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Pared-down 'CHIPs' bill with tax break for US semiconductor makers—but no section 174 fix—heads to White House

After months of negotiations, Congress this week passed and will send to President Biden bipartisan legislation designed to boost domestic semiconductor manufacturing and encourage US research activities. However, while the measure includes an investment tax credit intended to promote domestic production of semiconductors, lawmakers did *not* add a provision that would retroactively permit expensing for research expenditures under tax code section 174.

House passage of the CHIPS Act of 2022 (H.R. 4346: text; section-by-section summary) occurred on July 28, by a vote of 243-187. The measure cleared the Senate just one day earlier on a 64-33 vote, which included the backing of 17 Senate Republicans.
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220722_2_suppA.pdf
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220722_2_suppB.pdf

The vote in the House came less than 24 hours after Senate Majority Leader Charles Schumer, D-N.Y., and Sen. Joe Manchin, D-W.Va., announced that they had reached an accord on a tax, climate, health care, and deficit reduction bill dubbed the Inflation Reduction Act of 2022. (See related coverage in this issue for the latest news on Senate Democrats' apparent budget reconciliation deal and its prospects for passage in the coming days.)

Accord over reconciliation leads to friction over CHIPS

After the Senate Democrats announced their reconciliation deal, House Republican leaders began urging a "no" vote on the CHIPS legislation—the same position that Senate Minority Leader Mitch McConnell, R-Ky., had adopted up until the point on July 14 when it appeared Sen. Manchin had entirely broken off talks on a "Build Back Better" package and could only support a narrower bill focused only on health care. (McConnell had vowed that Republicans would not vote for CHIPS legislation if Democrats continued to pursue a broad tax-and-spending bill, but he dropped his opposition to CHIPS once it looked as though an expansive reconciliation package had no chance of becoming law.)

House Minority Leader Kevin McCarthy, R-Calif., suggested Senate Democrats' turnabout on reconciliation amounted to bad faith.

"They lied about reconciliation," McCarthy said. ". . . [Senate Republicans] said they weren't going to [support the CHIPS Act] without making sure reconciliation isn't going. The day they voted for it, [Democrats] said they had a deal on reconciliation."

But in the end, 24 House Republicans still ended up backing the bill. And progressive Democrats—some of whom had earlier viewed the CHIPS legislation as so-called "corporate welfare"—came around in strong enough numbers, buoyed by their renewed hopes of a more robust reconciliation package coming down the pike, to easily send the legislation to President Biden's desk.

25 percent investment tax credit plus funding for domestic chip makers

The CHIPS legislation, which the nonpartisan Congressional Budget Office (CBO) estimates will cost roughly $80 billion over 10 years, leans heavily on direct funding aimed at building, expanding, and modernizing domestic semiconductor facilities, along with boosting funding for research and development programs administered by the Department of Commerce.
URL: https://www.cbo.gov/system/files?file=2022-07/hr4346_chip.pdf

On the tax side, the bill would create a 25 percent investment tax credit (under new tax code section 48D) for "qualified property"—generally, tangible and depreciable or amortizable property—that is constructed or acquired new by the taxpayer and is integral to the operation of a facility for which the primary purpose is the manufacture of semiconductors or equipment used in semiconductor manufacturing. The provision would also allow taxpayers, including partnerships and S corporations, to receive the credit under a direct-pay option (similar to the direct-pay provisions for delivering certain clean energy tax incentives in the House-approved version of the Build Back Better Act and in the Inflation Reduction Act, the budget reconciliation proposal that was recently unveiled in the Senate).

The credit, which carries a 10-year cost of roughly $25 billion according to CBO, generally would be available for property placed in service after December 31, 2022, and for which construction begins before January 1, 2027.

Expensing of research expenditures left out, for now

Though the policy maintains broad bipartisan support, the CHIPS legislation now making its way to the White House does *not* include language aimed at reversing a change within tax code section 174—originally enacted as part of the 2017 Tax Cuts and Jobs Act (P.L. 115-97)—that, as of January 1 of this year, requires certain research expenditures to be amortized over a number of years rather than deducted currently.

As a result, advocates of the section 174 fix likely have to hope that it can be added as an amendment to the emerging Inflation Reduction Act that the Senate may vote on the week of August 1, or else wait until the post-midterm election lame duck session, when that and a number of other potential revenue measures (related to retirement tax policy and certain expired and expiring provisions known as "tax extenders") may be in play as part of a potential year-end tax-and-appropriations package.

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