The 2024 Green Book and Tax Implications: A Primer

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On March 9, 2023, the Treasury Department released the General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals (sometimes called the Green Book) to accompany President Joe Biden's proposed budget for FY 2024. As in the 2022 Green Book,[1] these proposals would:

- Significantly increase tax burdens on corporations and certain individual taxpayers.
- Make sweeping changes to the international tax regime.
- Substantially impact planning for transfers of wealth by treating transfers by gift and at death as realization events for income tax purposes.
- Rescind tax incentives currently available with respect to fossil fuels.

Some notable changes from the 2022 Green Book include proposals to:

- Quadruple the stock repurchase excise tax rate (from 1% to 4%).
- Impose additional requirements on claiming tax-free treatment for spin-offs and split-offs.
- Implement aspects of Pillar Two of the Organization for Economic Cooperation and Development (OECD) framework.
- Impose a minimum tax on individuals with a net worth over $100 million.
- Modify the tax treatment of grantor trusts and the transfer tax valuation rules for nonmarketable assets.
- Prevent related parties from shifting basis through partnerships.
- Limit the use of retirement accounts by "high-income" taxpayers.
- Recharacterize real property depreciation recapture as ordinary income.
- Extend a number of existing tax provisions to include digital assets (cryptocurrency and similar technologies).

Treasury officials have described the Green Book as a "conceptual" document providing a starting point for discussions with Congress. While unlikely that the proposals will be signed into law while Republicans hold a majority in the House, the Green Book serves as a good indication of Democratic tax policy going forward.

Brief descriptions of certain noteworthy proposals in the Green Book and our observations follow.

Corporations

Raise the corporate income tax rate: Similar to prior Biden administration proposals, the Green Book proposes to raise the corporate income tax rate from 21% to 28%. Easily the single largest revenue-raising provision in the Green Book, this would significantly increase the tax costs associated with taxable corporate transactions and with operating a business in corporate form generally. It would also increase the value of tax attributes tied to the corporate rate, such as net operating losses. If enacted as proposed, the rate increase would generally be effective for taxable years beginning after December 31, 2022 (with a prorated increase for noncalendar taxable years straddling that date).

[1] For a detailed discussion of the 2022 Green Book, see our client alert "Biden Administration's Green Book Proposes Significant Changes to Tax Regime."

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Increase the stock repurchase excise tax rate: The Green Book proposes to quadruple (from 1% to 4%) the rate of the excise tax on stock repurchases that was enacted in 2022 as part of the Inflation Reduction Act.[2] If enacted, the proposal would apply retroactively to all repurchases made after December 31, 2022, the original effective date of the excise tax.

> ***Worth noting:*** Apart from the rate increase, the Green Book does not include any other proposed changes to the excise tax provisions, including the types of transactions that are subject to the tax.

Impose new restrictions on tax-free spin-offs: The Green Book proposes significant changes to the U.S. tax code's rules governing tax-free spin-off and split-off transactions (Spin-Offs). A Spin-Off generally involves the separation of a historic business line of a parent company (Parent) into an independent, separately traded entity (Spinco). If the Spin-Off satisfies certain requirements under Section 355, the transaction is not taxable to the Parent, Spinco or shareholders who receive Spinco stock.

Frequently, the Parent may receive cash "boot" from the Spinco or cause the Spinco to assume Parent liabilities as a way of partially "monetizing" the Spinco business and reallocating some of the Parent's historic debt to Spinco. Very generally, such reallocations can be tax-free to the Parent to the extent the amount reallocated does not exceed Parent's tax basis in the assets transferred to the Spinco. Under current law, the Parent can also reallocate additional debt to the Spinco — even in excess of the tax basis of the Spinco assets — through a "debt-for-debt exchange," by which the Parent receives newly issued Spinco debt "securities" and uses them to retire outstanding Parent debt.

The Green Book revives an earlier Build Back Better Act (BBBA) proposal to restrict debt-for-debt exchanges that was passed by the House (but not the Senate) in 2021. If enacted, the proposal would effectively repeal the favorable treatment of debt-for-debt exchanges by subjecting them to a tax basis limitation similar to that currently applied to Spinco liability assumptions and boot payments. It would apply a single, aggregate tax basis limitation to (1) the amount of liabilities assumed by the Spinco, (2) the amount of boot paid by the Spinco and transferred to the Parent's creditors and (3) the principal amount of debt securities (and the value of certain debt-like preferred stock) issued by the Spinco and transferred to the Parent's creditors. The Parent would generally be taxed on any built-in gain in the Spinco business to the extent the sum of these items exceeds the Parent's tax basis in the assets transferred to the Spinco.

> ***Worth noting:*** This would introduce new structuring challenges for many companies engaging in Spin-Offs, although several other techniques may be available to achieve tax-efficient monetization in a given transaction.[3]

Separately, the Green Book proposes two novel requirements that, if not satisfied, would make a Spin-Off fully taxable to the Parent (but not to shareholders). First, the Spinco must be "adequately capitalized" as a result of the Spin-Off. Second, the Spinco must continue to be an "economically viable entity" after the completion of the Spin-Off. The satisfaction of each prong would be based on all relevant facts and circumstances, including the projected and actual amount of contingent liabilities assumed by the Spinco and whether the Spinco declares bankruptcy within five years after the Spin-Off.

> ***Worth noting:*** These provisions, if enacted, could introduce substantial tax uncertainty in many transactions, as they appear to require an evaluation of Spinco's prospective business performance, the future resolution of any contingent liabilities and other post-Spin-Off factors that may not be ascertainable at the time of the transaction.

The Green Book's Spin-Off proposals would generally apply to transactions occurring after the date of enactment. A transition rule would provide "grandfathering" relief for transactions that are the subject of a prior binding agreement, public announcement or Internal Revenue Service (IRS) ruling request.

Disallow losses in certain corporate liquidations: Consistent with a proposal from the BBBA, the Green Book proposes a new disallowance rule for losses recognized in certain corporate liquidations that occur within a "controlled group" (defined by reference to a 50% common ownership threshold) where the liquidating corporation's assets remain in the controlled group following the liquidation. Treasury would have authority to provide for deferral (rather than permanent disallowance) of such losses until the controlled group disposes of the liquidating corporation's assets, as well as authority to address the use of controlled partnership structures to circumvent the provision.

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[2] For more detailed discussions of the recently enacted excise tax on stock repurchases, see our client alerts "Proposed Excise Tax on Stock Repurchases Has Far-Reaching Implications for Corporate Transactions," "New Corporate Minimum Tax and Stock Repurchase Tax Will Take Effect in 2023, but Questions Remain" and "IRS Issues Initial Guidance for New Excise Tax on Stock Buybacks and Corporate Alternative Minimum Tax."

[3] For a more detailed overview of such techniques, see our client alert "Build Back Better Act Would Change Monetization Playbook for Tax-Free Spin-Offs."

> ***Worth noting:*** The proposal would make so-called "Granite Trust" planning — an important and widely used loss recognition technique under current law[4] — a much less powerful tool for harvesting built-in losses.

Reform the definition of corporate "control": The definition of "control" used for purposes of the tax rules relating to incorporating transfers, reorganizations and Spin-Offs generally requires ownership of at least 80% of the voting power of a corporation's voting stock and at least 80% of each class of nonvoting stock; it does not have a "value" prong. Echoing proposals from prior Democratic administrations, the Green Book would supplant that definition with a threshold requiring ownership of 80% or more of a corporation's stock by both voting power **and** value.

> ***Worth noting:*** This would generally make it harder to structure intentionally taxable (or busted) incorporating transfers as a way of triggering built-in gains or losses and would also prevent qualifying Spin-Offs of a less-than-80% economic interest in the Spinco through the use of dual-class voting structures.

Expand taxable dividend treatment: The Green Book proposes a number of rules targeted at transactions perceived to inappropriately avoid taxable dividend treatment under current law, including rules addressing (1) elimination of earnings and profits (E&P) through distributions of certain high-basis stock, (2) leveraged distributions funded by related corporations with a principal purpose of avoiding dividend treatment and (3) purchases of a corporation's stock by its subsidiary — so-called "hook stock" — in exchange for cash or other property. The Green Book would also repeal the statutory "boot-with-in-gain" limitation for dividend-equivalent boot payments in reorganizations.

> ***Worth noting:*** Many of these proposals appear to be aimed at tax planning strategies that were commonly implemented by U.S. parented companies to repatriate offshore cash prior to the overhaul of the international tax regime by the Tax Cuts and Jobs Act (TCJA). While the proposals are less relevant to U.S. parented companies in the post-TCJA world, they could have a significant impact on foreign parented companies and many private equity transactions.

International

Make major changes to GILTI: The Biden administration proposes substantial changes to the global intangible low-tax income (GILTI) regime that was created by the TCJA, including:

- Reduce the Section 250 deduction from 50% to 25%, resulting in a GILTI rate of 21% (*i.e.*, 75% of the proposed 28% corporate rate).
- Eliminate the 10% exemption for qualified business asset investment (QBAI).
- Calculate the Section 904 foreign tax credit (FTC) limitations for GILTI income (the GILTI basket) and foreign branch income (the branch basket) on a country-by-country basis.
- Apply a similar country-by-country approach to tested losses.
- Decrease the 20% disallowance of FTCs incurred to 5% and allow FTCs to be carried forward 10 years (on a country-by-country basis).
- Allow net operating losses to be carried forward (on a country-by-country basis).
- Repeal the "high-tax exception" for both GILTI and Subpart F.
- Eliminate the "tested income exception" for foreign oil and gas extraction income.

> ***Worth noting:*** The elimination of the QBAI exemption and the high-tax exception would push the U.S. further away from a territorial system of international taxation and toward a worldwide system in which a business' income is taxed by the country in which the parent corporation of that business is located.

The proposal also includes provisions that would implement aspects of the multilateral global minimum tax regime adopted by the OECD (Pillar Two) and being implemented by the European Union and several other jurisdictions. More specifically, the proposal would account for (on a country-by-country basis) any taxes paid by a U.S. corporation's non-U.S. parent under an "income inclusion rule" (IIR) providing relief for "sandwich" structures in which a non-U.S. parent owns a U.S. subsidiary that owns stock in controlled foreign corporations (CFCs).

> ***Worth noting:*** The proposed 21% GILTI rate is higher than the 15% global minimum rate adopted by the OECD in connection with Pillar Two. Moreover, there would continue to be a 5% "haircut" for GILTI basket FTCs (reduced from the current 20% haircut). As a result of these provisions, the effective foreign tax rate that one would have to pay to avoid GILTI could be as high as 22.11%. This rate is substantially higher than the 15% global minimum tax rate currently being adopted pursuant to Pillar Two.

[4] In a typical Granite Trust transaction, a corporation that owns a depreciated subsidiary transfers a portion of the subsidiary's stock to a different entity — typically a related entity — so as to reduce the corporate shareholder's direct ownership to below the 80% threshold at which losses are permitted to be recognized under the U.S. tax code's liquidation rules. The subsidiary then liquidates for tax purposes, allowing the corporate shareholder to access the built-in loss reflected in its remaining subsidiary stock.

The country-by-country approach for GILTI and branch basket FTCs would be a sea change in international taxation, eliminating most planning that relies on a "cross-crediting" strategy. Firms with an international footprint may be compelled to make allocations to dozens of GILTI and branch baskets in addition to their baskets for general and passive income. Although the country-by-country approach would sequester tested losses in their countries of origination, preventing multinational firms from offsetting tested income arising in one country with a tested loss arising in another, the proposal's provision for loss carryforwards may help mitigate some of the adverse impact to taxpayers from a country-by-country approach.

The proposed decrease in the GILTI deduction to 25% is intended to be effective for taxable years beginning after December 31, 2022, meaning that, if enacted, it would generally impact the current taxable year. The remainder of these proposals, including the country-by-country limitations on cross-crediting, are not intended to take effect until taxable years beginning after December 31, 2023, generally allowing taxpayers to leave their existing cross-crediting strategies in place for the current taxable year.

Narrow the dividends received deduction under Section 245A with respect to non-CFC foreign corporations: This proposal would limit the dividends received deduction under Section 245A (the 245A DRD) with respect to dividends received by U.S. shareholders from foreign corporations that are not CFCs. While the 245A DRD would remain unchanged with respect to dividends paid by CFCs, with respect to dividends from non-CFC foreign corporations, the 245A DRD would only be available to the extent the foreign corporation is a "qualified foreign corporation," which term includes corporations incorporated in a territorial possession of the United States and foreign corporations eligible for the benefits of a comprehensive income tax treaty with the United States. In addition, the size of the 245A DRD would be reduced to 65% of the foreign-sourced dividends received from a non-CFC qualified foreign corporation if the U.S. shareholder owns at least 20% of the stock (by voting power and value) of the qualified foreign corporation and to 50% of the foreign-sourced dividends received if a U.S. shareholder owns less than 20%.

Expand Section 265 disallowance of deductions: This proposal would extend Section 265, which disallows deductions allocable to certain tax-exempt income, to deductions allocable to a class of foreign income that is taxed at a preferential rate or not at all, including the Section 250 deduction for a portion of GILTI income and the Section 245A deduction for certain dividends. This would replace Section 904(b)(4), which treats deductions as if they were disallowed solely for purposes of the FTC calculation.

> ***Worth noting:*** The Green Book does not indicate how deductions would be allocated to the income targeted by this proposal. If done in accordance with existing allocation regulations, the disallowance of these deductions would be particularly onerous for taxpayers with significant interest expense and high-tax CFCs with substantial GILTI income. It is also unclear how this proposal would interact with the rules for allocating interest for foreign tax credit purposes under the existing regulations.
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> In a footnote, the Green Book states that this proposal is not intended to create any inferences regarding current law, including whether Section 265 currently disallows such deductions. Though the mere mention of this controversial position could signal Treasury's interest in considering it as a regulatory matter, the substance of this footnote suggests that any regulations attempting to implement the proposal are likely to be purely prospective.

Expand anti-inversion rules: U.S. corporations and certain partnerships (including foreign partnerships with a U.S. trade or business) that redomicile outside the United States in a merger or acquisition with a non-U.S. corporation would be treated as U.S. corporations if more than 50% of the combined entity is held by former shareholders of the initial entity. Even if continuity is 50% or less, the final entity would be treated as domestic if (1) the domestic corporation's fair market value is greater than the foreign acquiring corporation's fair market value immediately before the combination, (2) the combined entity is managed and controlled in the U.S. and (3) the "expanded affiliated group" does not have substantial business activities in its new jurisdiction.

> ***Worth noting:*** This would be a major shift in the operation of Section 7874, which under current law imposes special rules on inversions in which initial shareholders acquire 60-79% of the final company but does not alter the non-U.S. status of that final company. Instead, the new Section 7874 would act as an "on/off" switch, imposing domestic status on each company produced by cross-border mergers as long as shareholders of the U.S. entity own more than 50% of the combined company. This switch may be flipped even where there is significantly less than 50% U.S. shareholder continuity if the various exceptions, add-backs and other adjustments in the existing regulations are retained in their current form. Strikingly, it appears possible that the alternative "managed and controlled" test could apply even where there is zero U.S. shareholder continuity, as in a debt-financed all-cash acquisition of a larger U.S. corporation by a smaller non-U.S. corporation that is managed and controlled in the United States.

These new rules could also change the definition of "domestic entity acquisition" to apply on a business-line-by-business-line basis. For example, the new Section 7874 could ensnare a non-U.S. corporation's acquisition of substantially all of the assets of a trade or business of a U.S. corporation (as opposed to substantially all of the U.S. corporation's total assets, as is required under current law). Treasury would be granted regulatory authority to define a "trade or business," a term that does not currently have clearly defined lines as to the scope of activities required in this context.

> ***Worth noting:*** This could create substantial uncertainty and high costs in many cross-border transactions, particularly if the acquisition of a relatively small amount of assets were to be construed to be an acquisition of a stand-alone trade or business. For example, this proposal would appear to apply the inversion rules to any carve-out or asset sale by a U.S. corporation of a division or even product line to a non-U.S. corporation. The proposal also would appear to prevent a U.S. corporation from spinning off (even taxably) one of its businesses into a non-U.S. corporation, except in the very rare case where the substantial business activities test is satisfied.
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> There does not appear to be any grandfathering relief for deals that have signed but not yet closed. If this proposal becomes law, non-U.S. corporations looking to acquire stock or assets of U.S. companies in transactions that might be caught by these expansions of Section 7874 will face serious pressure to close any outstanding deals.
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> These rules could also impact ordinary course internal restructuring of multinational groups, although Treasury would be granted regulatory authority to exempt certain internal restructurings involving partnerships from the application of Section 7874.

Expand Section 961(d) stock loss rule to include GILTI and transition tax deductions: The proposal provides that, for purposes of calculating any loss realized by a U.S. shareholder on a disposition of stock of a foreign corporation, a U.S. shareholder's basis in such stock and the basis in other property by reason of which a domestic corporate U.S. shareholder owns stock of a foreign corporation, will be reduced by the amount of any (1) 245A DRD, (2) GILTI deduction under Section 250 and (3) any transition tax deduction under Section 965(c), in each case that were attributable to the stock of such foreign corporation. Section 961(d) generally already contains such a rule with respect to the 245A DRD, although the expansion to include basis in other property could also cause a basis reduction for determining a U.S. shareholder's loss in, *e.g.*, an interest in a partnership that holds stock of a foreign corporation.

Expand information reporting for operations in foreign jurisdictions: In connection with the country-by-country proposals described above, the proposal expands reporting requirements with respect to each "foreign business entity" of a U.S. person by treating each separate taxable unit, such as a foreign branch or a disregarded entity, as a separate foreign business entity. Currently, such reporting is required only with respect to an interest in a foreign partnership or a foreign corporation. In addition, for this purpose and except as provided in Treasury regulations, the proposal generally provides that the annual accounting period for a taxable unit that is a branch or disregarded entity is the annual accounting period of its owner. In addition, Treasury has authority to treat non-resident U.S. persons as if they were residents for purposes of these reporting rules.

Replace BEAT with UTPR: The Base Erosion and Anti-Abuse Tax (BEAT) introduced by the TCJA would be repealed and replaced with an Undertaxed Profits Rule (UTPR) that is consistent with the UTPR that is described in the Pillar Two model rules. The UTPR would generally disallow a portion of the deductions that would otherwise be available to a domestic corporation or the U.S. branches of a foreign corporation to the extent foreign members of the same "financial reporting group" (generally, a group of business entities that prepare consolidated financial statements) have low-taxed income that is not subject to a Pillar Two-compliant IIR.

As a result of the exception for amounts subject to an IIR, such as the revised GILTI rules discussed above, the UTPR generally would not apply to U.S. multinationals and would primarily apply to foreign-parented multinationals with operations in low-tax jurisdictions that are not subject to an IIR. The UTPR would only apply to financial reporting groups with global annual revenue of the dollar equivalent to €750 million or more in at least two of the prior four years. In addition, the UTPR would not apply to a group with operations in no more than five jurisdictions outside of the group's primary jurisdiction and where the book value of the group's tangible assets in those jurisdictions is less than $57 million, in addition to certain other de minimis exceptions.

When the UTPR applies, domestic group members would be disallowed U.S. tax deductions to the extent necessary to collect the hypothetical amount of top-up tax required for the financial reporting group to pay an effective tax rate of at least 15% in each foreign jurisdiction in which the group has profits. The amount of this top-up tax would be determined based on a jurisdiction-by-jurisdiction computation of the group's profit and effective tax rate consistent with the Pillar Two rules.

The proposal also contains a complex coordination rule that would reduce the UTPR to be collected by the United States to the extent members of the financial reporting group are subject to a qualified UTPR in one or more other jurisdictions. It also includes a domestic minimum top-up tax that would apply to U.S. profits when another jurisdiction adopts a UTPR.

> ***Worth noting:*** According to the Green Book, when another jurisdiction adopts a UTPR, the proposal would also ensure that taxpayers continue to benefit from tax credits and other tax incentives that promote U.S. jobs and investment. The Green Book does not expand on how this would be implemented.

Repeal FDII: The Green Book would repeal the deduction available to U.S. corporations on their foreign-derived intangible income, sometimes referred to as "FDII." The Green Book states that "resulting revenue will be used to encourage R&D" but provides no concrete details.

Allocate Subpart F and GILTI to U.S. shareholders who sell CFC stock in the middle of the year: The pro rata share rules for Subpart F and GILTI purposes generally only allocate Subpart F income and GILTI inclusions to U.S. Shareholders who hold stock on the last day of the taxable year in which the foreign corporation is a CFC. The proposal would modify the pro rata share rules so that a U.S. shareholder of a CFC that owns, directly or indirectly, a share of stock of the CFC for only part of the CFC's taxable year, but not on the last relevant day, would be required to include in gross income a portion of the foreign corporation's Subpart F income for the year. Such portion would generally be determined by reference to the amount of any dividends paid to such shareholder, or to a CFC of such shareholder, to the extent the dividends were paid out of E&P that would qualify for a 245A DRD. The remainder of the CFC's Subpart F income would be allocated to the U.S. shareholder(s) that owns the stock of the CFC on the last relevant day. The proposal would also similarly revise the pro rata share rules for determining a U.S. shareholder's GILTI inclusion with respect to a CFC.

Expand CFC E&P for purposes of E&P limitation on Subpart F income: The proposal would generally repeal Section 952(c)(3) to the extent it provides that, in calculating the E&P for purposes of the Section 952(c) current E&P limitation on Subpart F income, the CFC is not to take into account installment sales, last-in-first-out (LIFO) inventory adjustments and the completed contract method of accounting. As a result, the E&P of a CFC would be determined for all purposes by taking into account LIFO, installment sales and the completed contract method of accounting.

Expand scope of Section 338(h)(16): This proposal would apply the principles of Section 338(h)(16) to U.S. shareholders who recognize gain in connection with a change of entity classification (for example, via a "check-the-box" election) or on a sale of a "hybrid" entity treated as a corporation for non-U.S. tax purposes but as a partnership or disregarded entity for U.S. tax purposes. This would cause the source and character of any item resulting from such transactions to be determined as if the seller sold or exchanged stock for FTC purposes. This would generally conform the treatment of a "check and sell" transaction with the treatment of a sale of corporate stock subject to a Section 338 election.

The effect of this proposal might be limited if the country-by-country proposals described above are enacted. As noted, those proposals would limit the utility of cross-crediting strategies, which would make the transactions targeted by this proposal less appealing in general. For example, the sale of a CFC with a Section 338 election in a country-by-country FTC regime would be much less likely to give rise to a Section 951A inclusion offset by excess credits.

Limit interest deductions for multinational groups: The proposal contains a limitation on the net interest deductions for U.S. tax purposes, in addition to those provided by current Section 163(j), that applies whenever a member of a "financial reporting group" (generally, a multinational group that prepares consolidated financial statements) has net interest expense for financial reporting purposes that exceeds the member's proportionate share of the financial reporting group's consolidated net interest expense reported on the group's consolidated financial statements. A member's proportionate share of the financial reporting group's net interest expense would be determined based on the member's proportionate share of the group's earnings before interest, taxes, depreciation and amortization (EBITDA) as reflected in the financial reporting group's consolidated financial statements.

Whenever a member has excess financial statement net interest expense, a deduction would be disallowed for the member's excess net interest expense for U.S. tax purposes. On the other hand, if a member's net interest expense for financial reporting purposes is less than the member's proportionate share of the net interest expense reported on the group's consolidated financial statements, such excess limitation would be converted into a proportionate amount of excess limitation for U.S. tax purposes and carried forward three years.

If a member of a financial reporting group is unable to substantiate its proportionate share of the group's net interest expense for financial reporting purposes, or if a member so elects for this alternative rule to apply, then the member's interest deduction

would instead be limited to the member's interest income plus 10% of the member's adjusted taxable income (as defined under Section 163(j)).

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

> ***Worth noting:*** As a result of this definition, this proposal would generally not seem to have much practical effect on a U.S.-parented multinational because it would generally treat both the U.S. subsidiaries and CFCs of a U.S.-parented multinational as a single member of the financial reporting group. Accordingly, this proposal is mostly likely to have an impact primarily on non-U.S.-parented multinationals with U.S. operations.

The proposed rules would apply before the application of Section 265 (as expanded by the rules discussed above), which generally disallows a deduction for amounts allocable to tax-exempt income. The proposed rules contain certain exemptions, such as for financial services entities (which would be excluded from the financial reporting group), and for financial reporting groups that would otherwise report less than $5 million of net interest expense, in the aggregate, on one or more U.S. income tax returns for a taxable year.

Expand dividend equivalent payments to include certain payments with respect to partnerships: The proposal would treat certain payments on derivative transactions with respect to publicly traded partnerships (and certain other partnerships specified in Treasury Regulations) that generate income that is effectively connected with a U.S. trade or business as a U.S. source dividend equivalent payment (generally subject to U.S. withholding tax at a rate of 30%, subject to reduction by an applicable tax treaty).

Expand availability of retroactive QEF elections for PFICs: Under the proposal, taxpayers would be eligible to make a retroactive qualified electing fund (QEF) election with respect to stock owned in a foreign corporation that is treated as a passive foreign investment company (PFIC) without obtaining IRS consent provided the circumstances do not prejudice the IRS. For example, if the taxpayer owned the PFIC in taxable years that are closed to assessment, the taxpayer would need to obtain consent and pay an appropriate amount to compensate the IRS for the taxes not paid in the closed years on amounts that would have been includable in the taxpayer's income if the taxpayer had made a timely QEF election.

Introduce on-shoring and off-shoring incentives: The Green Book provides a business credit for "reducing or eliminating a trade, business, or line of business currently conducted outside the United States and starting up, expanding, or otherwise moving the same trade or business within the United States, to the extent that this action results in an increase in U.S. jobs." It also denies deductions for expenses related to moving jobs out of the United States, and no deduction would be allowed against a U.S. shareholder's GILTI or Subpart F income inclusions for any expenses paid or incurred in connection with moving a U.S. trade or business outside the United States.

> ***Worth noting:*** These proposals lack key details, including (1) specific requirements for attaining the business credit, (2) how to measure a business activity's impact on U.S. jobs and (3) how these incentives avoid violating any World Trade Organization (WTO) and state aid rules.

Partnerships

Tax carried interests as ordinary income: Taxpayers with taxable income over $400,000 who perform services for an "investment partnership" and hold a profits interest in such partnership would be required to pay tax at ordinary rates, as well as pay self-employment taxes on their allocable share of income from that interest and on gains from the sale of that interest. This proposal is substantially identical to the corresponding 2022 Green Book proposal.

Increase and expand the NIIT and harmonize it with SECA: The Green Book proposes to subject all pass-through business income of taxpayers with at least $400,000 of adjusted gross income to either the net investment income tax (NIIT) or Self-Employment Contributions Act (SECA) tax, and to increase the NIIT and additional Medicare tax rates by 1.2% each. This proposal is substantially similar to the corresponding 2022 Green Book proposal, except (1) the increases to the NIIT and additional Medicare tax rates have been added, bringing the maximum rates for each tax to 5% of applicable income above $400,000, (2) the proposals would be retroactively effective for tax years beginning after December 31, 2022, and (3) the NIIT would "phase in" for adjusted gross incomes between $400,000 and $500,000.

Prevent basis shifting through partnerships by related parties: Certain partnership tax rules allow parity to generally be maintained between outside basis (the partners' basis in their partnership interests) and inside basis (the partnership's basis in its assets). For example, if a partnership has in effect a Section 754 election, under certain circumstances, the partnership can step up the basis of its retained assets upon distributing other assets to a partner. If a partnership has inside basis of $100x

in an asset and distributes that asset to a partner who has an outside basis of $60x, then the partner generally will take a basis equal to the lesser of inside and outside basis (here, $60x) in the distributed asset, and the amount of the step-down in the distributed asset (here, $40x) may be allowed as a step-up in the partnership's retained assets due to the Section 754 election.

The Green Book notes that this type of "basis shift" resulting from a Section 754 election is beneficial from a tax perspective when basis is shifted from nondepreciable distributed assets to undistributed depreciable or amortizable assets, and the Green Book proposes to target such basis-shifting transactions by related parties. For any partner in the distributing partnership that is related to the distributee-partner, the proposal applies a "matching rule" that delays the basis step-up of undistributed property until the distributee-partner disposes of the distributed property in a fully taxable transaction.

> ***Worth noting:*** It remains unclear whether the proposal seeks to apply the "matching rule" only to transactions perceived as abusive, or whether it will apply to all basis shifting transactions between related parties. It is similarly unclear what is meant by "related" party in this context.

Amend and expand the centralized partnership audit regime: The Green Book proposes two changes to the centralized partnership audit regime that was implemented starting in 2018. Currently, if an election under Section 6226 (the push out election) results in a net decrease in a partner's tax liability, then that net decrease can reduce the partner's current tax liability to zero, but it permanently disallows the use of any excess amount from reducing subsequent years' tax liabilities. The Green Book proposes to amend the audit regime to permit the carryover of such a reduction in tax that exceeds a partner's current tax liability.

Second, the centralized partnership audit regime currently allows Chapter 1 (income tax) assessments to be made and collected at the partnership level, whereas assessments for taxes under Chapters 2 and 2A (self-employment income tax and net investment income tax) must be made and collected at the partner level. The Green Book notes that these regimes are intrinsically linked, and there is an inefficiency in requiring the IRS to audit a partnership's returns regarding Chapter 1 taxes and the individual partners' returns regarding Chapters 2 and 2A taxes. Accordingly, the Green Book proposes amending the centralized partnership audit regime to include items that affect the partners' Chapters 2 and 2A taxes.

Individuals

Increase top individual rate: The top rate for individual taxpayers would increase from 37% to 39.6%. The number of people subject to this top rate also would increase due to the application of the top rate to income over $400,000 ($450,000 for married taxpayers filing jointly), as compared to $578,125 ($693,750 for married taxpayers filing jointly) in 2023.

> ***Worth noting:*** As in the 2022 version, the Green Book deviates from President Biden's campaign proposals by omitting any revival of the Pease limitation or other policies that would reduce the value of itemized deductions.

Tax capital gains as ordinary income: Currently taxed at preferential rates, long-term capital gains and qualified dividend income would be taxed at ordinary income rates for taxpayers whose income exceeds $1 million ($500,000 for married taxpayers filing separately), indexed for inflation after 2024. The proposal would be effective for gains required to be recognized for dividends received on or after the date of enactment (as opposed to the date of **announcement**, as phrased in the 2022 Green Book, and so without retroactive effect.)

> ***Worth noting:*** Full repeal or partial rollback of the rate preference for long-term capital gains and qualified dividend income would have profound ramifications for individual taxpayers, compounding the incentives to defer realization events for appreciated investments, increasing the economic value of capital losses and capital loss carryforwards, and bringing dividend-bearing equity investments closer to tax parity with interest-bearing debt investments.

Impose a minimum tax on individuals with a net worth over $100 million: In addition to the increased rates that would apply to high earners, the proposed rules include a minimum tax of 25% on total income (comprised of taxable income and unrealized gains on capital and ordinary assets) for individuals with a net worth over $100 million. The tax would be payable in installments: over nine years for the first year in which the tax applies, and over five years for each subsequent year. The tax would be treated as a "prepayment" of capital gains tax, such that the gains would not be taxed again in a later sale or realization event. Taxpayers with a net worth over the threshold would also be subject to annual reporting requirements to the IRS, including descriptions of their assets, liabilities and basis information. If over 80% of an individual's wealth is in illiquid assets, they may be able to defer their tax liability but would be subject to a deferral charge not exceeding 10% of their unrealized gains.

Gifts, Estates and Trusts

Treat transfers of appreciated property by gift or at death as realization events: The Green Book includes sweeping gain recognition proposals, similar to those included in prior Biden administration Green Books. Transfers of appreciated property by gift or at death generally would be treated as recognition

events. Capital gains recognized at death would be able to be offset by capital losses and carryforwards, and the tax on gains recognized at death would be deductible against the estate tax. Limited exclusions from gain recognition would be available, including a $5 million exclusion per taxpayer and exclusions for transfers to a U.S. spouse or charity. Transfers of property to and distributions of property from irrevocable trusts generally also would be recognition events.

Modify the tax rules for grantor trusts and GRATs: Under current law, a grantor is obligated to pay the income tax on income earned by a grantor trust. The Green Book proposals do not eliminate a grantor's obligation to pay the income taxes attributable to a grantor trust but generally would treat the grantor's payment of the income taxes of an irrevocable trust created on or after the date of enactment as a taxable gift. The Green Book proposal also would cause transactions between a grantor and a grantor trust that are disregarded for income tax purposes under current law to be potential gain recognition events.

Grantor retained annuity trusts (GRATs) are a popular type of trust for highly volatile or appreciating assets. After funding a GRAT, the settlor retains an annuity that is based on an IRS-prescribed interest rate. The Green Book proposal would curtail the effectiveness of GRATs, including by requiring (1) GRATs to have a 10-year minimum term and a maximum term that spans the grantor's life expectancy plus 10 years and (2) the GRAT remainder interest to have a value equal to the greater of 25% of the assets contributed or $500,000, but in no event greater than the full value of the assets contributed.

Overhaul the generation-skipping transfer tax: The Green Book significantly modifies the generation-skipping transfer (GST) tax rules. Currently, to the extent GST exemption is allocated to a trust, the trust can exist for multiple generations without being subject to GST tax, and trust distributions to grandchildren and more remote descendants will not incur a GST tax. The Green Book would recognize GST exemption as effective in protecting transfers only to individuals two generations below the transferor; transfers to any younger generation would be protected only in limited circumstances.

Curtail valuation discounts: Factors such as a lack of control and lack of marketability often warrant valuation discounts for transfers of illiquid assets. The Green Book would restrict discounts available under current law, valuing partial interests in nonpublicly traded property transferred to or for the benefit of a family member as a pro rata share of the aggregate interests in the property held by the family. The new rule would apply only to property in which the family has at least a 25% interest.

Restrict the use of defined value formula clauses: Favorable court decisions have upheld taxpayers' use of formula clauses in making gifts of interests in hard-to-value assets. These formulas include as a variable the value of property as finally determined for federal gift or estate tax purposes, permitting taxpayers to make transfers without incurring gift or estate tax if the value of the transferred assets is successfully challenged by the IRS. The Green Book would curtail the ability of taxpayers to effectively utilize formula clauses that adjust the interests in property transferred based on IRS involvement.

Recharacterize trust loans as distributions: Trustees often have the flexibility to loan trust assets to beneficiaries in lieu of making distributions. In a departure from current law, the Biden administration's proposal would treat trust loans to beneficiaries as distributions for income and GST tax purposes. The proposal also would treat a grantor's repayment of a loans from a grantor trust as an additional contribution to the trust for GST tax purposes.

Other

Limit use of retirement accounts by high-income taxpayers: High-income taxpayers (defined as taxpayers with a modified adjusted gross income over $400,000, or $450,000 if married and filing jointly) would be required to distribute at the end of each year at least 50% of any excess over $10 million vested and held under a tax-favored retirement arrangement, including IRAs. Further, if the vested balance exceeds $20 million, high-income taxpayers would be required to distribute at minimum the lesser of (1) the entire excess over $10 million or (2) any portion of the aggregate balance held in a Roth IRA or designated Roth account. Taxpayers failing to satisfy this requirement would be subject to a 25% excise tax on the portion of the distribution not taken (reduced to 10% if corrective action is taken promptly).

> ***Worth noting:*** This change would greatly limit the ability of high-income taxpayers to retain retirement account balances in excess of $10 million. These provisions would be effective for years beginning after December 31, 2023.

Recapture all real property depreciation as ordinary income: Under current law, Section 1250 property (including buildings and certain other depreciable real property) for which depreciation deductions have been taken in excess of the straight-line method are subject to recapture as ordinary income only to the extent of that excess. Any amounts depreciated under the straight-line method are instead generally subject to capital gains treatment on disposition of the property. The Green Book proposal would apply ordinary income treatment to 100% of the amount of any depreciation deductions taken on Section 1250 property held for more than one year.

Worth noting: This change would apply to businesses and individuals with an adjusted gross income of at least $400,000 but would not apply to depreciation deductions taken prior to 2024. Because depreciation deductions taken on Section 1250 property rarely exceed the amount taken under the straight-line method, this would impact most noncorporate holders of depreciable real estate.

Repeal like-kind exchanges: Another proposal would limit eligibility for "like-kind" exchanges under Section 1031. Each taxpayer would be allowed to defer up to $500,000 of gain each year ($1 million for married taxpayers filing jointly) for like-kind exchanges of real property. Gains in excess of that amount would be recognized in the taxable year when the taxpayer transfers the real property. These changes would require real estate investment trusts (REITs) to distribute gains on property sales that could otherwise be deferred under Section 1031. Given timing rules under Section 1031 and the proposal's application to exchanges completed in taxable years beginning after December 31, 2023, this proposal may pick up many exchanges that begin in 2023.

Extend existing rules to encompass digital assets: These proposals amend and clarify several rules to ensure that digital assets (broadly defined as a "digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary") are captured. These include (1) wash sale rules (where an entity sells stock or a security at a loss and they or a related party repurchase the same or substantially identical stock or security within 30 days), (2) securities loan nonrecognition rules (where no gain or loss is recognized in loans of securities meeting certain requirements), (3) Foreign Account Tax Compliance Act (FATCA) reciprocity (which would require U.S. brokers and digital asset exchanges to report information on the substantial foreign owners of passive entities holding digital assets, for the purpose of sharing with FATCA-partner countries), (4) Section 6038D reporting (where individuals holding at least $50,000 in aggregate foreign financial assets must disclose certain information to the IRS), and (5) Section 475 mark-to-market rules (permitting dealers in securities to use the mark-to-market method of accounting with respect to its securities). While these proposals do not generally classify digital assets as "securities" per se, they continue the general governmental trend of extending "security-like" treatment to digital assets.

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