2021 Tax Reform

House Ways & Means Committee Draft Legislation

9/24/2021

Jonathan G. Blattmachr, Esq., AEP (distinguished)
Robert S. Keebler, CPA/PFS, MST, AEP(distinguished)
Martin M. Shenkman, CPA/PFS, MBA, AEP(distinguished), JD

The House Draft Almost Certainly Is Not the Final Word. There May Be Many Small Final Words.

- There are aspects of the House Ways & Means proposal still being written by the staff.
- Speaker Pelosi has advised her colleagues to anticipate further changes.
- Whatever passes in the House (the Constitution requires all tax legislation to originate there) will then go to the Senate. Senator Sanders has made many proposals that would affect estate planning. A few, but no where near all, of his proposals are in the House Ways & Means Committee proposed bill.
- Moreover, Senator Wyden, chair of the Senate Finance Committee, has made several proposals, including some that would increase situations where gain on appreciated assets would be recognized. Perhaps, the lowest hanging fruit for that would be the elimination of the income tax free "step up" in basis under Section 1014. It is understood that the life insurance industry has lobbied "hard" against all "no step up" proposals.
- The legislation would impose additional reporting requirements for third party network transactions. Because the Democrats need all of its member in the Senate (together with the two independents who generally vote with them), it is unclear what will pass.

https://www.cbo.gov/publication/57444

2021 Tax Reform – *IRS Funding & Compliance*

- The legislation would appropriate nearly $80 billion to the IRS to improve compliance.
  - Additional funds would be appropriated to Treasury to supervise the IRS and the Tax Court.
  - These funds would be available to the through 9/30/2031.
  - The CBO estimates this would make the IRS's 2031 budget 90% larger than its current baseline projection and would double staffing.
  - The CBO estimates 75% of the money would be used for enforcement and this is estimated to increase revenue by $200B over 10-years.

- The legislation would impose additional reporting requirements for third party network transactions.

https://www.cbo.gov/publication/57444

2021 Tax Reform – *IRS Funding & Compliance*

- The legislation would also impose limitations on pass-through deductions for conservation easements to curb these "syndicated" transactions being used as tax shelters.
  - These new rules would apply after 12/23/2016 generally.
  - Or, in the case of certified historic structures after 12/31/18.

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2021 Tax Reform – *IRS Funding & Compliance*

- Modification of Procedural Requirements Relating to Assessment of Penalties:
  - This change would repeal the requirement that a supervisor must approve an employee's determination to assess penalties. The IRS has lost the ability to impose tax penalties on account of the failure to get supervisor approval.
  - This change would be retroactively effective to 12/31/2000.

2021 Tax Reform – *Social Safety Net*

- Child Tax Credit – extension American Rescue Plan Act (ARP) changes
- Credit for Other Dependents – extension of ARP changes
- Child and Dependent Care Tax Credit – ARP changes made permanent
- Employer-Provided Dependent Care Assistance – ARP changes made permanent
- Earned Income Tax Credit – ARP changes made permanent
- Premium Tax Credit – Temporary expansion
- Payroll Tax Credit for Child Care Workers – New credit

2021 Tax Reform – *Social Safety Net*

- Caregiver Expenses – New credit
  - Up to $4,000
  - 50% of qualified expenses incurred caring for relatives living at home unable to perform the activates of daily living
  - Phased-out if the taxpayer's income for the year exceeds $75,000

2021 Tax Reform – *Individuals*

- The 39.6% rate is restored:

TOP OF EACH BRACKET

	S	MFJ/QW	MFS	HOH	T&E
10%	$9,950	$19,900	$9,950	$14,200	$2,650
12%	$40,525	$81,050	$40,125	$54,200	-
22%	$86,375	$172,750	$86,375	$86,350	-
24%	$164,925	$329,850	$164,925	$164,900	$9,550
32%	$200,000	$400,000	$200,000	$200,000	-
35%	$400,000	$450,000	$225,000	$425,000	$12,500
39.6%					

- The 20% capital gains rate increases to 25%

Using 2021 figures, except for the new 35% and 39.6% thresholds.

TOP OF EACH BRACKET

	S	MFJ/QW	MFS	HOH	T&E
0%	$40,400	$80,800	$40,400	$54,100	$2,650
15%	$400,000	$450,000	$225,000	$425,000	$12,500
25%					

New rate applies The date the bill is introduced.

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2021 Tax Reform – *Individuals*

- 3.8% Net Investment Income Tax (NIIT) expansion
  - Expands the NIIT to cover income derived in the ordinary course of a trade or business for high income taxpayers
  - Does not apply to income on which FICA is already imposed
  - Takes away the advantage of S corps which pay low salary
  - Applies after 12/31/21

Expanded NIIT Threshold	
Married Filing Jointly (MFJ)	$500,000
Head of Household (HoH)	$400,000
Single	$400,000
Married Filing Separately	$250,000
Estates & Trusts	$12,500

2021 Tax Reform – *Individuals*

- New Section 199A Limitation
  - Imposes a maximum allowable deduction - I.E. A CAP ON THE AMOUNT THAT MAY BE CLAIMED AS A DEDUCTION
  - Applies after 12/31/21

199A Maximum Deduction	
Married Filing Jointly (MFJ)	$500,000
Head of Household (HoH)	$400,000
Single	$400,000
Married Filing Separately	$250,000
Estates & Trusts	$10,000

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2021 Tax Reform – *Individuals*

- Excess Business Loss Limitation
  - Section 461(l) limits pass-through business net losses which can offset non-business income to $250,000 (or $500,000 MFJ)
  - This was added by the TCJA and set to sunset in 2025 (note, the CARES Act modified the effective date)
  - This legislation would permanently apply the limitation beyond 2025

2021 Tax Reform – *Individuals*

- *New* High Income Taxpayer Surcharge
  - A surcharge equal to 3% of excessive Modified AGI
  - The Modified AGI threshold is $5,000,000 generally ($2,500,000 MFS)
  - **The Modified AGI threshold is $100,000 for trusts & estates (What to do to avoid this without losing the benefits of trust: QSST)**
  - Modifications to AGI include a reduction for investment interest

39.6% + 3.8% + 3% = 46.4%

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2021 Tax Reform – *Individuals, Trusts & Estates*

- Termination of the Temporary Increase in the Unified Credit
  - Resets the estate tax exemption to $5,000,000 in 2010 dollars
  - In 2022, the exemption will therefore be approximately: $6,000,000

The exemption change will be effective to deaths, GST transfers, and gifts made after December 31, 2021

Estate & GST Taxes

Review of Current Situation

- ***Recall:***
  - The TCJA doubled the Basic Exclusion Amount and GST exemption from 2018-2025 ($10,000,000 in 2011 dollars)
  - In 2026 the exemption is set to revert to pre-TCJA law (5,000,000 in 2011 dollars)
  - This legislation will accelerate sunset to 2022

POTENTIAL
"USE-IT-OR-LOSE-IT"
OPPORTUNITY

Estate & GST Taxes

How to Use the Exemption Now

- *You cannot use part of the $11.7mm exemption now and preserve the balance. To use the excess above $6mm now, essentially you have to use the entire $11.7mm now. If married, have one spouse do the large gift.*
- *How to use it*
  - *Make large gifts now. Borrowing should work and provide a Section 2053 deduction off set. But who will be the lender?*
  - *Do a SLAT before the law's effective date when new grantor trusts will be included in the grantor's gross estate OR prevent the SLAT from being a grantor trust (and how to do that)*
  - *Do a SPAT before the law's effective date when new grantor trusts will be included in the grantor's gross estate OR prevent the DAPT from being a grantor trust. (Is that really viable?*)

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Estate & GST Taxes

How to Use the Exemption Now Continued

- *Can do a Sibling Lifetime Access Trust (who might, or might not, exercise a power of appointment back in favor of the grantor). If created after the effective date of the legislation (likely the day the President signs it into law), must ensure its not a grantor trust. How do you prevent the possibility of a successor trust for the grantor making the original trust a grantor trust?*
- *Watch out of the reciprocal trust doctrine. Choose a "better" jurisdiction. And if there is more than one trust, use a different jurisdiction for each trust.*
- *Consider a gift by promise. But there is some uncertainty including any provision for interest. Failure to provide for adequate interest may mean additional contributions are made triggering the grantor trust inclusion rule of proposed Section 2901.*

Estate & Gift Taxes

Exemption Reduction Math – "Use It or Lose It"

2021 gifts use this portion of the exemption first.

Old Exemption
$5,850,000

2021 gifts use this portion of the exemption second.

Lost if not used before the law changes.

2018 Exemption Increase
$5,850,000

2021 Estate Tax Exemption $11,700,000

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2021 Tax Reform – *Individuals, Trusts & Estates*

- Section 2032A Special Valuation reduction increase:
  - Section 2032A allows a taxpayer to value property used in a family farm or business based on its current use, rather than its highest and best use;
  - The amount a valuation can be reduced has been frozen at $750,000 for many years.
  - The legislation would increase the allowable reduction to $11,700,000 and index it for inflation.
  - The change would apply to deaths after 12/31/21.

2021 Tax Reform – *Individuals, Trusts & Estates*

- Grantor Trusts
  - The legislation would add Section 2901, which would cause grantor trusts to be included in the gross estate of the grantor (or constitute gifts if terminated during lifetime (unless returned to the grantor).
  - The legislation would also add Section 1062, which would cause transactions between grantor trusts and their grantors (or Section 678 Trusts and their deemed owners) to be recognized for income tax purposes, effectively overruling Rev. Rul. 85-13 and, among other things, foreclosing installment (note) sales to grantor trusts and GRATs, as a practical matter.
  - These changes will apply to trusts created on or after the date of enactment and transfers on or after the date of enactment to pre-existing trusts

Existing trusts will be grandfathered and there may be a short window of opportunity capture significant future tax benefits.

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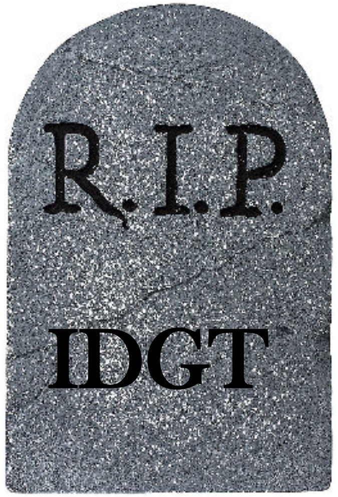
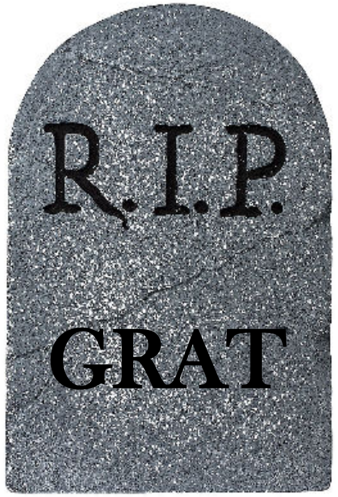
Grantor Trusts – Sec. 2901

- Assets in grantor trusts are included in the grantor's estate (except grandfathered ones)
- Distributions from grantor trusts during the life of the deemed owner are gifts
- The assets of a grantor trust are deemed to be a gift if the grantor trust status is "turned off"
- However, the bill provides an adjustment for such taxable gifts as to avoid double taxation





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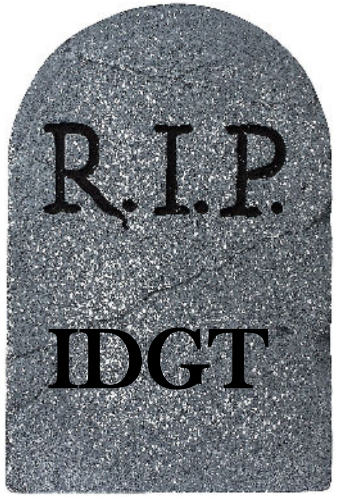
IDGT Sales – Sec. 1062

- Deemed ownership disregarded in determining whether a transfer is a sale or exchange
  - Exception for fully revocable trusts
  - Deemed owners expanded to related parties for the purposes of new Section 1062



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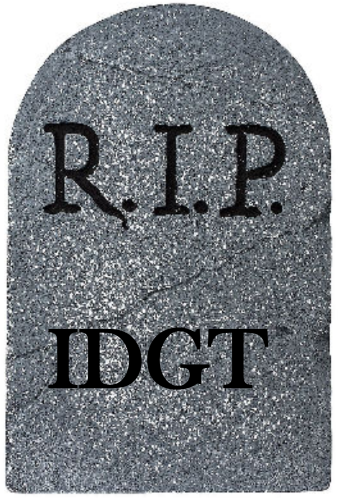
Taint for Sections 2901 and 1062 for Additional Contributions

- There are some practitioners who have expressed concerned whether any transaction between a pre-existing grantor trust and the grantor will mean the trust loses part of its grandfathering even for transactions for full value
- This does not apply for GST tax, Chapter 14 and other rules but caution nonetheless needs to be exercised



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2021 Tax Reform – *Individuals, Trusts & Estates*

- Valuation Rules
  - The legislation would amend **Section 2031** to eliminate valuation adjustments for non-business assets.
  - This is similar to a proposal from Senator Sanders earlier this term.

This provision would apply to transfers after the date of enactment.

Valuation Rules – In General

- Appraisals commonly consider valuation adjustments for:
  - Marketability
  - Minority interests
  - Blockage
  - Taxes on Built-in Gain

Valuation Rules – New Section 2031(d)

- New General Valuation Rules
  - The "Non-business" assets of an entity transferred are valued as if the asset were transferred directly
  - Non-business assets means any asset not used in the active conduct of a trade or business
  - Certain "Passive assets" can be treated as business assets if used in the active conduct of a trade or business

Valuation Rules – New Section 2031(d)

- **“Non-Business Assets:”**
  - Held for the production or collection of income, and
  - Not used in the <u>active</u> conduct of a trade or business.

- Certain **“Passive Assets”** can be treated as business assets if used in the active conduct of a trade or business:
  - Certain hedges
  - Real property trades or business in which the transferor materially participates

- Additional exception for **“reasonably required” working capital**

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Valuation Rules – New Section 2031(d)

- **Look-thru rule:**
  - Designed to prevent any discount for non-business assets held in a lower-tier entity
  - 10% ownership interest threshold
  - The upper-tier entity is treated as if directly owning its ratable share of the lower-tier entity's assets

Valuation Rules

Example

	Before Enactment	After Enactment
Gross Value	$10,000,000	$10,000,000
Marketability Adjustment	(2,000,000)	(0)
Minority Interest Adjustment	(1,200,000)	(0)
Net Value	$6,800,000	$10,000,000
Estate Tax @ 40%	$2,720,000	$4,000,000

Valuation Rules

Example/Summary

Operation	Trade or Business	Owned by	Marketability Discount	Subtract out Non-Business Assets
Automobile Dealership	Yes	Family Members	Yes	Yes
Apartment Building – Material Participation	Yes	Family Members	Yes	Yes
Triple Net Lease Real Estate – No Material Participation	No	Family Members	No	N/A – entire enterprise treated as a non-business asset

2021 Tax Reform – *Retirement Plan Limits*

- Contribution Limits for Taxpayers with Large Balances – ***New* Sec. 409B**
  - Annual additions (any contributions) are prohibited if the taxpayer has an excessive balance, effective after 12/31/21.
  - However, the limit would only apply to taxpayers with AGI in excess of the following thresholds:

Contributions to High Balance Plans Limited	
Married Filing Jointly (MFJ)	$450,000
Head of Household (HoH)	$425,000
Single	$400,000
Married Filing Separately	$400,000

All figures would be adjusted annually for inflation.

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2021 Tax Reform – *Retirement Plan Limits*

- Contribution Limits for Taxpayers with Large Balances – ***New* Sec. 409B**
  - This applies to a tax year when total defined contribution plan and IRA accumulations exceeds $10,000,000 (the applicable threshold) on 12/31 of the prior year.
  - Rollovers would not be considered an addition
  - Accounts acquired by death or divorce or separation would not be considered an addition
  - Additional reporting requirements imposed on accounts in excess of $2,500,000
  - Section 4973(i) is added to impose a 6% excise tax

2021 Tax Reform – *Retirement Plan Limits*

- Increased RMD for High-income Taxpayers with Large Balances – ***New* Sec. 4971(e)**
  - An additional minimum distribution will be imposed on taxpayer's with large retirement account balances after 12/31/21.
  - It will apply when total defined contribution plan and IRA accumulations exceed $10,000,000 on 12/31 of the prior year.
  - However, these limits would only apply to high-income taxpayers:

Large Balance RMDs Imposed	
Married Filing Jointly (MFJ)	$450,000
Head of Household (HoH)	$425,000
Single	$400,000
Married Filing Separately	$400,000

2021 Tax Reform – *Retirement Plan Limits*

- Increased RMD for High-income Taxpayers with Large Balances – ***New* Sec. 4971(e):**
  - **50% Distribution Rule:** The new additional minimum distribution would generally be 50% of the amount total accumulations exceed $10M ("the applicable dollar amount")
  - **100% Distribution Rule:** In addition, to the extent that the combined balance amount in traditional IRAs, Roth IRAs and defined contribution plans exceeds $20 million, that excess is required to be distributed from Roth IRAs and Roth designated accounts in defined contribution plans up to the lesser of (1) the amount needed to bring the total balance in all accounts down to $20 million or (2) the aggregate balance in the Roth IRAs and designated Roth accounts in defined contribution plans.

2021 Tax Reform – *Retirement Plan Limits*

- Roth Conversion Income Limitations – **Amends Section 408A(e)**
  - Before 2010, those with income in excess of $100,000 were prohibited from making Roth Conversions.
  - Currently, income limitations remain for Roth contributions; however "backdoor" conversions easily end-run these limits.
  - The bill would eliminate Roth conversions for taxpayer with income in excess of the following thresholds:

Roth Conversion Income Limitation	
Married Filing Jointly (MFJ)	$450,000
Head of Household (HoH)	$425,000
Single	$400,000
Married Filing Separately	$400,000

Note, the proposed effective date for this new limitation is ***2032****.*

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2021 Tax Reform – *Retirement Plan Limits*

- New Prohibited Investments
  - The legislation would prohibit an IRA from holding an investment which are only offered to accredited investors (i.e. nonregistered securities).
  - This is an attempt at rough justice from Congress in order to prohibit investments that taxpayers use to accumulate huge sums in their retirement accounts.
  - IRAs holding such assets after the effective date would deemed to be distributed; however, a 2-year transition period is provided.
  - The effective date would be 12/31/21.

2021 Tax Reform – *Retirement Plan Limits*

- IRA Non-Compliance Statute of Limitations
  - Currently, the SOL for valuation related reporting and PTs is 3 years.
  - The legislation would extend this to 6 years.
  - This would apply to taxes to which the current 3-year period ends 12/31/21.

2021 Tax Reform – *Retirement Plan Limits*

- IRA Self-Dealing
  - Currently, an IRA cannot invest in a business entity in which the IRA owner holds a 50% or greater interest.
  - The legislation reduce this threshold to 10% for investments which are not tradable on an established securities market.
  - This limit would include direct and indirect interests.
  - Further, the legislation would change this limit to an IRA requirement (it is currently a PT).
  - This change would apply after 12/31/21, with a 2-year transition period for IRAs already holding such assets.

2021 Tax Reform – *Retirement Plan Limits*

- Disqualified Persons
  - The bill would clarify that for the purposes of the PT rules, the IRA owner and beneficiary of an “inherited” IRA is always a disqualified person.
  - This would apply to transactions after 12/31/21.

2021 Tax Reform – *Individuals*

- Certain disaster relief payments excluded from taxable income.
- Repeal of the temporary limitation on personal casualty losses *and* an extension of time to file a claim is provided in certain circumstances.

2021 Tax Reform – *Corporate & International*

- Graduated corporate rate structure to replace the 21% flat rate:

Income Brackets			Rate
$0	to	$400,000	18%
$400,000	to	$5,000,000	21%
$5,000,000	and over		26.5%

- New international interest expense limits, new outbound international provisions, new inbound international provisions, BEAT modifications, and various other business tax provisions.

2021 Tax Reform – *Other Select Business Reforms*

- Interestingly, the legislation would allow eligible S-corporations to reorganize as partnerships tax-free.
  - Eligible S-corporations means any corporation that was an S-corporation on 5/13/1996 (prior to the "check the box" regulations).
  - If the reorganization is desired, the corporation would have to completely liquidate to a domestic partnership within two years of 12/31/21.

2021 Tax Reform – *Other Select Business Reforms*

- Work Opportunity Tax Credit (WOTC) Enhancement During COVID-19 Recovery Period
  - The legislation would increase the WOTC to 50% for the first $10,000 in wages through 12/31/2023 for all targeted groups, except summer youth employees.
  - The increase would also be available in the second year of employment (current law limits it to the first year).

2021 Tax Reform – *Other Select Business Reforms*

- Modifications to Limitation on Deduction of Excessive Employee Remuneration: The effective date of the new expanded limit on the eight most highly compensated officers as provided for in the ARPA would be moved up from 12/31/26 to 12/31/21.
- Termination of Employer Credit for Paid Family Leave and Medical Leave: Accelerates the termination of the credit from 2026 to 2024.
- Modification of Rules for Partnership Interests Held in Connection with the Performance of Services (12/31/21 effective date)
- Limitation on Certain Special Rules for Section 1202 Gains – basically caps the exclusion to 50% if the taxpayer's AGI exceeds $400,000 (9/13/21 effective date)
- Constructive Sales – to include digital assets (12/31/21 effective date)
- Wash Sales – to include digital assets (12/31/21 effective date)

2021 Tax Reform – *Specialized Practice*

- State and local bond incentives
- US Possessions Economic Activity Credit – new tax credit
- NMTC: Permanent extension and temporary increase
- HTC: Temporary and permanent increases
- LIHTC: Temporary state allocation increase
- Qualified Wildfire Mitigation Expenditures – new tax credit
- Neighborhood Homes Credit – new tax credit

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2021 Tax Reform – *Energy, Specialized Practice Areas*

- Renewable Energy Production Credit – extension and modification
- Qualifying Electric Transmission Property – new tax credit
- Carbon Oxide Sequestration – extension & modification
- Second Generation Biofuel Credit – extension
- Sustainable Aviation Fuel Credit – new tax credit
- Credit for Production of Clean Hydrogen – new tax credit
- Energy Efficient Commercial Buildings Deduction – temporary increase and modification
- Energy Efficient New Home Credit – extension, increase and modification

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2021 Tax Reform – *Energy, Specialized Practice Areas*

- Qualified Fuel Cell Motor Vehicles – modification and extension
- Alternative Fuel Refueling Property Credit – modification and extension
- Bicycle commuting fringe benefit reinstated and expanded
- Credit for new electric bicycles – a new credit
- Advanced energy project credit – extension
- Labor Costs of Installing Mechanical Insulation Property – a new credit
- Qualified Environmental Justice Programs – a new credit
- Superfund reinstatement
- Nuclear Power Production Credit – a new credit
- **Green Publicly Traded Partnerships – PTP expansion**

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2021 Tax Reform – *Energy, Broad Application*

- Energy Credit – extension and modification
  - Business credit
  - Generally extended through 2033
  - The definition of *Energy Property* and the application of the 30% credit is expanded to include: energy storage technology, qualified biogas property, and microgrid controllers
  - Increased credit for solar in low-income communities
  - Credit treated as payment and fully refundable

	Solar Investment Tax Credit										
	2006-2019	2020-2021	2022	2023	2024	2025	2026-2031	2032	2033	2034	2035
Current Law	30%	26%	26%	22%	10%	10%	0%	0%	0%	0%	0%
Proposal	30%	26%	30%	30%	30%	30%	30%	26%	22%	10%	10%

2021 Tax Reform – *Energy, Broad Application*

- Non-business energy property credit – extension and modification:
  - Extended through 2031 (was set to expire in 2021);
  - Credit increased from 10% to 30% of qualified energy efficiency improvements;
  - Lifetime cap increased from $500 to $1,200;
  - Numerous other small changes.

2021 Tax Reform – *Energy, Broad Application*

- Residential Energy Efficient Property – extension and modification:
  - – Extended through 2033 (was set to expire in 2023);
  - – Expanded to included *qualified battery storage technology expenditures*.

	Residential Energy Efficient Property									
	2006-2019	2020-2021	2022	2023	2024	2025	2026-2031	2032	2033	2034
Current Law	30%	26%	26%	22%	0%	0%	0%	0%	0%	0%
Proposal	30%	26%	30%	30%	30%	30%	30%	26%	22%	0%

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2021 Tax Reform – *Energy, Broad Application*

- New Qualified Plug-in Electric Drive Motor Vehicles
  - Credit for personal use vehicles through 2031
  - Capped at 50% of the purchase price
  - Base credit of $4,000
  - Additional $3,500 for vehicles with greater battery capacity
  - Additional $4,500 for vehicles assembled in the US
  - Additional $500 for vehicles with US-made parts
  - Phaseout for taxpayers with income in excess of $800,000 (MFJ)
  - MSRP vehicle eligibility cap
  - 2 or 3 wheeled vehicles separately eligible
  - Repeals the current credit provided by Section 30D

2021 Tax Reform – *Energy, Broad Application*

- Credit for Previously-owned Qualified Plug-in Electric Drive Motor Vehicles.
  - Credit equals:
    - ❑ $1,250, plus
    - ❑ The lessor of $1,250 of $208.50 for each kwh of battery capacity exceeding 4 kwh.
  - Credit cannot exceed 30% of the sale price.
  - Sale price cannot exceed $25,000.
  - Phased-out as AGI exceeds $150,000 (MFJ).
  - Car must be at least two model years earlier than the calendar year
  - Must be acquired with a *qualified sale.*
  - Can only claim the credit once every 3-years.

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2021 Tax Reform – *Energy, Broad Application*

- Credit for Qualified Commercial Electric Vehicles
  - Credit equals 30% of the vehicle's basis
  - Must be a plug-in vehicle without a combustion engine (or a qualified fuel cell vehicle)
  - Credit available from 2022 through 2031

Conclusions