construction period and during the five-year recapture period after the project is placed in service
2) Apprenticeship requirements during the construction of the project

For the ITC, the proposal states that, once an ITC eligible project has been placed in service, if it does not meet prevailing wage requirements associated with any alterations or repairs during the five-year period beginning after it has been placed in service, the enhanced credits shall be recaptured under rules similar to section 50(a)(1). A taxpayer may bring the facility into compliance by paying any affected workers the difference between the actual compensation paid to such workers and the wages required to be paid to those workers to meet prevailing wage requirements, plus any applicable interest. In addition, such taxpayer must also pay a penalty to the IRS equal to $5,000 per affected worker.

Projects that commence construction before date of enactment or have a maximum net output of less than one megawatt would be treated as eligible for the bonus rate (i.e. exempt from prevailing wage and apprenticeship requirements).

The proposal would add the domestic content requirement to the ITC. If the project meets the requirements, the proposal would provide a base credit increase of 2% of the amount otherwise allowable, or a bonus credit increase of 10% of the amount otherwise allowable with respect to such facility.

Finally, the ITC would be expanded in the proposal to include new technologies eligible for a 6% base credit rate or a 30% bonus rate through the end of 2031, phasing down in 2032 and 2033. These technologies are also eligible for increased credits if the domestic content requirements are met. These new ITC technologies include energy storage technology, linear generators, microgrid controllers, dynamic glass, and biogas property.

The proposal would apply to facilities placed into service after December 31, 2021. The amendments pertaining to newly eligible property apply to period after December 31, 2021 under rules similar to former section 48(m).

The JCT has estimated that the above proposals would lose approximately $106.8 billion over a 10-year period.

KPMG observation

The proposal would make significant changes to the ITC and PTC. Most significantly, linking eligibility for full credit rates to requirements for prevailing wages and apprenticeships and the additional increase for domestic content is completely new. These requirements would likely affect the economics of developing these projects, either because accessing the higher credit rates would likely result in projects that are also more expensive to build, or because the credits could end up significantly less in the event the new requirements are not met. For the ITC, it would be interesting to see how meeting labor and domestic content requirements could, depending on the cost, increase ITC eligible basis. Furthermore, the need to substantiate and adequately monitor compliance with these standards would be new and potentially difficult for both taxpayers and the IRS. These requirements will be closely watched as this legislative process advances. It further remains to be seen if these requirements would be permissible under the Senate procedures governing budget reconciliation bills.

The proposal would make other interesting changes to the ITC and PTC. In particular, reviving PTC eligibility for solar would provide added flexibility for those projects, though note that the PTC...
requirement that electricity is ultimately sold to third parties would apply to solar. Additionally, because the PTC is not subject to normalization rules, this may be a welcome change for regulated utilities developing solar projects. The normalization rules require regulated utilities to spread the benefit of investment tax credits and accelerated depreciation over the useful life of an asset. The normalization rules are intended to allow utilities to use the economic benefit of the tax incentives to make additional investments, rather than immediately pass the benefits on to ratepayers. It is argued, however, that the rules often have the effect of making it less cost effective for utilities to make their own ITC eligible investments in comparison to unregulated entities. On the other hand, while the addition of new technologies to the ITC, especially energy storage, would be a long awaited change, many regulated utilities would likely also benefit from flexibility around normalization for energy storage but such flexibility was not included in the proposal.

Finally, the effective dates of the changes in the proposal should be considered carefully. For the most part the changes would be effective for projects that are placed in service after December 31, 2021. For the newly eligible ITC technologies (e.g. storage), the effective date invokes a transition rule under former section 48(m) which generally operates so that the credit provisions apply only to the portion of the eligible basis that is constructed after the effective date. The proposal also helpfully provides that projects that are under construction before the date of enactment would be eligible for the bonus rate, regardless of whether the bonus rate requirements are met.

Increase in energy credit for solar facilities placed in service in connection with low-income communities

The proposal would add a provision for an enhanced ITC for solar projects that receive an allocation of environmental justice solar capacity limitation from the Secretary. The allocation criteria the Secretary would consider include:

• The greatest health and economic benefits (including ability to withstand extreme weather events) for individuals in low-income communities;
• The greatest employment and wages for such individuals; and
• The greatest engagement with outreach to, or ownership by, such individuals, including through partnerships with local governments and community-based organizations.

The annual capacity limitation is 1.8 gigawatts for each calendar year 2022 through 2031 and zero for calendar years thereafter. The annual capacity limitation would be increased by the amount of any unused allocations from the preceding calendar year, but not beyond 2033. Such projects receiving an allocation of environmental justice solar capacity limitation would receive an additional 10% credit if located in a low-income community (as defined within the New Markets Tax Credit program under section 45D) or an additional 20% credit if such project is a qualifying low-income residential building project or a low-income economic benefit project. This section would apply to periods after December 31, 2021 under rules similar to section 48(m) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990).

The JCT estimate for this provision is included in the score in the previous proposal.

KPMG observation

This enhanced amount would be another entirely new component of the ITC. Adding an additional
10% or 20% credit to the ITC, depending on the application of labor and domestic content credit amounts, could potentially result in credits rates for these projects at 50% and would certainly offer an attractive incentive to develop solar in low-income communities.

**Elective payment for energy property and electricity produced from certain renewable resources, etc.**

The proposal would add a new section allowing taxpayers to elect to be treated as having made a payment of tax equal to the value of credit they otherwise would have claimed under the following provisions:

- Section 48 ITC
- Section 45 PTC
- Section 45Q credit for carbon capture and sequestration
- Section 30C credit for alternative fuel vehicle refueling property credit
- Section 48C advanced energy project credit
- Section 48D investment credit for transmission property
- Section 48E zero emissions facility credit
- Section 45W zero-emission nuclear production tax credit
- Section 45X clean hydrogen production credit

For the credits under sections 48, 45, and 48D the proposal would impose a phasedown of 100% direct pay contingent meeting domestic content requirement. Specifically, for facilities that do not meet the domestic content requirements, the election for direct payment would be limited to 90% of the otherwise allowable credit value for projects that commence construction in 2024, 85% for projects that commence construction in 2025, and 0% for projects that commence construction in 2026 and later. Taxpayers making a direct payment election under this rule would forfeit 100% of their otherwise allowable tax credits, notwithstanding the reduction in the direct payment. In other words, no credit is available for the portion of the reduced direct payment.

The proposal states that the Secretary shall provide exceptions in some circumstances. Specifically, if the Secretary, in consultation with the Secretary of Commerce, determines that such materials and products are not produced in the United States in sufficient quantity and quality or inclusion of domestic material will increase the cost of such facility by more than 25%, the applicable percentage with respect to such facility would be 100%.

The proposal states that, for purposes of the election, tax-exempt entities, including State and local governments and Indian tribal governments, are treated as taxpayers eligible to elect a direct payment. In the case of a partnership or S corporation, elections and direct payments are made at the partnership or S corporation level. The proposal would make some special rules applicable to tax-exempt and government entities, partnerships, and S corporations. For instance, the proposal states that direct payment amounts shall be treated as tax-exempt income for purposes of sections 705 and 1366 and that a partner’s distributive share of such tax-exempt income shall be based on the partner’s distributive share of the otherwise applicable credit for each tax year. The proposal directs the Secretary to issue regulations or other guidance providing rules for determining the partner’s distributive share of the tax-exempt income.

The proposal also provides that taxpayers may be required to provide information or submit to a registration as required by the Secretary.
This provision would apply to projects placed into service after December 31, 2021. Projects could make elections under this section starting 180 days after date of enactment.

The JCT estimate for this provision is included in the score in the previous section.

**KPMG observation**

The idea of refundable energy tax credits through a direct pay mechanism has been included in various proposals over the last few years. In many cases, developers do not have sufficient tax liability to use the available credits and must rely on tax equity investors to assist in financing projects. Accordingly, a direct pay mechanism has been viewed as a way to remove barriers and more efficiently incentivize the development of a greater number of projects.

The proposal adds potentially new layers (and new complications) to this idea by linking direct pay for many of the credits to meeting the domestic content requirements. This is on top of direct pay amounts that may already be significantly limited if the prevailing wage and apprenticeship requirements are not satisfied. However, it is important to note that the proposal provides that the direct pay phase down for failure to meet domestic content requirements would not apply to projects on which construction begins prior to 2024, so there would be some lead time to transition to these requirements.

Additionally, while the text includes some helpful specifics about how a direct pay program would operate, there are still some open questions. For instance, the text appears to leave most of the procedural aspects of the program, e.g., how much front-end vetting would be required and how much time it would take for refunds to be reviewed and paid, to be handled in regulations. The proposal does not specify whether or not regulated utilities would have to normalize the refund. Regulations would also be necessary to speak to certain issues related to the treatment of a direct payment by tax-exempt entities and partnerships. And specific to partners in partnerships, it is not clear in the proposal how the passive activity and at-risk rules, which currently limit the benefit of tax credits to individual investors, would apply.

**Investment credit for electric transmission property**

The proposal includes an investment tax credit equal to a percentage of the taxpayer’s basis in qualifying electric transmission property under section 48D. The credit would be available with a base credit rate of 6% of the basis of qualified electric transmission property or a bonus credit rate 30% of the basis of qualified electric transmission property. In order to claim the ITC at the bonus credit rate, taxpayers would have to satisfy:

1) Prevailing wage requirements for the duration of the construction of the project and for five years after the project is placed into service, and
2) Apprenticeship requirements during the construction of the project.

Qualifying electric transmission property is defined as tangible, depreciable property that is:

- An electric transmission line that is capable of transmitting electricity at a voltage of not less than 275 kilowatts and has a transmission capacity of not less than 500 megawatts; or
- A related transmission property, with respect to any electric transmission line, that is any property listed as a ‘transmission plant’ in the Uniform System of Accounts for the Federal Energy Regulatory Commission (FERC), and that is necessary for the operation of such electric transmission line.
credit is allowable with respect to related transmission property unless the taxpayer is also allowed a credit for the qualifying electric transmission property to which it relates.

The proposal would add the domestic content requirement to this transmission ITC. If the project meets the requirements, the proposal would provide a base credit increase of 2% of the amount otherwise allowable, or a bonus credit increase of 10% of the amount otherwise allowable with respect to such facility.

Under the proposal, the transmission ITC would be refundable under a direct pay election. This credit is one of the credits that would be subject to a phase down if domestic content requirements are not satisfied. Specifically, for projects that do not meet the domestic content requirements, the election for direct payment would be limited to 90% of the otherwise allowable credit value in 2024, 85% in 2025, and 0% in 2026 and later.

No credit would be allowed for with respect to (1) any property if the Federal Energy Regulatory Commission or any regional transmission organization has, before January 1, 2022, selected for cost allocation such property for cost recovery, or (2) any property if the construction of such property begins before January 1, 2022, or construction of any portion of the qualifying electric transmission line to which such property relates begins before such date.

The proposed credit would be effective for property placed in service after December 31, 2021.

The JCT has estimated that the proposal would lose approximately $9.8 billion over a 10-year period.

KPMG observation

Transmission lines and associated equipment are often owned by regulated utilities so this proposal could raise issues related to how to structure investment in, and ownership of, these assets in order to best realize the benefit of the credit. This proposal does not allow regulated utilities to opt out of normalization. As noted previously, because the ITC is subject to the normalization rules, regulated utilities may not be as incentivized as nonregulated entities to make these investments. Additionally, if there is an election to make the credit refundable, it is not clear whether the refund would be subject to normalization rules.

The specific prohibition on eligibility for the transmission ITC for projects already under construction but not yet placed in service is notable. The reasoning for that limiting language is unclear but it is likely an effort to limit the incentive to purely newly investment, rather than subsidizing projects that have been under development for several years and for which significant investments have already been made.

Zero emissions facility credit

The proposal would add what would be a new section 48E providing for a new 30% capped credit for qualified property that is part of a zero emissions facility.

A zero emissions facility is a facility which:

1) Generates electricity;
2) Does not generate any greenhouse gases;
3) Uses a technology or process which, in the calendar year in which an amount of credit is designated
with respect to such facility, achieved a market penetration level of less than 3% for the commercial generation of electricity; and

4) Does not otherwise meet the definitions for eligible property under the renewable energy production credit, the advanced nuclear power credit, the carbon oxide sequestration credit, or the energy investment tax credit.

Eligible property is tangible, depreciable property, not including a building or its structural components, that is necessary for the generation of electricity.

Taxpayers would not be automatically eligible for the section 48E credit. Rather, credits would be allocated by the Secretary, in consultation with DOE and EPA, through an application process. The Secretary would be authorized to allocate up to $250 MM in credits per calendar year beginning with calendar year 2022 and ending with calendar year 2031. To be credit eligible, qualified property must be placed in service within four years from the date of the credit allocation.

In determining which zero emissions facilities to certify under section 48E, the Secretary is supposed to take into consideration which facilities:

1) Will result in the greatest reduction of greenhouse gas emissions;
2) Have the greatest potential for technological innovation and commercial deployment; and
3) Will result in the greatest reduction of local environmental effects that are harmful to human health.

Taxpayers applying for an allocation of credit are required to provide written assurances to the Secretary that all laborers and mechanics employed by contractors and subcontractors are paid prevailing wages and that the apprenticeship requirements are satisfied.

Taxpayers may elect to receive a direct payment in lieu of this credit under rules similar to those described above providing for an elective payment for energy property and electricity from certain renewable resources.

The proposal would be effective for periods after December 31, 2021, under rules similar to former section 48(m).

The JCT has estimated that the proposal would have a negligible effect on revenue over a 10-year period.

KPMG observation

This proposed zero emissions facility credit suggests an intent to provide incentives for clean energy regardless of the underlying technology. The prevailing wage/apprenticeship requirements and the direct pay provisions would apply similarly to those discussed in sections 136101 and 136102, and section 136104, respectively.

Extension of credit for carbon oxide sequestration

The proposal would extend and modify the credit for carbon oxide sequestration facilities.

Current law section 45Q allows credits to taxpayers who capture and sequester qualifying carbon oxide. The amount of the credit depends on how the capture carbon oxide is used. For carbon oxide disposed of in permanent storage and not used in an enhanced oil recovery (EOR) project, the credit increases to $50 per metric ton by 2026 and is adjusted for inflation in later years. For carbon oxide that is used as a
tertiary injectant in an EOR project or utilized in a commercial product or process, the credit increases to $35 per metric ton in 2026 and is adjusted for inflation in later years.

Under section 45Q, facilities must meet certain minimum capture thresholds in order to claim the credit. For qualified facilities other than electric generating facilities, taxpayers generally must capture and sequester 100,000 metric tons of carbon oxide per tax year. For electric generating facilities, taxpayers must capture and sequester at least 500,000 metric tons of carbon oxide per tax year. A lower threshold of 25,000 metric tons is available if the carbon oxide is deployed in utilization projects. Qualified facilities must begin construction by January 1, 2026. Taxpayers may claim these credits for a 12-year period from the date the carbon capture equipment was originally placed in service.

The proposal would extend the section 45Q credit for projects that commence construction before the end of 2031.

The proposal also would modify the minimum capture thresholds. To qualify for the credit, direct air capture facilities must capture no less than 1,000 metric tons of carbon oxide per year. Electricity generating facilities must capture no less than 18,750 metric tons of carbon oxide and 75% of total carbon emissions. Other industrial facilities must capture no less than 12,500 metric tons of carbon oxide and 50% of total carbon emissions.

The proposal provides a base credit rate of $10 and a bonus credit rate of $50 per metric ton of carbon oxide captured for geological storage and a base credit rate of $7 and a bonus credit rate of $35 per metric ton of carbon oxide captured and used as tertiary injectant in an EOR project or utilized in a commercial product or process. The proposal would provide an enhanced credit for direct air capture facilities at a base rate of $36 and a bonus rate of $180 per metric ton of carbon oxide captured for geological storage and base rate of $26 and a bonus rate of $130 per metric ton of carbon captured and utilized for an allowable use by the taxpayer.

In order to claim the section 45Q credit at the bonus credit rate, taxpayers would have to satisfy the:

1) Prevailing wage requirements for the duration of the construction of the project and for the 12-year credit period, and
2) Apprenticeship requirements during the construction of the project.

Projects that commenced construction before the date of enactment would be treated as eligible for the bonus rate.

Under the proposal, the section 45Q credit would be refundable under a direct pay election. The extension would be effective for facilities the construction of which begins after December 31, 2025. The other changes would be effective for tax years beginning after December 31, 2021.

The JCT has estimated that the proposal would lose approximately $908 million over a 10-year period.

KPMG observation

Carbon capture projects continue to generate significant interest from developers and investors. The economics of these projects in most cases rely on the availability of a subsidy because for many of these projects there is no revenue stream associated with the capture activity. It is unknown how a potential decrease in subsidy level under the proposed prevailing wage and apprenticeship requirements may affect project economics. Similar to the PTC and ITC, the...
The proposal would provide a transition rule for section 45Q projects currently under construction by making those projects eligible for the bonus credit rate, without regard to labor requirements. Also note that the proposal does not include the availability of an increased credit for domestic content, though, relatedly, section 45Q projects would not be subject to the phase down of the direct payment amount associated with the domestic content requirement.

If projects are able to satisfy the prevailing and wage and apprenticeship requirements, the availability of direct pay would be a positive development. For section 45Q, the sheer volume of potential tax credits available for these projects almost necessitates the use of tax equity, however, typical tax equity investors have been proceeding carefully for a variety of reasons including novel technology, offtake and storage uncertainty, and commodity price risk. A direct pay section 45Q tax credit could make these projects significantly less complicated to finance.

Finally, the proposed modifications to the minimum capture thresholds would be a welcome change for many taxpayers. The current law minimum capture thresholds have proven difficult to satisfy for some projects.

**Green energy publicly traded partnerships**

The proposal would expand the rules governing publicly traded partnerships to include a much broader list of qualified income items that would effectively allow for renewable energy projects to be treated as good assets for testing a publicly traded partnership under section 7704.

The list of new qualified income items would be as follows:

1) The generation of electric power or thermal energy exclusively using as its energy source wind, biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower (as defined in section 45), and marine and hydrokinetic renewable energy;

2) Tipping fees paid to open loop biomass or municipal solid waste facilities for accepting or processing open loop biomass or municipal solid waste;

3) Income from the operation of energy investment credit property (as defined in section 48(a)(3)) without regard to any date by which the construction of such property must begin;

4) The production, storage, or transportation of any fuel which (1) uses as its primary feedstock carbon oxides captured from an anthropogenic source or the atmosphere, (2) does not use as its primary feedstock carbon oxide which is deliberately released from naturally occurring subsurface springs, and (3) is determined by the Secretary, in consultation with the Secretary of Energy and the EPA Administrator to achieve a reduction of not less than a 60% in lifecycle greenhouse gas emissions (as defined in section 211(o)(1)(H) of the Clean Air Act, as in effect on the date of the enactment of this clause) compared to baseline lifecycle greenhouse gas emissions (as defined in section 211(o)(1)(C) of such Act, as so in effect); and

5) Income from the operation of a facility that qualifies under section 45Q(d)(without regard to any sunset date).

The proposal would be effective for tax years beginning after December 31, 2021.

The JCT has estimated that the proposal would lose approximately $975 million over a 10-year period.
KPMG observation

Publicly traded partnerships are a popular source of equity financing for partnerships that earn 90% or more of their gross income from certain natural resources activities and/or from certain buckets of passive income, such as interest and dividends. The inclusion by the proposal of green energy projects in the category of assets that produces good qualifying income would provide an additional form of financing for green energy developers. Some green energy developers have previously raised funding via a publicly traded C corporation YieldCo, which is effectively a synthetic publicly traded partnership that is taxed as a corporation but builds up enough tax “shield” (generally in the form of accelerated depreciation) so that the YieldCo does not pay entity-level taxes on a current year basis.

Given that the YieldCo IPO market is extremely slow and the only YieldCos that remain in the marketplace have strong green energy developers as sponsors, it remains to be seen whether the inclusion of green energy assets in a publicly traded partnership structure would be a boon for most green energy developers and/or whether it would lead to current YieldCos converting to partnership status. This is especially true given the complicated and expensive nature of compliance for a publicly traded partnership, particularly with respect to section 704(c) allocations and the need for units in a publicly traded partnership to be fungible. Finally, the fact that a YieldCo issues a Form 1099 to its investors, in contrast to K-1s issued by publicly traded partnerships, can lead to a broader investor base as some potential investors either shy away from or cannot invest in entities that issue K-1s.

Zero-emission nuclear power production credit

The proposal includes a new credit for the production of electricity from a qualified nuclear power facility.

A qualified nuclear power facility is any nuclear facility that is owned by the taxpayer, that uses nuclear energy to produce electricity, was not previously awarded a credit allocation under section 45J, and is placed in service before date of enactment. For purposes of this credit, a facility may only be treated as qualified if no portion of which is a qualified facility for purposes of the zero-emissions facility credit.

If wage and apprenticeship requirements are satisfied a credit equal to 1.5 cents per kilowatt hour is available. The credit is then reduced as the sales price of electricity increase. The phase out operates by reducing the credit for any year by 80% of the excess of gross receipts from electricity produced and sold over the product of 2.5 cents and the amount of electricity sold.

If the wage and apprenticeship requirements are not satisfied a credit equal to 0.3 cents per kilowatt hour is available. In this case the credit is phased out by reducing the credit for any year by 80% of the excess of gross receipts from electricity produced and sold over the product of 0.5 cents and the amount of electricity sold.

Under the proposal the zero-emissions nuclear power production credit would be refundable under a direct pay election.

This provision would terminate on December 31, 2026. This provision would apply to electricity produced and sold after December 31, 2021, in tax years beginning after such date.

The JCT has estimated that the proposal would lose approximately $15.9 billion over a 10-year period.
## Renewable fuels

### Extend tax incentives for biodiesel (including renewable diesel), agri-biodiesel, biodiesel mixtures, alternative fuel, and alternative fuel mixtures

For periods beginning after December 31, 2021 and before January 1, 2032, the proposed legislation would extend:

- Biodiesel (including renewable diesel) and biodiesel mixture tax incentives of $1.00 per gallon,
- Small agri-biodiesel producer credit nonrefundable income tax credit of $0.10 per gallon, and
- Alternative fuel and alternative fuel mixture tax incentives of $0.50 per gallon.

The JCT has estimated that the proposal would lose approximately $32.9 billion over a 10-year period.

### Extend tax incentives for second generation biofuel

For periods beginning after December 31, 2022 and before January 1, 2032, the proposed legislation would extend the second-generation biofuel producer nonrefundable income tax credit of up to $1.01 per gallon.

The JCT has estimated that the proposal would lose approximately $238 million over a 10-year period.

### Provide tax incentives for sustainable aviation fuel

For periods beginning after December 31, 2022 and before January 1, 2032, the proposed legislation would provide tax incentives for each gallon of certified sustainable aviation fuel in a qualified mixture that is sold for use or used as a fuel in aviation during the tax year. The credit would be:

- $1.25 per gallon of sustainable aviation fuel that has a lifecycle greenhouse gas emissions reduction percentage of at least 50% in comparison with petroleum-based jet fuel, plus
- A supplementary credit of up to $0.50 per gallon for each percentage point by which the lifecycle greenhouse gas emissions reduction percentage exceeds 50%.

The proposed legislation provides that “qualified mixture” means a mixture of sustainable aviation fuel and kerosene that is produced in the United States, in the ordinary course of the producer’s trade of business, for sale or use in an aircraft and is transferred into the fuel supply tank of the aircraft in the United States. “Sustainable aviation fuel” means liquid fuel that meets ASTM International Standard D7566 or the Fischer Tropsch provisions of 10 ASTM International Standard D1655, Annex A1; however, it is not derived from palm fatty distillates or 13 petroleum. Sustainable aviation fuel is excluded from the definitions of biodiesel and renewable diesel.

The proposed legislation provides a specified certification methodology. In addition, the Treasury Department is required to established optional certification procedures within two years of enactment.

The incentive is to be claimed by the mixture producer in only one of the following ways:

- A nonrefundable general business tax credit under new section 40B,
- An excise tax credit against section 4081 excise tax (and payment in excess of excise tax liability)
under sections 6426 and 6427, or
• A refundable income tax credit under section 34.

The producer is required to be registered by the IRS as a condition to allowance of the incentives.

The section 40B credit would be included in income under section 87.

The JCT has estimated that the proposal would lose approximately $618 million over a 10-year period.

KPMG observation

Although the proposed legislation would require the qualifying mixture to be produced in the United States, it would not require the sustainable aviation fuel to be produced in the United States; thus, the credit would be allowable with respect to imported sustainable aviation fuel, absent limiting language. Similarly, the proposed legislation would require the mixture to be transferred into the fuel supply tank of the aircraft in the United States but would not require the air transportation to be domestic. This would be consistent with an intention to increase use of sustainable aviation fuel in both domestic and international aviation.

The claimant in the proposed legislation would be the mixture producer, who might not be the producer of the sustainable aviation fuel. The IRS may establish procedures similar to the existing “biodiesel certificate” requirements as part of its certification procedures for mixture producers to substantiate the claim.

The proposed legislation would require the producer of the sustainable aviation fuel to be registered but does not include such registration under existing section 4101, unlike similar current registrations for biodiesel and alcohol producers. Application for section 4101 registration is made on Form 637, Application for Registration (For Certain Excise Tax Activities). The IRS may establish procedures for registration that are consistent with existing procedures.

Although the proposed legislation would include section 40B in income under section 87, it is silent with respect to claims made under sections 34, 6426, and 6427. The income tax implications of claims made under sections 34, 6426, and 6427 are expected to be consistent with the conclusions of Sunoco, Inc. v. United States, 129 Fed. Cl. 322 (2016), aff’d 908 F.3d 710 (Fed. Cir. 2018), cert denied No. 18-1474 (October 7, 2019) (relating to income tax implications of alcohol mixture credits). In Sunoco, the alcohol mixture credits are treated as reducing excise tax liability and therefore reduces the deduction associated with any excise taxes.

To the extent sustainable aviation fuel is taxable fuel within the meaning of section 4083, it would be subject to excise tax under section 4081. The IRS may provide guidance on this issue similar to the guidance it provided with respect to renewable diesel.

Clean hydrogen

The proposal would create a new tax credit for the production of clean hydrogen produced by a taxpayer at a qualified clean hydrogen production facility during the 10-year period beginning on the date such facility is placed in service. The new tax credit, the “clean hydrogen production credit” under new section 45X, would be effective beginning in 2022.

For any tax year, the credit is an amount equal to the product of (1) the applicable amount multiplied by
(2) the kilograms of qualified clean hydrogen produced by the taxpayer at a qualified clean hydrogen production facility during the 10-year period beginning on the date the facility was placed in service. The applicable amount would be an amount equal to the applicable percentage of $0.60. There is an enhanced credit amount of the applicable percentage of $3.00 where certain wage and workforce requirements are met.

The applicable percentage is 20% in the case of qualified clean hydrogen that is produced through a process that, as compared to hydrogen produced by steam methane reforming, achieves a percentage reduction in lifecycle greenhouse gas emissions which is at least 40% but less than 75%. If the percentage reduction is at least 75% but less than 85%, the applicable percentage is 25%. If the percentage reduction is at least 85% but less than 95%, the applicable percentage is 34%. If the percentage reduction is at least 95%, the applicable percentage is 100%.

The proposal would provide a series of definitions of purposes of new section 45X.

• The term “lifecycle greenhouse gas emissions” would have the same meaning given such term under subparagraph (H) of section 211(o)(1) of the Clean Air Act as in effect on the date of enactment of this proposal.

• “Qualified clean hydrogen” would mean hydrogen that is produced through a process that, as compared to hydrogen produced by steam-methane reforming of non-renewable natural gas, achieves a percentage reduction in lifecycle greenhouse gas emissions of at least 40%.

  o The term does not include any hydrogen that is properly allocable to another general business credit or under subchapter B of chapter 65 of subtitle F (such as the alternative fuel excise tax credit and payment provisions). The hydrogen must be produced in the United States or a possession of the United States in the ordinary course of a trade or business of the taxpayer for sale or use.

• A “qualified clean hydrogen production facility” is a facility owned by the taxpayer that produces qualified clean hydrogen. To qualify for the enhanced credit, a qualified clean hydrogen production facility must also satisfy certain wage and workforce requirements described below.

• The term “steam-methane reforming” means a hydrogen production process in which high-temperature steam is used to produce hydrogen from natural gas, without carbon capture and sequestration.

A qualified clean hydrogen facility would have to begin construction by December 31, 2028 to be eligible for the clean hydrogen production credit.

There would be an enhanced credit rate if taxpayers satisfy:

1) A prevailing wage requirement for the full construction period, and for any alteration or repair of such facility during the 10-year credit period; and

2) Apprenticeship requirements during the construction, alteration, or repair of such facility.

Taxpayers may elect to receive a direct payment in lieu of this credit under rules described above providing for an elective payment for energy property and electricity from certain renewable resources.

Notably, the proposal permits a taxpayer to receive both the section 45 credit for electricity produced
from renewable resources and the credit for the production of clean hydrogen. The electricity would be treated as sold to an unrelated person if such electricity were used at a qualified clean hydrogen energy facility to produce clean hydrogen.

In lieu of the clean hydrogen production credit, the proposal would permit a taxpayer to elect to treat clean hydrogen facilities (or any portion of such facility) as energy property. The energy percentage with respect to such property ranges from six to 30% depending on the type of qualified clean hydrogen that the facility is designed and reasonably expected to produce.

Finally, the proposal would terminate the alternative fuel excise tax credit as it relates to hydrogen.

The JCT has estimated that the proposal would lose approximately $9.1 billion over a 10-year period.

**KPMG observation**

Similar to the proposal for the zero emissions facility credit, the clean energy hydrogen production credit indicates an intent to incentivize clean energy while being agnostic as to the technology used to generate clean energy.

A taxpayer who produces electricity from green energy and uses such electricity in the production of clean hydrogen would be eligible for both the section 45 credit and the clean energy hydrogen production credit. Importantly, the proposal provides that, in such a case, the electricity shall be treated as sold by a taxpayer to an unrelated person. This is important because the section 45 credit generally is not available for a taxpayer who produces energy for its own account.

**Green energy and efficiency incentives for individuals**

**Extension, increase, and modifications of nonbusiness energy property credit**

Current law section 25C provides a tax credit for certain expenditures to improve the energy efficiency of a taxpayer’s principal residence. Two types of property qualify for the credit: (1) Qualified Energy Efficiency Improvements; and (2) Residential Energy Property Expenditures. The section 25C credit is equal to the sum of 10% of the cost of qualified energy efficiency improvements and eligible costs for residential energy property expenditures, subject to a limit of a $500 nonrefundable tax credit for the taxpayer’s lifetime. Under current law, the section 25C credit is scheduled to expire December 31, 2021.

The proposal would provide for general modifications as well as expansions to the nonbusiness energy property credit under section 25C. The provisions are as follows:

1) Increase the credit percentage from 10% to 30% for installing qualified energy efficiency improvements;
2) Replacement of the lifetime cap on credits with a $1,200 annual credit limitation;
3) Updates to the rules to reflect advances in energy efficiency, while also removing eligibility of roofs and advanced main air circulating fans;
4) Requirement for taxpayers and manufacturers to comply with reporting the identification number of certain property placed in service in order to access the credit; and
5) Expansion of the credit to cover the costs of home energy audits with a 30% credit available for such costs, up to a maximum credit of $150.
The proposal generally would be effective for property placed in service after December 31, 2021.

The JCT has estimated that the proposal would lose approximately $14.9 billion over a 10-year period.

**Residential energy efficient property**

Current law section 25D provides a credit for installing renewable energy property in a residence. Generally, the credit is 26% if property is placed in service in 2021 or 2022, 22% if placed in service in 2023, with a complete phaseout thereafter. Property eligible for the section 25D credit includes solar electric, solar water heating, fuel cell, small wind, or geothermal heat pump properties.

The proposal would extend the section 25D credit for 10 years, through the end of 2033. The phaseout rules would be modified to provide a 30% credit for property placed in service from 2022 to 2031, a 26% credit for property placed in service in 2032, and a 22% credit for property placed in service in 2023.

The proposal also would add qualified battery storage technology expenditures to the list of expenditures that are eligible for the section 25D credit. A qualified battery storage technology expenditure is an expenditure for battery storage technology (1) installed in connection with a dwelling unit located in the United States used as a residence by the taxpayer that (2) has a capacity of not less than three kilowatt hours.

The proposal would be effective for expenditures made after December 31, 2021.

The JCT has estimated that the proposal would lose approximately $21 billion over a 10-year period.

**Energy efficient commercial buildings deduction**

Current law section 179D provides a tax deduction for energy efficient commercial building property. The maximum allowable section 179D deduction is $1.80 per square foot. This deduction was made permanent in 2020.

The proposal would make three meaningful changes to section 179D:

1) Modification of efficiency standard—the proposal would only require a building to increase its efficiency relative to a reference building by 25%, as compared to 50% under current law.

2) Maximum amount of deduction—the proposal would change the maximum energy efficient commercial buildings deduction to an amount equal to $0.50 per square foot, but increased (but not above $1.00) by $0.02 for each percentage point by which the total annual energy and power costs for the building are certified to be reduced by a percentage greater than 25%. There is a bonus credit rate of $2.50 per square foot, increased by $0.10 per square foot for every percentage point by which designed energy cost savings exceed 25% against the reference standard, not to exceed $5.00 per square foot. These amounts would be adjusted for inflation. The maximum amount represents the total section 179D deduction that may be claimed for a building for the current tax year plus the three preceding tax years.

3) Alternative deduction for energy efficient retrofit building property—the proposal would allow a taxpayer to elect to take a deduction for the tax year which includes the date of a building’s qualifying final certification with respect to a qualified retrofit plan. The amount of the deduction is equal to the lesser of (1) the maximum amount described above or (2) the aggregate adjusted basis of energy efficient retrofit building property placed in service by the taxpayer pursuant to such qualified retrofit
Energy efficient building property is depreciable (or amortizable) property installed on or in any qualified building, which is installed as part of the interior lighting systems, the heating, cooling, ventilation, and hot water systems, or the building envelope, and which is certified under rules provided in the Code. A qualifying building must be located in the United States and be at least five years old before the establishment of the qualified retrofit plan with respect to such building.

A qualified retrofit plan is a written plan prepared by a qualified professional which specifies modifications to a building which, in the aggregate, are expected to reduce such building’s energy usage intensity by 25% or more in comparison to the baseline energy usage intensity of such building. The baseline energy usage intensity means, simply, the energy usage intensity certified by a qualified professional prior to the retrofit, with potential adjustments to take into account weather.

For tax-exempt entities, the proposal would offer the ability to allocate the deduction to the person primarily responsible for designing the property (effectively giving the tax-exempt entity a discount).

To claim the bonus deduction amount, taxpayers would have to satisfy:

1) A prevailing wage requirement for the full construction period; and
2) Apprenticeship requirements during the construction of the project; each as discussed in more detail earlier herein.

The proposal generally would be effective for tax years beginning 2022 or later. The alternative deduction for energy efficient retrofit property would be effective for property placed in service in 2022 or later, in tax years ending after such date, if such property were placed in service pursuant to a qualified retrofit plan established after such date.

The JCT has estimated that the proposal would lose approximately $626 million over a 10-year period.

**Extension, increase, and modifications of new energy efficient home credit**

Current law section 45L provides a tax credit for the construction of new energy efficient homes that are purchased on or before December 31, 2021. The section 45L credit is $2,000 per dwelling unit, generally.

For single family homes, the proposal would extend the section 45L credit through 2031 and increase the credit to $2,500, generally, for energy efficient single family and manufactured new homes meeting certain Energy Star requirements. The credit can increase to $5,000 for eligible single family and manufactured new homes certified as zero energy ready under the Department of Energy Zero Energy Ready Home Program.

For multifamily homes, there is a base credit of $500 and a bonus credit of $2,500 for multifamily units which meet certain Energy Star requirements. The credit can increase to a base credit of $1,000 and a bonus credit of $5,000 for eligible multifamily units certified as zero energy ready under the Department of Energy Zero Energy Ready Home Program.

To claim the bonus deduction amount for a multifamily unit, taxpayers would have to satisfy a prevailing wage requirement for the full construction period.

The proposal would be effective for dwelling units acquired in 2022 or later.

The JCT has estimated that the proposal would lose approximately $2.7 billion over a 10-year period.
Modifications to income exclusion for conservation subsidies

Current law section 136 provides that a taxpayer’s gross income shall not include the value of any subsidy provided (directly or indirectly) by a public utility to a customer for the purchase or installation of any energy conservation measure.

The proposal would expand this income exclusion for the following amounts:

1) Amounts provided (directly or indirectly) by a public utility to a customer, or by a state of local government to a resident of such state or locality, for the purchase or installation of any water conservation or efficiency measure;

2) Amounts provided (directly or indirectly) by a storm water management provider to a customer, or by a state or local government to a resident of such state or locality, for the purchase or installation of any storm water management measure; or

3) Amounts provided (directly or indirectly) by a state or local government to a resident of such state or locality for the purchase or installation of any wastewater management measure, but only if such measure is with respect to the taxpayer’s principal residence.

The proposal would be effective retroactively for amounts received after December 31, 2018.

The JCT has estimated that the proposal would lose approximately $48 million over a 10-year period.

Greening the fleet and alternative vehicles

Refundable new qualified plug-in electric drive motor vehicle credit for individuals (section 136401)

Under current law, the section 30D tax credit available for qualified plug-in electric vehicles is between $2,500-$7,500 and phases out beginning with the second calendar quarter following the calendar quarter which includes the first date on which the number of vehicles manufactured by the manufacturer after December 31, 2009, for use in the United States is at least 200,000.

The proposal would make the credit refundable for new qualified plug-in electric drive motor vehicles placed into service by the taxpayer during the tax year. The amount of credit would be increased to a base amount of $4,000 plus an additional $3,500 for vehicles placed into service before January 1, 2027 with battery capacity no less than 40 kilowatt hours, and for vehicles with battery capacity of no less than 50 kilowatt hours thereafter.

The credit amount allowed for a qualified vehicle would be increased by $4,500 if the final assembly of the vehicle is at a facility in the United States which operates under a union-negotiated collective bargaining agreement. The amount of credit allowed for a qualified vehicle would be increased by $500 if the vehicle model is assembled by a manufacturer which utilizes no less than 50% domestic content in component parts of such vehicles and such vehicles are powered by battery cells which are manufactured within the United States.

The amount of credit allowed for a qualified vehicle would be limited to 50% of its purchase price.
Beginning in 2027, this credit would only apply with respect to vehicles for which final assembly is within the United States.

No credit would be allowed for vehicle by which the manufacturer’s suggested retail price exceeds the applicable limitation, which is as follows:

- Sedans: $55k
- Vans: $64k
- SUVs: $69k
- Pick-up trucks: $74k

The credit would be phased out by $200 for each $1,000 of the taxpayer’s modified adjusted gross income as exceeds $800,000 for married filing jointly, $600,000 for head of household, and $400,000 in any other case.

The taxpayer could elect to transfer the credit to the vehicle dealer, provider the dealer is registered as an eligible entity with the Secretary, discloses the MSRP, credit amount, associated fees, and the amount to be paid to the taxpayer in the form of a down payment or otherwise with respect to the transfer of credit. The Secretary would establish a program to make advance payments to any eligible dealer equal to the cumulative amount of transferred credits.

This proposal would provide for a 10% credit, not to exceed $2,500, for two and three wheeled plug in electric vehicles which have a battery capacity of no less than two and a half kilowatt hours, are manufactured primarily for use on roads and highways, and are capable of achieving a speed of 45 miles per hour or greater, and otherwise meet the requirements of this section.

This provision would be effective beginning after December 31, 2021, replacing section 30D, the plug-in electric drive motor vehicles credit. No credit would be allowed under this provision for vehicles acquired after December 31, 2031.

The proposal to allow for transfer of the credit would be effective for vehicles purchased or leased after December 31, 2022.

The JCT has estimated that the proposal would lose approximately $15.6 billion over a 10-year period.

**KPMG observation**

The modifications to section 30D in the proposal would result in a substantial enhancement and overhaul to the credit. Under the proposal, a taxpayer could be potentially be eligible to receive a refundable tax credit of up to $12,500, for a vehicle that meets the battery capacity, domestic assembly and collective bargaining, and domestic content standards listed above.

The proposal indicates that current law section 30D would be replaced by the modification as of January 1, 2022, indicating that vehicles impacted by the current law 200,000 threshold would once again be eligible for credit, provided the other applicable requirements are satisfied.

**Credit for previously owned qualified plug-in electric drive motor vehicles (section 136402)**

The proposal would provide a new credit for previously owned qualified plug-in electric drive vehicles. Buyers could claim a base credit of $1,250 for the purchase of qualifying used EVs, with additional
incentives for battery capacity. The credit is capped at the lesser of $2,500 credit or 30% of the sale price. The credit would be refundable.

Buyers with up to $75,000 ($150,000 for married couples filing jointly and $112,500 for head of household filers) in adjusted gross income could claim the full amount of the credit. The credit would phase out by $200 for every $1,000 in AGI in excess of the limitation. Buyers would have to purchase the vehicle from a dealership for personal use and could not claim the credit more than once every three years. The credit would only apply to the first resale of a used EV and includes restrictions on sales between related parties.

The credit would apply to vehicles acquired after December 31, 2021.

The JCT has estimated that the proposal would lose approximately $1.4 billion over a 10-year period.

Credit for qualified commercial electric vehicles

This proposal would create a new credit for qualified commercial electric vehicles placed into service by the taxpayer. The amount of credit allowed by this provision with respect to a qualified commercial electric vehicle would be equal to 30% of the cost of such vehicle. In the case of vehicles acquired by tax exempt entities, the person who sold the qualified vehicle to such entity would be treated as the taxpayer that placed such vehicle into service.

Among other requirements, in order to a qualified commercial electric vehicle, the vehicle must be propelled to a significant extent by an electric motor which draws electricity from a battery which has a capacity of not less than 10 kilowatt hours and is capable of being recharged from an external source of electricity, or is a fuel cell vehicle based upon the requirements of section 30B.

This provision would take effect after December 31, 2021. No credit would be allowed under this provision for a vehicle acquired after December 31, 2031.

The JCT has estimated that the proposal would lose approximately $11.6 billion over a 10-year period.

Qualified fuel cell motor vehicles

This proposal would extend the credit for the purchase of a qualified fuel cell motor vehicle through 2031, but only with respect to vehicles not of a character subject to depreciation. Beginning on January 1, 2022, commercial fuel cell vehicles otherwise eligible for this credit would be eligible for the new credit for qualified commercial electric vehicles.

The JCT has estimated that the proposal would lose approximately $44 million over a 10-year period.

Alternative fuel refueling property credit

Under current law, taxpayers are eligible to claim an income tax credit for up to 30% of the cost of electric vehicle recharging stations. The credit is capped at $30,000 per location per year for business taxpayers and $1,000 for recharging stations installed at an individual’s residence. The credit is not available for recharging stations placed in service after 2021.

The proposal would extend the expiration date for the alternative fuel refueling property credit for 10 years (through December 31, 2031).
The proposal would increase the per location limitation to $100,000 (from $30,000) for depreciable property and $3,333.33 (from $1,000) in any other case.

Beginning in 2022, the proposal would expand the credit for zero-emissions charging infrastructure by providing a base credit of 6% for expenses up to $100,000 and 4% for allowable expenses in excess of such limitation (i.e., it allows a credit for expenses beyond the limit if certain requirements are met). The proposal would provide an alternative bonus credit level of 30% for expenses up to $100,000 and 20% thereafter.

To qualify for the credit for expenses in excess of the $100,000 limitation, the property must: 1) be intended for general public use and either accept credit cards as a form of payment or not charge a fee, or 2) be intended for exclusive use by government or commercial vehicle fleets. In order to claim the bonus credit amount with respect to eligible property, taxpayers must satisfy prevailing wage and apprenticeship requirements for the duration of the construction of such property.

Taxpayers could elect to make the credit refundable through a direct pay mechanism.

The proposal would be effective for property placed in service after December 31, 2021. No credit would be allowed for any property placed in service after December 31, 2031.

The JCT has estimated that the proposal would lose approximately $6.3 billion over a 10-year period.

KPMG observation
As businesses and communities seek to add more charging station infrastructure, the proposed credit could be an important tool for motivating investment.

Reinstatement and expansion of employer-provided fringe benefits for bicycle commuting

The proposal would repeal the suspension of the qualified bicycle commuting fringe benefit under section 132(f) and expand the benefit to include employer reimbursement of reasonable expenses incurred by an employee for purchase, lease, rental, improvement, repair or storage of a “qualified commuting property” so long as the property is regularly used for travel between the employee’s residence and place or employment or to mass transit facility that connects to place of employment or residence. “Qualified commuting property” includes bicycles, e-bikes, scooters, e-scooters (not to exceed 100 pounds or 20 miles per hour), and bikeshares. The exclusion would be limited to 30% of the amount allowed for qualified parking, which is currently $270 per month for 2021, but is indexed annually.

The changes are proposed to be effective for tax years beginning after December 31, 2021.

The JCT estimated that the provision would decrease revenues by approximately $183 million over a 10-year period.

Credit for certain new electric bicycles

This proposal would provide for a 15% refundable tax credit for qualified electric bicycles placed into service before January 1, 2032.
Under the proposal, taxpayers could claim a credit of up to $1,500 for electric bicycles placed into service by the taxpayer for use within the United States. A taxpayer could claim the credit for one electric bicycle per tax year (two for joint filers).

The JCT has estimated that the proposal would lose approximately $7.4 billion over a 10-year period.

**Investment in the green workforce**

**Extension of the advanced energy project credit**

The proposal would extend and expand the qualified advanced energy property (QAEP) credit.

The QAEP credit under section 48C is a 30% investment tax credit that is available for the construction, re-equipping, or expansion of a manufacturing facility that constructs QAEP. Included in the definition of QAEP is property such as solar, wind and other renewable energy component property, electric grids, carbon dioxide capture and sequestration property, and plug-in electric vehicles and component parts, among other eligible property. QAEP credits were first enacted as part of the *American Recovery and Reinvestment Act of 2009*, and $2.3 billion in QAEP credits were originally authorized. All of the credits were allocated by Treasury in two separate allocation rounds.

The proposal would allow the Secretary to allocate an additional $2.5 billion in credits for each year from 2022 through and including 2031. $400 million in credits each year is reserved for projects in automotive communities.

In order for a project to be eligible for the advanced energy project credit, taxpayers must satisfy

1) Prevailing wage requirements for the establishment, expansion, or re-equipping of a manufacturing facility and for five years after the project is placed into service, and
2) Apprenticeship requirements during the construction of the project.

Similar requirements to the original credit would apply, with a few notable changes. The Secretary would determine allocations to projects each year with a requirement that property is placed in service within 4 years of the date of the allocation. Projects would be given priority if the manufacturing is not for the assembly of parts or if they have the greatest potential for commercial deployment of new applications.

Additionally, the Secretary would give consideration to projects with the greatest net impact in reducing greenhouse gas emissions, the greatest domestic job creation, and greatest job creation in historically underserved communities whose population is at significant risk of experiencing adverse health and environmental effects of greenhouse gas emissions.

Taxpayers could elect to make the credit refundable through a direct pay mechanism.

The Secretary of Treasury would have to establish a certification program no later than 180 days after the date of enactment this proposal.

The JCT has estimated that the proposal would lose approximately $2.1 billion over a 10-year period.

**KPMG observation**

The proposed direct pay option would allow the section 48C credit to more effectively benefit the...
Qualified environmental justice program credit

The proposal would create a new refundable tax credit for eligible educational institutions that incur costs during the tax year as part of a qualified environmental justice program. Under the proposal, eligible institutions would apply to the Secretary for an allocation of credit for an applicable percentage of costs incurred with respect to their qualified environmental justice programs.

The applicable percentage would be 30% with respect to a program involving material participation of faculty and students of Historically Black Colleges and Universities (HBCUs) and Minority Serving Institutions (MSIs), and 20% in all other cases.

The Treasury Secretary would be authorized to allocate $1 billion per year for the period 2022 through 2031 to the selected eligible institutions. In consultation with the Secretaries of Energy, Education, and Health and Human Services, the Treasury Secretary would select programs for an allocation of credit based on the following criteria:

- The extent of participation of faculty and students from HBCUs and MSIs
- The extent of the expected effect on the health or economic outcomes of individuals residing in areas within the United States that are low-income areas or areas that experience, or are at risk of experiencing, multiple exposures to qualified environmental stressors
- The creation or significant expansion of qualified environmental justice programs

Qualified environmental stressors with respect to an area would include a contamination of the air, water, soil, or food with respect to such area or a change relative to historical norms of the weather conditions of such area. Qualified environmental justice programs are those designed to address or improve data about environmental stressors for the primary purpose of improving or facilitating the improvement of health and economic outcomes of individuals residing in low-income areas or areas that experience, or at risk of experiencing, multiple exposures to qualified environmental stressors.

The proposal would require the Treasury Secretary to publish the identity of each institution receiving an allocation of credit and the amount of the allocation. Applicants selected to receive an allocation would be required to make their submitted applications publicly available and to report annually to the Secretary the amounts paid or incurred and the expected impact of the project. Failure to comply with these requirements would reduce the eligible educational institution’s allocation to zero.

The eligible educational institution would have five years after receiving an allocation to incur costs eligible for the credit. The amount of credit for any taxable year would be limited to the credit dollar amount allocated to such program less any credits previously claimed for such program. The proposal would be effective on the date of enactment.

The JCT has estimated that the proposal would lose approximately $5 billion over a 10-year period.
Reinstatement of Superfund excise taxes on crude oil and imported petroleum products

For periods beginning after December 31, 2021, the proposed legislation would reinstate the Hazardous Substance Superfund tax ("Superfund tax") at a rate of 16.4 cents per barrel. The Superfund tax is indexed for inflation beginning in calendar year 2023.

The revenues from Superfund the tax would be dedicated to the Hazardous Substance Superfund Trust Fund.

The JCT has estimated that the proposal would increase revenues by approximately $38.4 billion over a 10-year period.

KPMG observation

Upon reinstatement, domestic crude and imported petroleum products would be subject to both the 16.4 cents per barrel Superfund tax and the 9 cents per barrel Oil Spill Liability Trust Fund Tax ("Oil Spill tax"). Thus, in calendar year 2022, the total tax per barrel would be 26.1 cents per barrel.

Reinstatement of the Superfund excise tax on hazardous chemicals, which expired in 1995, is included in the bipartisan infrastructure bill that passed the Senate in August.

Social safety net

Child tax credit

The JCT estimated that the various provisions related to the child tax credit would have a combined impact of decreasing revenues by approximately $556 billion over 10 years.

Modifications to child tax credit applicable beginning in 2021

While ARPA made several temporary modifications to the child tax credit (CTC) for the 2021 tax year, one of the more significant changes was the addition of a new section that directed the Treasury to establish a temporary program for making advanced periodic payments to eligible taxpayers during 2021. These payments may equal up to 50% of what the Treasury estimates to be the refundable CTC amount based on the taxpayer’s 2020 return (or 2019 return if the 2020 return is not available), considering the passage of time with respect to the ages and status of the taxpayer’s qualifying children. If a taxpayer receives advance payments in excess of the CTC for 2021, the taxpayer’s federal tax liability may be increased by the excess amount received, subject to a safe harbor based on a taxpayer’s modified adjusted gross income (MAGI).

The proposal would modify the safe harbor rule by providing that the safe harbor would not apply if the Secretary determines that a child was taken into consideration for the advance payment due to fraud or intentional disregard of rules and regulations by the taxpayer.

The proposal would also expand the information the Secretary is able to consider in determining eligibility
for, and the amount of, the advance payments. Under current law, the Secretary is limited to considering the information included on an individual’s prior year tax return. Under the proposal, the Secretary would be able to consider any information known to the Secretary.

In addition, in the case of an advance payment made with respect to a joint return, the proposal would treat half of the advance payment as being made to each individual filing the return.

The proposal would apply to tax years beginning, and payments made, after December 31, 2020.

Extension and modification of child tax credit and advance payment for 2022

Taxpayers may claim a CTC for each qualifying dependent child with the appropriate taxpayer identification number (TIN). The value of the CTC, the amount of any refundable portion of the CTC, the age of a qualifying dependent child, and TIN requirements vary based on the tax year due to the temporary provisions within the TCJA and the temporary provisions within ARPA.

For the 2021 tax year, the CTC a taxpayer may claim is made of up of two components: the CTC that was enacted by the TCJA, effective for tax years 2018 through 2025, and the increased CTC provided for in ARPA, effective for the 2021 tax year only.

CTC allowed under the TCJA: Effective for tax years 2018 through 2025, excluding tax year 2021

Taxpayers may claim a CTC of up to $2,000 per qualifying dependent child under the age of 17 with a Social Security Number (SSN). The credit is generally refundable up to $1,400 per qualifying dependent child if the taxpayer has earned income of up to $2,500 and does not claim the foreign earned income exclusion. The TCJA also created a new, nonrefundable $500 credit for nonqualifying child dependents (ODTC). Under the TCJA, the CTC and ODTC together are phased out by $50 for each $1,000 by which a taxpayer’s MAGI exceeds $200,000 ($400,000 for married couples filing jointly).

CTC allowed under ARPA: Effective for tax year 2021

For tax year 2021 only, ARPA:

- Increased the CTC amount to $3,000 per qualifying dependent child age six and older and $3,600 per qualifying dependent child under the age of six,
- Increased the age limit of a qualifying child to include a dependent child under the age of 18,
- Made the CTC fully refundable for taxpayers with a principal place of abode in the United States for more than one-half the tax year, and
- Removed the earned income requirement.

ARPA did not modify the ODTC.

ARPA created a new phase-out range for the additional $1,000 per qualifying child (or $1,600 per qualifying child under age six) credit amount provided under ARPA. The additional credit amount is phased out by $50 for each $1,000 by which a taxpayer’s MAGI exceeds $75,000 ($112,500 for head of household; $150,000 for married couples filing jointly). The remaining $2,000 CTC amount allowed under the TCJA is phased out by $50 for each $1,000 by which a taxpayer’s MAGI exceeds $200,000 ($400,000 for married couples filing jointly).

ARPA directed the Treasury to establish a temporary program for making advanced periodic payments to taxpayers during 2021. These payments may equal up to 50% of what the Treasury estimates to be the
refundable CTC amount based on the taxpayer’s 2020 return (or 2019 return if the 2020 return is not available) considering the passage of time with respect to the ages and status of the taxpayer’s qualifying children.

Additionally, ARPA directed the Treasury to create an online information portal where taxpayers may elect to not receive the advanced periodic payments, or may make the Treasury aware of any changes during the year that might impact the advanced amount (e.g., birth of a qualifying child, change in marital status, or change in income). If a taxpayer receives advance payments in excess of the CTC for 2021 to which that taxpayer is entitled, the taxpayer’s federal tax liability may be increased by the excess amount received, subject to a safe harbor based on a taxpayer’s MAGI.

ARPA provided for a reimbursement for the cost of the credit for certain U.S. territories.

**For tax years after 2025**

For tax years after 2025, a taxpayer may claim a CTC of up to $1,000 per qualifying dependent child with an SSN or an individual taxpayer identification number (ITIN). The refundable portion of the CTC will be the lesser of $1,000 per qualifying child, or 15% of earnings in excess of $3,000. The CTC will be phased out for taxpayers with MAGI over $75,000 ($110,000 for married couples filing jointly).

**Proposal**

The proposal would generally extend ARPA’s temporary 2021 expansion and advance payment of the CTC through tax year 2022. However, the proposal includes several modifications to the CTC and advance payment rules that would only apply to tax year 2022. The proposal would:

- Change the MAGI used for purposes of the income phaseout of the CTC to be the MAGI of the taxpayer for the preceding tax year (2021) if it is less than the taxpayer’s MAGI for the current tax year (2022);

- Adjust the CTC, ODTC, and phase-out thresholds applicable to the additional CTC amount provided under ARPA for inflation;

- Increase the safe harbor amount to $3,000 ($3,600 for a child under the age of 6) for certain taxpayers in cases where repayment may be required because the advance CTC payment amount received during the year exceeds the CTC amount allowed on their tax return (these increased safe harbor amounts would be adjusted for inflation to match the CTC amounts); and

- Eliminate the 50% limit on advance payments that was in effect for tax year 2021, with the result that advance payments would be made for the full 2022 tax year, rather than for half the year as in 2021.

The proposal would also eliminate the SSN requirement for a qualifying child that was added to the CTC rules by the TCJA. Thus, under the proposal, the CTC may be claimed if any valid TIN (such as an ITIN) of the qualifying child appears on the return, as long as the TIN is issued on or before the due date of the return.

The proposal would apply to tax years beginning, and payments made, after December 31, 2021.
Establishment of monthly child tax credit with advance payment through 2025

Monthly child tax credit

For tax years 2023 through 2025, the proposal would create a new monthly refundable CTC that would replace the existing CTC. Under the proposal, the CTC allowed in a tax year would be the sum of the “monthly specified child allowances” for each month of that tax year. The allowance amount for any month would be $250 for each “specified child,” or $300 if the specified child will not have reached age six by the end of the tax year.

The CTC would be fully refundable for any month in which the taxpayer (or at least one of the spouses in the case of a joint return) has a principal place of abode in the United States or Puerto Rico for more than half of the month.

The monthly allowance amount would be reduced under two separate phaseouts. The “initial phaseout” would apply to taxpayers with MAGI in excess of an applicable threshold ($75,000 for a married individual filing separate return, $150,000 for married couples filing jointly, and $112,500 for all other taxpayers). Taxpayers with MAGI in excess of $400,000 if married filing jointly ($300,000 for head of household, and $200,000 for all other taxpayers) would also be subject to a “secondary phaseout.” For both phaseouts, the monthly allowance would be reduced by one-twelfth of 5% of the excess of the taxpayer’s MAGI over the applicable threshold amount. However, the initial phaseout is limited so the monthly allowance amount is not reduced below $166.67.
MAGI used for purposes of the income phaseout is the lower of the MAGI of the taxpayer for the current tax year or the two preceding tax years. Any amount excluded under section 911 (foreign earned income exclusion), 931 (exclusion of income for a bona fide resident of American Samoa), or 933 (exclusion of income for a bona fide resident of Puerto Rico) is added back to AGI in order to calculate MAGI for purposes of the limitation.

Under the proposal, the monthly allowance amount and first phaseout threshold would be indexed for inflation beginning in tax year 2023.

Under the proposal, a specified child is a child who in a given calendar month:

- Has the same principal place of abode as the taxpayer for more than one-half of the month,
- Is younger than the taxpayer and will not, as of the close of the tax year which includes such month, reach age 18,
- Receives care from the taxpayer during the month that is not compensated,
- Is not the spouse of the taxpayer during the month,
- Is not a taxpayer with respect to whom any child is a specified child for the month, and
- Is either a citizen, national or resident of the United States (or if the taxpayer is a citizen or national of the United States, a child who is legally adopted by the taxpayer or is lawfully placed with the taxpayer for legal adoption by the taxpayer).

Special rules regarding the birth and death of a specified child would apply. A taxpayer claiming a specified child born or deceased during the tax year would receive a monthly specified child allowance for the entire year (e.g., a December birth results in 12 monthly allowances for the year of birth).

The proposal would direct Treasury to make monthly advance payments of the monthly CTC. The amount of the monthly advance payment would be determined based on the number and ages of specified children and the taxpayer’s MAGI as reported for the preceding tax year if a tax return was filed for that year, or information provided by the taxpayer through a specified alternative mechanism (including the on-line portal) which is sufficient to estimate the monthly advance payment. Monthly advance payments would only be made if the taxpayer (in the case of a joint return, either spouse) has a principal place of abode in the United States or Puerto Rico for more than one-half of the month.

Under the proposal, a taxpayer would need to establish “presumptive eligibility” with respect to a specified child before the taxpayer would be able to claim the monthly CTC and receive monthly advance payments for that child. The proposal provides that in order to establish presumptive eligibility for a month, a taxpayer would be required to express a reasonable expectation and intent that the taxpayer will continue to be eligible to claim the child as a specified child for at least two months after the month for which presumptive eligibility is established. Presumptive eligibility would need to be renewed annually, and would be established by providing information on the prior-year tax return, through an online portal, or by other means as would be established by the IRS. Also, presumptive eligibility would generally provide protection from “recapture” of excess advance payments.

The proposal provides that a taxpayer who does not elect to receive advance payments may establish a period of presumptive eligibility for a specified child for the purpose of claiming the monthly CTC on a tax return.

In order to claim this proposed CTC, a taxpayer would need to provide the name and valid TIN of the specified child on the taxpayer’s tax return. Both the child’s TIN and the taxpayer’s TIN would need to be issued on or before the due date for filing the return.
The proposal provides that the amount of the monthly CTC allowed for a year would be reduced by the advance payments received during the year, and a reconciliation would be included as part of the CTC calculation on the taxpayer’s return. As noted above, presumptive eligibility generally provides a safe harbor from recapture, where a taxpayer’s excess advance payments increase his or her tax liability. However, a taxpayer would be subject to recapture if the Secretary determines that the amount of advance payments was determined on the basis of fraud or reckless or intentional disregard of the rules, or if an advance payment was received for a month that was not part of the period of presumptive eligibility for the child. Recapture would also apply if the advance payment was based on a filing status other than the taxpayer’s filing status for the applicable tax year, or if the amount of the advance payments was based on MAGI that was less than the taxpayer’s lowest MAGI in the current tax year or the two preceding tax years. If a taxpayer is subject to recapture and receives advance payments in excess of the taxpayer’s allowable monthly CTC during a tax year, the taxpayer’s tax liability for the tax year would be increased by the excess amount.

Credit for certain other dependents

For tax years 2023 to 2025, the proposal would create a new nonrefundable other dependent credit tax credit (ODTC) that would replace the existing ODTC. Under the proposal, a taxpayer would be allowed a $500 nonrefundable credit for each “specified dependent” of the taxpayer. A specified dependent is defined as a dependent other than a specified child, who is a citizen, national, or resident of the United States.

The new ODTC would be subject to a phaseout of $50 for each $1,000 (or fraction thereof) by which a taxpayer’s MAGI exceeds $400,000 if married filing jointly ($300,000 for head of household, and $200,000 for all other taxpayers).

Similar to the new monthly CTC, a taxpayer would need to provide the name and valid TIN of the specified dependent on the taxpayer’s tax return to claim the new ODTC. Both the dependent’s TIN and the taxpayer’s TIN would need to be issued on or before the due date for filing the return.

KPMG observation

It appears that converting the existing CTC to a monthly CTC, combined with the new requirement to establish presumptive eligibility, would enable the IRS to establish better control over the advance payment system and would reflect the fact that not all dependent children would have that status for the entire year. While establishing presumptive eligibility may be burdensome for some taxpayers, the fact that advance payments would not be subject to recapture should be a welcome simplification for many recipients of the payments.

Refundable child tax credit after 2025

The refundable portion of the CTC varies based on the tax year due to the temporary provisions under the TCJA and the temporary provisions within ARPA.

Under the TCJA, for tax years 2018 through 2025, excluding tax year 2021, the CTC is generally refundable up to $1,400 per qualifying dependent child if the taxpayer has earned income in excess of $2,500 and does not claim the foreign earned income exclusion.

ARPA made the CTC fully refundable and removed the earned income requirement for tax year 2021
only.

For tax years after 2025, the refundable portion of the CTC will be the lesser of $1,000 per qualifying child, or 15% of earnings in excess of $3,000. Thus, the CTC of up to $1,000 per qualifying child may be fully refundable if the earned income requirement is met.

Proposal

The proposal would make the CTC permanently fully refundable, regardless of a taxpayer’s earned income, for all tax years after 2025 for taxpayers with a principal place of abode in the United States for more than one-half of the tax year.

This proposal would be effective for tax years beginning after December 31, 2025.

Child and dependent care tax credit

Certain improvements to the child and dependent care credit made permanent

The child and dependent care tax credit (CDCTC) is a credit meant to partially reimburse eligible taxpayers for certain child and dependent care expenses incurred while the taxpayer is working, training, or looking for work. The proposal’s modifications to the CDCTC are generally consistent with the modifications proposed by the Biden Administration on May 28, 2021. One notable difference between the Biden Administration’s proposal and this proposal is that this proposal would adjust the CDCTC for inflation each year.

Tax years before and after the 2021 tax year

Under current law, for tax years before and after the 2021 tax year, the CDCTC is nonrefundable. An eligible taxpayer is allowed a maximum credit of up to 35% of up to $3,000 in eligible expenses for one qualifying individual (or $6,000 in eligible expenses for two or more qualifying individuals). A qualifying individual includes a qualifying dependent child under the age of 13, or a spouse or other dependent who is physically or mentally incapable of caring for himself or herself and who has the same principal abode as the taxpayer for more than one-half of the tax year.

A taxpayer is eligible to exclude up to $5,000 in employer-provided dependent care assistance. In computing the CDCTC, the eligible expense limitation is reduced by any employer-provided dependent care benefits that are excluded or deducted from an eligible taxpayer’s income.

An eligible taxpayer’s maximum reimbursement percentage is reduced by one percentage point for each $2,000 (or fraction thereof) by which the taxpayer’s AGI exceeds $15,000, until the taxpayer’s maximum reimbursement percentage reaches 20% at AGI of $43,000. This 20% rate continues to apply at all income levels above $43,000.

The amounts above are not indexed for inflation and have not been increased since 2001.

Tax year 2021

ARPA made special, temporary modifications to the CDCTC for the 2021 tax year. For tax year 2021, the CDCTC is fully refundable for eligible taxpayers with a principal abode in the United States for more than one-half of the 2021 tax year. Additionally, the maximum reimbursement percentage is increased from 35% to 50% for 2021, and the eligible expense limitation is increased from $3,000 to $8,000 for one
qualifying individual (and from $6,000 to $16,000 for two or more qualifying individuals).

ARPA applies a two-part phase-out to the reimbursement percentage phase out for tax year 2021. An eligible taxpayer’s maximum reimbursement percentage is reduced by one percentage point for each $2,000 (or fraction thereof) by which the taxpayer’s AGI exceeds $125,000, until the taxpayer’s maximum reimbursement percentage reaches 20% at AGI of $183,000. This 20% rate applies at all income levels below $400,000. An eligible taxpayer’s maximum reimbursement percentage begins decreasing again by one percentage point for each $2,000 (or fraction thereof) by which AGI exceeds $400,000 and is reduced to zero at AGI in excess of $438,000.

ARPA increased the exclusion for employer-provided dependent care assistance to $10,500. It also provides for a reimbursement for the cost or value of the refundable CDCTC for U.S. territories.

**Proposal**

The proposal would make ARPA’s special, temporary modifications to the CDCTC for the 2021 tax year permanent. Additionally, the proposal would adjust the eligible expense limitation and phaseout threshold for inflation each year.

The proposal would also modify a special rule that applies for calculating earned income when one spouse is either a full-time student or mentally or physically unable of caring for themselves. Under the proposal, for each month in which the student or incapacitated spouse qualifies, the spouse is deemed to have earned income equal to one-twelfth of $8,000 (adjusted for inflation) in the case of one qualifying individual or one-twelfth of $16,000 (adjusted for inflation) if there are two or more qualifying individuals.

The proposal would make permanent the reimbursement for the cost or value of the refundable CDCTC for U.S. territories.

This proposal would be effective for tax years beginning after December 31, 2021.

The JCT estimated that the provision would decrease revenues by approximately $95 billion over 10 years.

By making ARPA’s modifications to the CDCTC permanent, the proposal would greatly increase the benefit to most taxpayers but would completely deny the credit to higher-income taxpayers who are presently eligible for a reduced benefit for tax years after 2021.

Under current law, the CDCTC amounts are not adjusted for inflation, and have not been increased since 2001. Because the CDCTC amounts are not adjusted for inflation, the benefit provided by the CDCTC diminishes with time as the cost of living increases. Under the proposal, the CDCTC amounts would be adjusted every year to keep up with inflation, thus providing the intended ongoing tax relief to qualifying families.

**Increase in exclusion for employer-provided dependent care assistance made permanent**

The proposal would permanently increase the exclusion for employer-provided dependent care assistance from $5,000 to $10,500. The amount would then be subject to inflation adjustment. The
The JCT estimated that the provision would decrease revenues by approximately $3.3 billion over 10 years.

Supporting caregivers

Payroll tax credit for child care workers

The proposal would allow an eligible child care employer a refundable credit against Medicare taxes for each calendar quarter for 50% of the qualified child care wages paid to each eligible employee. Maximum wages taken into account would be $2,500 per quarter (subject to cost of living adjustment) for an eligible employee. An eligible child care employer must operate one or more qualified child care facilities certified as an HHS Participating Child Care Provider by HHS under section 418A(c) of the Social Security Act.

An eligible employee wage could not exceed 25% of the dollar amount in effect for determining highly compensated employees and the aggregate wage for the one-year period ending with the close of the quarter could not exceed 100% of the dollar amount under 414(q)(1)(B)(ii), which is currently $130,000 for 2021. Qualified wages are paid at a rate in excess of the “applicable minimum rate,” which is pay at a GS-3 level.

The credit is proposed to be effective for calendar quarters beginning after December 31, 2021.

The JCT estimated that the provision would decrease revenues by approximately $7.1 billion over 10 years.

Credit for caregiver expenses

The proposal would create a new temporary nonrefundable tax credit for individuals who incur caregiver expenses in relation to “qualified care recipients.” The amount of the credit would be 50% of unreimbursed qualified expenses, up to $4,000. The credit would be phased out by 1% for every $2,500 or fraction thereof by which the taxpayer’s AGI exceeds $75,000.

A qualified care recipient is defined as a spouse, child, parent, sibling, or other specified family member or member of the taxpayer’s household, who has been certified by a Medicare, Medicaid, or Children’s Health Insurance Program enrolled provider as having long-term care needs expected to be at least 180 consecutive days, a portion of which occurs within the tax year. The individual must live in a personal residence as opposed to an institutional care facility. Individuals with long-term care needs are defined as (1) those of at least six years of age who are unable to perform certain activities of daily living without substantial assistance, or who are otherwise subject to health and safety risks; (2) individuals aged two through six who require substantial assistance with eating, transferring, or mobility; and (3) individuals under the age of two who require specific durable medical equipment by reason of a severe health condition, or who require the assistance of a skilled practitioner if their parents are absent.

Qualified expenses are defined as those incurred for goods, services, and supports that assist a qualified care recipient in performing basic activities and are provided solely for use by such recipients. These include human assistance from caregivers, assistive technologies and devices, accessibility modifications of the recipient’s residence, and certain other specified expenses. The expenses must be substantiated to be eligible for the credit, under regulations or other guidance issued by the IRS. Qualified expenses under this provision would not include amounts taken into account for purposes of the child and
dependent care tax credit, the exclusion for amounts paid to employees under dependent care assistance programs, the itemized deduction for medical expenses, or amounts which represent excludable distributions from a health savings accounts. In addition, no credit can be claimed in relation to expenses reimbursed by insurance or expenses paid to certain related individuals.

This provision would be effective for tax years beginning after December 31, 2021 but does not apply to tax years beginning after December 31, 2025.

The JCT estimated that the provision would decrease revenues by approximately $28.4 billion over 10 years.

KPMG observation

The caregiver credit would be available in addition to the child and dependent care tax credit and would help defray out-of-pocket costs for taxpayers providing care to elderly family members and those with additional long-term care needs.

Earned income tax credit

The earned income tax credit (EITC) is a refundable credit intended to support low- to moderate-income working families. The EITC is based on a worker’s family size, filing status, AGI, and earned income.

For childless workers, ARPA made a number of temporary changes to the EITC effective only for tax year 2021, including:

- Lowering the minimum age from 25 to 19 (18 for certain former foster and homeless youth, and 24 for certain eligible students);
- Eliminating the maximum age at which the credit was available (age 64);
- Increasing the maximum credit and phaseout percentage from 7.65% to 15.3%;
- Increasing the maximum credit available from $543 to $1,502;
- Increasing the income threshold for single filers from $15,980 to $21,430 and from $21,920 to $27,370 for married taxpayers filing jointly;
- Increasing in earned income at which the maximum credit amount is reached from $4,220 to $9,820; and
- Increasing phaseout amount from $5,280 to $11,610.

Beginning in 2021 and effective for all subsequent years, ARPA provided that taxpayers with children who would otherwise qualify for the EITC but for the fact that the children do not have an SSN may claim EITC as childless workers.

Additionally, ARPA provided a temporary special rule for 2021 that allowed a taxpayer who earned less income in 2021 than 2019 to elect to compute the EITC using the taxpayer’s 2019 earned income amount.

Proposal

The proposal would make permanent ARPA’s temporary changes to the EITC for childless workers and would adjust the relevant thresholds for inflation each year starting in 2022.
The proposal would also allow taxpayer whose earned income for any tax year is less than the taxpayer’s earned income for the prior tax year to elect to use the taxpayer’s prior-year earned income for purposes of computing the EITC.

This proposal would be effective for tax years beginning after December 31, 2021.

The JCT estimated that the provision would decrease revenues by approximately $135.3 billion over 10 years.

There is also a proposal relating to funds for administration of the EITC in the territories.

**Expanding access to health coverage and lowering costs**

**Make permanent the American Rescue Plan expansion of premium tax credits**

The premium tax credit (PTC) is provided to certain individuals who purchase health insurance through a marketplace exchange established under the Affordable Care Act of 2010 (ACA). The PTC is a refundable credit and may be payable in advance directly to the insurer. Eligibility for an advance payment of the PTC is based on household income and family size, determined by reference to an individual’s most recent available year of tax data. As the advance payment of the PTC is based on prior year tax data, some taxpayers must reconcile their PTC by either paying back the advance payment (because actual income exceeded estimated income) or receiving a refund (because actual income was less than the estimated income).

Prior to the changes introduced by ARPA, the PTC was generally available to individuals with household income between 100 and 400% of the federal poverty line.

For 2021 and 2022, ARPA modified the PTC by reducing the percentage of annual income that households are required to contribute towards the premium and making individuals with income above 400% of the federal poverty line eligible for the credit. ARPA also suspended the requirement that taxpayers repay excess advance PTC payments for tax year 2020.

The proposal would permanently expand the PTC by decreasing the applicable contribution percentages of household income used for determining the PTC and permanently extending eligibility to taxpayers with household income above 400% of the federal poverty line.

The proposal would be effective for tax years beginning after December 31, 2021.

**KPMG observation**

While ARPA suspended the requirement that taxpayers increase their tax liability by all (or a portion of) their excess advance payments of the PTC for tax year 2020, the proposal does not mention whether this temporary suspension would be further extended.

**Modify employer-sponsored coverage affordability test for PTC eligibility**

The PTC is available to taxpayers for coverage purchased in healthcare marketplaces only if they do not have an offer of affordable, minimum value job-based coverage. Under the ACA, an employee’s job-based coverage is considered “affordable” if the employee contributes less than 9.5% of their household income.
income towards health insurance premiums. This percentage has been indexed for inflation and, for 2021, has been adjusted to 9.83%.

The proposal would revise the threshold to determine whether a taxpayer has access to affordable insurance through an employer-sponsored plan or a qualified small employer health reimbursement arrangement to 8.5% of household income for purposes of determining PTC eligibility.

The proposal would be effective for tax years beginning after December 31, 2021.

**KPMG observation**

While not eliminating the requirement that job-based coverage be affordable, the proposal has permanently eliminated any inflation indexing such that premiums must remain less than 8.5% of household income for purposes of determining PTC eligibility for all future tax years.

**Exclude lump-sum social security benefits from determining PTC eligibility**

Current law provides that taxpayers must include all lump-sum social security benefits in household income for the year in which the lump-sum benefit is awarded when calculating PTC eligibility.

The proposal would amend the calculation of modified adjusted gross income for purposes of calculating PTC eligibility to exclude lump-sum Social Security benefits.

The proposal would be effective for tax years beginning after December 31, 2021.

**KPMG observation**

Lump-sum social security benefits are generally treated as income in the year in which the amount is awarded rather than over several years for which the benefits may be earned. As a result, a lump-sum award can significantly reduce or eliminate an individual’s PTC for that year and may even require that individual to repay advance PTCs. This proposal would permanently exclude such benefits from the PTC eligibility calculation, regardless of when earned or awarded.

**Temporarily expand PTC eligibility for certain low-income populations**

Under current law, PTCs are only available to those whose income is above the federal poverty line and who meet certain program requirements (e.g., being ineligible for other types of minimum essential coverage, including Medicaid). In addition, taxpayers must estimate their income to be under a certain threshold to receive advance PTCs. If a taxpayer underestimates their income level and no longer qualifies for PTCs, they must repay those advance PTCs, subject to certain requirements and limitations.

**Proposal**

The proposal would expand eligibility of PTCs to taxpayers with household incomes below 100% of the federal poverty line. In addition, the proposal would provide that taxpayers with household incomes below 138% of the federal poverty line with access to employer-sponsored coverage or a qualified small employer health reimbursement arrangement may still receive PTCs, and the employers providing such coverage would not be subject to the employer shared responsibility payment with respect to those
taxpayers. Finally, the proposal would reduce the amount of the advance PTCs that must be repaid if a taxpayer underestimated their income and received too much advance PTC.

The proposal would be effective for tax years beginning after December 31, 2021 and ending before the later of January 1, 2025, or when the Secretary of the Department of Health and Human Services has certified implementation of the federal Medicaid program in states that opted out of Medicaid expansion.

KPMG observation

It appears this proposal is intended to close the Medicaid coverage gap. This “gap” commonly refers to individuals whose income is too high to qualify for Medicaid in states that have not opted to expand Medicaid under ACA rules but too low (i.e., below the federal poverty line) to qualify for any healthcare marketplace subsidies.

Modify special premium tax credit rules for those receiving unemployment compensation

Under ARPA, an individual who has received (or is approved to receive) unemployment benefits during 2021 is treated as if their income is no higher than 133% of the federal poverty line for purposes of determining PTC eligibility.

The proposal would extend the subsidy enhancement for those receiving unemployment compensation through 2025 and adjust the income level to treat those who qualify as having an income of 150% of the federal poverty line.

The proposal would be effective for tax years beginning after December 31, 2021.

Make permanent the credit for health insurance costs

Section 35, which was originally enacted by the Trade Act of 2002, grants a 72.5% credit of the amount paid for qualified health coverage for an eligible taxpayer and qualifying family members for the eligible coverage month. This health coverage tax credit, which has been extended numerous times over the years since its initial enactment, is set to expire at the end of 2021.

The proposal would make permanent the health coverage tax credit and increase the amount of the qualified health insurance premium covered by the credit from 72.5% to 80%.

The JCT has estimated that the proposal would lose approximately $198 million over a 10-year period.

Pathway to Practice medical school scholarship program

To increase the number of medical professionals serving rural and medically underserved communities, the proposal creates a medical scholarship program. Beginning in 2023, the Secretary of Health and Human Services is to award 1,000 “Pathway to Practice” scholarship vouchers to qualified students, who commit to practice for a specified time in a rural or medically underserved area following residency. Funding of a Pathway to Practice scholarship is in the form of a refundable tax credit to the educational institution.
The JCT has estimated that the proposal would lose approximately $4.88 billion over a 10-year period.

Higher education

Public university research infrastructure credit

The proposal would provide a new general business tax credit equal to 40% of the qualified cash contributions made by a taxpayer to a certified educational institution in connection with a qualifying research infrastructure program. Taxpayers could elect to claim this credit with respect to a qualifying cash contribution in lieu of treating such contributions as charitable deductions.

Institutions could designate contributions made by a taxpayer as qualified cash contributions only if such institution is certified as having been allocated a credit amount by the Treasury Secretary with respect to the qualifying project. The amount of cash contributions a certified educational institution could designate as qualified cash contributions could not exceed 250% of the credit amount allocated to such institution under the proposal. For example, as explained in the JCT technical explanation, if the Treasury Secretary allocates a $100 million credit amount to a certified educational institution for a qualifying project, the institution could designate up to $250 million (250% of $100 million) in qualifying cash contributions. These qualifying cash contributions, in turn, could generate up to $100 million (40% of $250 million) in credits for taxpayers.

The proposal would provide $500 million of credits for each of calendar years 2022, 2023, 2024, 2025, and 2026 to be awarded by the Secretary to eligible educational institutions on a project application basis. Credit amounts allocated to any one institution for all projects could not exceed $100 million per calendar year.

An eligible educational institution is a public college or university or certain non-profit organizations to which authority has been delegated by a public college or university to apply for administering credit amounts on behalf of the college or university. To qualify as a delegee of a public college or university, a non-profit organization would have to either be a supporting organization described in section 509(a)(3) or a foundation for a state or local college or university described in section 170(b)(1)(A)(iv).

A qualifying project means a project to purchase, construct, or improve research infrastructure property. Research infrastructure property includes any portion of a property, building, or structure of an eligible educational institution, or associated land, that is used for research.

The Treasury Secretary, after consultation with the Secretary of Education, would have to select applications from eligible education institutions: (1) based on the extent of the expected expansion of the institution’s targeted research within disciplines in science, mathematics, engineering, and technology; and (2) in a manner that ensures consideration is given to institutions with full-time student populations of less than 12,000.

The proposal would require the Treasury Secretary, upon allocating credit amounts to an applicant, to publicly disclose the identity of the applicant and the credit amount allocated to the applicant. Each certified educational institution, upon designating contributions of a taxpayer as qualified cash contributions, would have to publicly disclose the identity of the taxpayer and the amount of contributions designated in such time, form, and manner as the Secretary may require.

Under the proposal, the credit amounts could be recaptured or reallocated under certain circumstances during the five-year period beginning on the date of the allocation of the credit amounts to the educational institution. For this purpose, recapture would be effectuated by treating the qualifying cash
contributions as unrelated business taxable income (within the meaning of section 512) of the certified educational institution.

The proposal would be effective for qualified cash contributions made after December 31, 2021. The proposal requires the Treasury Secretary, in consultation with the Secretary of Education, to establish the allocation program within 180 days of the date of enactment. The proposal would not apply to qualified cash contributions made after December 31, 2033.

The JCT has estimated that the proposal would lose approximately $125 million over a 10-year period.

**Modification of excise tax on investment income of private colleges and universities**

The proposal would provide a phase out of the excise tax under section 4968 for certain educational institutions that provide sufficient qualified aid awards to students.

Section 4968, which was enacted as part of the Tax Cut and Jobs Act of 2017, imposes a 1.4% excise tax on the net investment income of certain private colleges and universities with at least 500 tuition-paying students and non-exempt use assets worth at least $500,000 per student.

Under the proposal, educational institutions that make qualified aid awards to students would be able to reduce the amount of section 4968 excise tax owed, potentially fully eliminating their tax liability, depending on the amount of aid given. Pursuant to the proposal, an educational institution could reduce its section 4968 tax liability by 1/13th for every percentage point by which its grant aid exceeds 20% of the aggregate undergraduate tuition and fees received by the institution from first-time, full-time undergraduate students. An educational institution could thus fully phase out its section 4968 excise tax liability by making qualified aid awards to first-time, full-time undergraduate students equal to or greater than 33% of such aggregate tuition and fees.

The reduction in excise tax for an educational institution for a tax year would be determined by a formula whereby tax liability would be reduced by a percentage equal to:

1) The excess (if any) of (a) the aggregate amount of grants and scholarships provided by the institution to its first-time, full-time undergraduate students for tuition and fees for academic periods beginning during the tax year, over (b) an amount equal to 20% of the aggregate undergraduate tuition and fees received by the institution from first-time, full-time undergraduate students for such academic periods, divided by

2) An amount equal to 13% of such aggregate undergraduate tuition and fees.

To qualify for the reduction in excise tax, an educational institution would have to meet certain reporting requirements.

In addition, for tax years beginning after 2022, this provision would amend the 500-tuition-paying-student threshold under section 4968 (noted above) to take into account only undergraduate students and would index the $500,000-per-student asset threshold for inflation.

The JCT has estimated this provision would cost approximately $2.3 billion over 10 years.

The provision would be effective for tax years beginning after December 31, 2021.
Treatement of Federal Pell grants for income tax purposes

The proposal would make Federal Pell grants fully excludible from gross income. Under current law, Federal Pell grants, which are a form of needs-based federal financial aid for college expenses, are excludible from gross income only if applied to qualified educational expenses such as tuition, and books, supplies and equipment required for the recipient’s course of instruction.

In addition, the proposal would treat Federal Pell grants like qualified scholarships for purposes of calculating the American Opportunity Tax Credit and the Lifetime Learning Credit.

This proposal would be effective for tax years beginning after December 31, 2021.

The JCT estimated that the provision would decrease revenues by approximately $1.9 billion over 10 years.

Repeal of denial of American Opportunity Tax Credit on basis of felony drug conviction

The proposal would repeal the prohibition that excludes students convicted of a federal or state felony offense relating to the possession or distribution of a controlled substance from qualifying for the American Opportunity Tax Credit.

This proposal would be effective tax years beginning after December 31, 2021.

The JCT estimated that the provision would decrease revenues by approximately $180 million over 10 years.

Drug pricing

Drug price negotiation program and excise tax

The proposal directs the Secretary of Health and Human Services to establish a Fair Price Negotiation Program, to reduce the cost of selected drugs that lack price competition. Under the program, the Secretary and drug manufacturers enter into agreements and negotiate a “maximum fair price” for the selected drugs in accordance with specified methodology. Manufacturers, producers and importers that do not comply will be subject to a nondeductible excise tax on sales of the selected drugs during periods of noncompliance. The program is proposed to begin in 2025.

KPMG observation

The proposed drug price negotiation program does not modify or replace the annual fee on branded prescription drugs enacted by the Patient Protection and Affordable Care Act.
Previously approved retirement savings proposals

Automatic contribution plans and arrangements

The proposal would require employers without an employer-sponsored retirement plan to auto enroll employees in either an IRA or deferral-only 401(k) plan. These arrangements would provide for automatic contributions starting at 6% and increasing 1% every year until reaching 10%. Employees may make an affirmative election not to contribute or to modify the contribution level. The proposed requirement would not apply to the following:

• Employers with five or fewer employees
• Government employers
• Church employers
• Any employer that has been in existence for fewer than two years

The penalty for not maintaining such a plan or arrangement would be $10 per day per employee (adjusted for inflation), not to exceed $500,000 per year.

The proposed effective date is for plan years beginning after December 31, 2022.

The JCT estimated that the provision would decrease revenues by approximately $22.7 billion over 10 years.

Increase in credit limitation for small employer pension plan start-up costs including for automatic contribution plan or arrangement

The proposal would expand section 45E’s credit for small employer pension start-up costs. The proposal would increase the eligible credit period from three years to five years. In addition, the credit would be expanded for employers with 25 or fewer employees to 100% of start-up costs up to a maximum of $5,000.

The proposed effective date is tax years beginning after December 31, 2021.

The JCT estimated that the provision would decrease revenues by approximately $1.1 billion over 10 years.

Credit for certain small employer automatic retirement arrangements

A new section 45U is proposed to provide small employers (100 or fewer employees) with a $500 nonrefundable tax credit for the first four years the employer maintains an automatic retirement arrangement. The credit is proposed to be effective for tax years beginning after December 31, 2021.

The JCT estimated that this provision, together with the proposal to increase the credit limitation for small employer start-up costs including for automatic contribution plans, would decrease revenues by approximately $1.1 billion over 10 years when combined.
Matching payments for elective deferral and IRA contributions by certain individuals

The proposal includes a new refundable credit of up to $500 (adjusted for inflation) paid by the Treasury into the retirement plan of an eligible individual. The credit would be 50% of the eligible individual’s contribution up to a maximum individual contribution of $1000 and would be subject to compensation limits. An eligible individual would not include individuals claimed as a dependent by another taxpayer or who are students. The credit is proposed to be effective for tax years beginning after December 31, 2024.

The JCT estimated that the provision would decrease revenues by approximately $22.9 billion over 10 years.

Deadline to fund IRA with tax refund

The proposal would provide that contributions to a taxpayer’s IRA made directly by the Treasury Department from federal tax return refunds at the election of the taxpayer would be treated as a contribution for tax year of the return, regardless of when the funds are actually paid to the IRA account. The proposal would apply to the extent the return is filed no later than the due date for filing the return (not including extensions). The proposal would be effective for tax years beginning after December 31, 2022.

The JCT estimated that the provision would have a negligible effect upon revenues over 10 years.
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