The Tax Law Center NYU LAW

FY 2024 Greenbook Options

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Introduction

This Memo includes selected policy options to consider for the FY2024 Greenbook. We are grateful for the opportunity to offer input as the Administration develops its Greenbook and for your consideration of the options that we describe.

We appreciate that the FY2023 Greenbook included several proposals that we recommended in our December 2021 memo, including options for (i) conforming corporate ownership standards, (ii) reforming grantor trusts, (iii) modifying rules related to grantor retained annuity trusts (GRATs), and (iv) providing for reciprocal reporting under the Foreign Account Tax Compliance Act (FATCA) and other information reporting improvements.

Many of the policy options in this Memo were also provided in our December 2021 memo. We believe that new developments over the past year have strengthened the case for several of the high-priority policies discussed below, including:

- Proposals that increase information reporting, such as those requiring uncertain tax position reporting for pass-through entities and imposing Form 3520 reporting requirements for off-shore trusts brought on-shore. Broader information reporting requirements would enable the IRS to more efficiently use the substantial IRS funding boost provided in the Inflation Reduction Act (IRA) to target non-compliance by high-income people.
- Proposals that improve the Corporate Transparency Act (CTA). Currently, the IRS does not have efficient and effective tools to identify the ultimate beneficiaries of substantial assets held in and income flowing through certain complex tiered structures. The first set of final rules under the CTA from FinCEN does not require beneficial owners to report their taxpayer identification numbers (TINs). If not addressed, this lack of reporting may severely hamper the Administration's ability to achieve its tax compliance and anti-corruption goals. The Administration should consider legislative options to address inadequacies resulting from the text of the CTA, as detailed below.
- Proposals related to pass-through businesses. The substantial IRS funding boost could also support the additional guidance that would be needed to support legislative proposals, as well as increased enforcement efforts in this major area of tax non-compliance among high-income filers.
- Proposals to reinstate the Child Tax Credit (CTC) and Earned Income Tax Credit (EITC) expansions enacted temporarily under the American Rescue Plan (ARP) and make design and delivery improvements to the expanded CTC. Recent research has documented the powerful impact of the EITC and CTC expansions, which achieved historic reductions in child poverty and significant improvements in food security and financial stability among low-income families.

The scope of this Memo is limited. Specifically, this Memo generally does not address:

- Proposals in the FY2023 Greenbook that were not enacted into law, including policies that were incorporated into the baseline for the FY2023 Greenbook;[1]
- Some of the policy decisions with the most significant revenue and policy impacts, including: (i) adjustments to tax rates or thresholds, (ii) the preferred option for addressing unrealized gains, (iii) extending or making permanent various expiring provisions in the law, or (iv) overall revenue goals;
- Critical administrative law issues affecting the federal tax system (such as OIRA review of certain tax regulations and responses to *CIC Services* and other litigation threats); and
- Proposals where there is likely a choice between a legislative and a regulatory option, many of which we discussed in our recommendations regarding the 2022-2023 Priority Guidance Plan (PGP).[2]

While we do not address the aforementioned issues in this Memo, we have given many of them significant thought and would welcome the opportunity to provide input separately. We also note that this Memo accounts for the Administration's stated goal of avoiding tax increases on "small businesses" and individuals making under $400,000 annually.

Corporate and International

As noted above, we focus on proposals not addressed in the FY2023 Greenbook but are happy to provide input on any of the previously proposed measures. We also note that because the FY2023 Greenbook was silent on anti-inversion rules, the sound anti-inversion proposals in the FY2022 Greenbook may be particularly attractive to carry forward.

Further, as indicated above, there are a large number of international tax issues that could be addressed either through regulation or legislation. These issues include: (i) nimble dividends and other issues relating to section 245A; (ii) the scope of section 961(c) (including the changes thereto proposed in various versions of the Build Back Better Act); (iii) consistency of elections among members of a group of foreign corporations under section 957(a)(2); and (iv) many others.

Prevent manipulation of the deduction for foreign-derived intangible income (FDII) through income acceleration

Law: Under current law, the amount of a domestic corporation's FDII for a taxable year for purposes of the section 250 deduction equals the product of its deemed intangible income for the year and the ratio of its foreign-derived deduction eligible income (FDDEI) to its deduction eligible income (DEI) for the year (the foreign-derived ratio).

[1] The FY2023 Greenbook baseline incorporated the revenue provisions in Title XIII of the version of the Build Back Better Act that passed the House of Representatives on November 19, 2021 (the House-passed BBB), except for the modification to the state and local tax deduction. Many of the policies in the House-passed BBB were not ultimately enacted. We assume that versions of these proposals will be under extensive consideration for this Greenbook and are happy to offer views on potential refinements.

[2] See Tax Law Center at NYU Law, Recommendations for the 2022-2023 Priority Guidance Plan, June 2, 2022.

Problem: Assuming a certain amount of FDDEI and DEI over a period of multiple years, taxpayers can increase their amount of FDII by causing the FDDEI to be accrued in a single year.[3] Suppose, for example, that a domestic corporation, DC, expects to earn $100x of DEI for each of the next 5 years, and that $50x in each year is expected to be FDDEI from sales to a foreign related party for on-sale to foreign unrelated parties. On that basis, the foreign-derived ratio would be 50% for each year. If, however, DC accelerates its FDDEI of $200x into the first year of the period by contracting with the related party for pre-payment for the remaining years, the foreign-derived ratio would be 80%, and DC's FDII (and thus, section 250 deduction) would be much higher.

Proposal: If the section 250 deduction for FDII is not eliminated, revise section 250 to prevent manipulation through income "bunching." This could be done by disregarding, for FDII computation purposes only, amounts that are received or accrued in advance of the period to which they are attributable. The disallowance could be limited only to amounts accelerated with a principal purpose of increasing a FDII deduction or from a related party. (Consideration could also be given to whether there is sufficient authority for Treasury and IRS to adopt this proposal through regulatory action under the broad regulatory authority of current section 250(c).)

Revenue: Expected to raise revenue, but the amount is unclear. A reported surge in tax benefits (over $3B from year-to-year) could potentially be attributable, in part, to income "bunching" and suggest significant revenue from disregarding income acceleration for FDII purposes.

Repeal non-qualified preferred stock (NQPS) designation

Law: NQPS is preferred stock with certain debt-like features. Since 1997, NQPS has been treated as taxable "boot" for some purposes and stock for other purposes. The NQPS provisions were enacted in response to concerns that certain types of preferred stock used in tax-free transactions more closely resemble taxable consideration.

Problem: The hybrid treatment of NQPS has made it a staple of affirmative corporate tax planning. In addition, the NQPS provisions add complexity to the Code.

Proposal: Repeal the provisions that treat NQPS as boot and all cross-referencing provisions (e.g., sections 354(a)(2)(C), 355(a)(3)(D), and 356(e)). Most recently, this proposal was included in the FY2017 Greenbook. The JCT analysis of this proposal is included in its description of the FY2013 Greenbook.

Revenue: $146M from 2016-2026 (per JCT, as scored in pre-TCJA context). $430M from 2017-2026 (per the Office of Tax Analysis (OTA)).[4]

[3] In fact, practitioners have highlighted that, "'[l]umpy FDDEI' can increase aggregate FDII." (See slide 15.)

[4] Where possible, we refer to previous revenue estimates for relevant proposals. Many of these were prepared against a different baseline and care should be taken to adjust accordingly when interpreting older estimates.

Tax Administration

Improve the Corporate Transparency Act

Problem: In announcing the initial set of final rules under the CTA, Secretary Yellen suggested that the rules would "level the playing field for honest businesses that play by the rules but are at a disadvantage when competing against bad actors who use shell companies to evade taxes, hide their illicit wealth, and defraud customers and employees." The Administration has also repeatedly stated priorities of (i) combating tax evasion and non-compliance among the wealthy and large businesses, including by focusing the IRS funding in the IRA on that non-compliance; (ii) combating corruption; and (iii) taking a multilateral approach that supports and complies with strong global standards, including by "effectively combat[ing] financial crime alongside our partners and allies."

These priorities are closely linked, but they cannot be fully and most efficiently achieved with the current weaknesses in the CTA that leave some of the most concerning ownership structures in the dark and constrain the extent to which the IRS can use the information that is collected efficiently. The Administration should determine what legislative route it prefers to ensure that the IRS has the information it needs to trace the ownership of income and assets flowing through tiered entities – whether by plugging holes in the CTA or setting up a parallel regime.

There are a number of gaps in the CTA, as implemented by the final rules. We discuss two of the largest gaps below.

First, the final rules do not require beneficial owners to report their TINs.[5] A TIN reporting requirement is important to ensure the IRS can accurately identify and link taxpayer information across entities and tax years. Without this information, investigators will likely need to spend limited and valuable resources verifying the identity of taxpayers and building links across databases and information from multiple sources.[6] If not addressed, this lack of TIN reporting will undermine the Administration's ability to achieve its tax compliance and anti-corruption goals by diverting needed IRS resources.

Second, we are concerned that bad actors will find it easy to work around the CTA's reporting requirements for beneficial ownership in practice. The database of beneficial ownership required by the CTA will not cover trusts, partnerships, or other entities that have no state law filing requirement. This hole is not a marginal issue. As seen previously in tax enforcement, the activities that are most corrosive to tax compliance and the rule of law are likely to flow over time towards these entities. The South Dakota trusts that are a focus of the Pandora Papers do not have a filing requirement at creation, and will become more attractive, not less, as a means to shield assets from tax and other regulatory authorities. Trusts formed elsewhere and later brought

[5] Although the rules require collection of employer identification numbers for domestic reporting companies, this information will not necessarily help the IRS verify beneficial owner identities or link taxpayer information across tax years and entities.

[6] In addition to TIN collection, it is important that the IRS have full, real-time access to the beneficial ownership database to ensure it is highly useful for law enforcement and tax administration purposes. Database access is expected to be addressed in a forthcoming CTA rulemaking.

onshore could also avoid reporting requirements. States may alter their rules for forming other entities to circumvent the CTA. In the absence of additional guidance, reporting companies may attempt to reorganize or convert into nonreporting entities to avoid compliance requirements.

Some of these inadequacies flow directly from the statutory text of the CTA, which was the product of a highly negotiated process during the Trump Administration. To the extent that FinCEN cannot fix all these statutory flaws through regulation, the Biden Administration should pursue legislation to do so. Compared to the Trump Administration, the Biden Administration has far different tax and anti-corruption priorities, and it has different stated views on multilateral cooperation and best practices in the anti-corruption and tax spaces.

Further, the Biden Administration is more aware of how gaping the CTA's largest inadequacies are due to the Pandora Papers stories. It also has an increased ability to counter non-compliance and pursue illicit actors due to the IRA's substantial infusion of funding for IRS enforcement activities. And both domestic and international attention on financial transparency has increased in the wake of the war in Ukraine, given that many sanctioned Russian elites hold extensive assets in the US, often through opaque entities and ownership structures. These developments will place increased scrutiny on whether the Biden Administration meets its stated promises in combating corruption and tax non-compliance. Strengthening the CTA is a crucial step to ensure that the Administration can achieve its priorities.

Proposal: There are two broad legislative strategies available to strengthen the CTA.

The first is to amend the CTA or otherwise legislate to (i) cover some of the most worrisome entities currently left out (certain trusts and partnerships), and (ii) ensure the CTA database is structured to link to TINs and modes of access so that it has practical utility for the IRS. Changes like these are consistent with international best practice that generally apply to all legal entities or associations. The US's current failure to meet these standards has been noted by the EU. The appropriate route for these improvements may not be a Greenbook proposal but should involve substantial Treasury tax input.

The second is to pursue a parallel track (e.g., through reciprocal FATCA[7]) to ensure the IRS has the ability to identify ultimate beneficial ownership of complex webs of entities. This would likely mean some duplication in reporting (as occurs today under the overlapping Foreign Bank and Financial Accounts (FBAR) and Form 8938 requirements). Duplicative reporting is suboptimal – but superior to the IRS not having adequate tools to efficiently identify beneficial ownership and to satisfy its existing information exchange obligations with partner jurisdictions.

We are happy to further discuss detailed options within each of these tracks. In particular, we have given consideration to:

- Ways to bring into the CTA trusts, partnerships, and other entities where there is no state filing requirement at creation, while taking into account the desire to ensure that entity creators can be put on notice about the need to comply through some interaction with a state or federal authority.

[7] See, e.g., FY2023 Greenbook, at 99.

- Ways to ensure that the database is useful in practice for the IRS, including by requiring the listing of TINs for both reporting companies and owners.
- Grouping and attribution rules to prevent avoidance.

Enhance information reporting

Improved information reporting remains crucial to ensure that restored IRS funding is used most effectively and efficiently and meets the Administration's goal to "increase equity in the tax system by enforcing the tax laws against those high-earners, large corporations, and complex partnerships who today do not pay what they owe." The various information reporting proposals proposed and discussed since the FY2022 Greenbook have been a major area of the Tax Law Center's work, and we would be happy to discuss options in further detail as you consider proposals in this space.

Adopt uncertain tax position (UTP) reporting requirement for pass-through entities

Law: Schedule UTP is a form that certain corporations are required to use to report federal income tax positions for which the corporation or a related party has either (i) recorded a reserve for federal income tax in audited financial statements, or (ii) not recorded a reserve because the corporation expects to litigate the position. Pass-through entities are not required to file a Schedule UTP or an equivalent.

Problem: There is substantial non-compliance with federal income tax law among partnerships and other pass-through entities.

Proposal: A requirement similar to Schedule UTP can be applied to certain partnerships to help better target partnership (and, potentially, S corporation) audits. This would likely require a grant of authority that allows the IRS to develop different rules than for current Schedule UTP, because Schedule UTP relies on financial accounting rules that do not generally apply to pass-throughs. This proposal could supplement the FY2023 Greenbook proposal to impose an affirmative requirement to disclose a position contrary to a regulation.

Revenue: Not yet estimated, likely modest, though restored IRS funding may improve chances of a non-negligible score.

Strengthen additional penalties

There are various proposals to increase underpayment penalties for high-net-worth or high-income taxpayers.[8] These proposals could be considered, in addition to the penalty enhancements included in the FY2023 Greenbook, in the development of the FY2024 Greenbook, as they can improve voluntary compliance and equity and build on the Administration's tax compliance agenda, while reinforcing compliance focus on the most egregious forms of tax avoidance and evasion.

Penalties options may also be consistent with the President's strategy on countering corruption. For example, under Objective 2.1, it is contemplated that "Treasury will issue regulations that

[8] See, e.g., the amendments to sections 6662(a) in the Restoring the IRS Act and the Stop CHEATERS Act.

will include reporting requirements for those with valuable information regarding real estate transactions." If this reporting includes tax reporting, appropriate penalty enhancements should be considered.

Enhance IRS hiring authorities

Law: The IRA included significant stable, long-term funding to rebuild the tax system.

Problem: It is crucial for the IRS to be able to rapidly and effectively use the infusion of funding in the IRA to increase compliance and rebuild the tax system. The IRS will need to be able to recruit needed employees quickly and offer attractive pay for employees who are skilled enough to be quickly productive in key roles across all IRS functions, especially Enforcement/Compliance. As part of the investment in the tax system, the House-passed BBB included important hiring authorities that would help the IRS ramp up hiring and recruit highly-skilled employees. These hiring authorities were consistent with IRS requests in recent years. During the legislative process, these hiring authorities were removed, however, likely due to reconciliation rules.

Proposal: Consider whether legislation on hiring authorities is needed to supplement existing hiring authorities that can be utilized through the administrative process, in order to achieve the goals of the IRA's investments in the tax system.

Revenue: Unclear, and would depend on factors including baseline assumptions regarding the extent to which the IRS can utilize existing hiring authorities without additional legislation.

Transfer Tax

The recommendations in this section would generally complement any proposal to address the taxation of unrealized capital gains. We are happy to discuss details of ensuring consistency with any unrealized gains proposal (as well as options for addressing the taxation of unrealized gains more broadly).

Impose Form 3520 reporting requirement for off-shore trusts brought on-shore

Law: Section 6048(c) requires any US person that receives a distribution from a foreign trust to file a Form 3520 reporting (i) the name of the trust, (ii) the aggregate amount of distributions, and (iii) other information the Secretary may prescribe.

Problem: There is no consensus among tax practitioners on whether a Form 3520 must be filed when a foreign trust is brought into a US jurisdiction because domesticating a foreign trust is not technically a distribution from a foreign trust to a US person. Some practitioners will choose to file a "protective" Form 3520 to report the domestication of a foreign trust, though this is not a uniform practice.[9]

Proposal: Treat the change in status from a foreign trust to a domestic trust as a distribution to a US person that requires a Form 3520 filing under section 6048(c). Any filing requirement under

[9] See, e.g., Caroline Jule, IRS Form 3520, Penalties, and Whether to Make a Protective Filing, CPA Journal (December 2017).

this section should require information on the foreign settlor and beneficial owners of the newly domesticated trust. This requirement would put the IRS and lawmakers on notice of how much money is being brought onshore, how often, and to what extent these newly domesticated trusts may be underreporting their federal income tax liability.

Revenue: Unclear but small; more likely to generate scoreable revenue assuming IRS is adequately funded.

Simplify annual exclusion gifts for trusts

Law: The first $16,000 of gifts made to each donee in 2022 is excluded from the donor's taxable gifts. There is no limit to the number of donees to whom such gifts are made in any one year. To qualify for this exclusion, each gift must be of a present interest rather than a future interest in the donated property. The Ninth Circuit has held that a transfer to a trust can qualify as a gift of a present interest if the beneficiary has a right to withdraw the gift, even if the withdrawal right only lasts for a limited period (referred to as *Crummey* powers).

Problem: There is no limit on the number of beneficiaries to whom *Crummey* powers are given. Often, *Crummey* powers are given to multiple discretionary beneficiaries, most of whom would never receive a distribution from the trust. As a result, a significant amount of the contributions made to these trusts can be inappropriately excluded from gift tax.

Proposal: Adopt section 10 of the For the 99.5 Percent Act. This rule would revise section 2503(b) to eliminate the present interest requirement for annual exclusion gifts and define a new category of transfers (without regard to the existence of any withdrawal or put rights). An annual limit of $20,000 (as adjusted for inflation) per donor on the donor's transfers of property within this new category would be imposed. A donor's transfers in the new category in a single year in excess of a total amount of $20,000 would be taxable, even if the total gifts to each individual donee did not exceed $16,000. The new category would include transfers in trust (other than to a trust described in section 2642(c)(2)), transfers of interests in pass-through entities, transfers of interests subject to a prohibition on sale, and other transfers of property that, without regard to withdrawal, put, or other such rights in the donee, cannot immediately be liquidated by the donee.

Revenue: $2.7 billion between 2016-2026, according to JCT for an identical proposal in the FY2017 Greenbook when the annual exclusion gift was $14,000. Note that this estimate assumes a lower basic exclusion amount and higher rates as proposed in the FY2017 budget.

Limit valuation discounts on nonbusiness assets

Law: Valuation is an important concept for transfer tax because it determines the amount of transfer taxes owed. The law allows partial interests in operating businesses to be valued lower than a proportionate share of the business's total fair market value to reflect lack of marketability or lack of control.

Problem: Often, ultra-high-net worth individuals take advantage of valuation discounts in their transfer tax planning. First, they stuff non-business assets (notably liquid assets) that are beyond the reasonable needs of working capital into their family-owned businesses. Then, when they

transfer partial interests in the business to their trusts or family members, the partial interest is subject to a valuation discount for purposes of calculating any transfer taxes owed. By stuffing non-business assets into operating businesses, these taxpayers artificially reduce the value of what are otherwise liquid or passive assets.

Proposal: Adopt section 138210 of H.R. 5376 as reported in the House on September 27, 2021 (the September 27 Ways and Means draft). This proposal limits valuation discounts on non-business assets in entities that are beyond the reasonable needs of working capital for the business.

Revenue: $19.9 billion between 2022-2031, according to JCT.

Miscellaneous

Strengthen protections against investments in non-public assets and self-dealing in "Mega-Roths"

Law: There are few limitations on the types of assets that can be held in an individual retirement account (IRA) under sections 408 and 4975. Existing self-dealing rules under section 4975 allow IRA owners to invest IRA assets in entities in which they have up to a 50% interest, and to invest IRA assets in entities where they act as company officers.

Problem: Tax-preferred retirement accounts like IRAs were intended to enable the middle class to save for retirement. Ultra-wealthy individuals with access to non-public securities are able to contribute these assets to a Roth IRA and allow them to grow tax-free (reported in one case to be over $5 billion).[10] IRA investment in entities where owners have privileged information or the ability to control entities' actions could lead to conflicts of interest or workarounds of IRA rules.

Proposal: Prohibit IRAs from holding assets that are not publicly traded, as suggested by Daniel Hemel and Steve Rosenthal in their statement for the record to the Senate Finance Committee. In addition, implement self-dealing language from section 138314 of the September 27 Ways and Means draft changing the ownership threshold for the prohibition on self-dealing for IRAs from a 50% interest in an entity to 10% interest and prohibiting investment of IRA assets where the IRA owner is an officer.

The approaches in section 138312 of the September 27 Ways and Means draft and the Retirement Improvements and Savings Enhancements Act of 2016 (RISE Act) discussion draft to preventing IRAs from holding undervalued non-publicly traded assets are different from each other and from the approach suggested by Hemel and Rosenthal. Section 138312 of the September 27 Ways and Means draft prohibits IRAs from holding assets whose issuers require IRA owners to represent that they have qualifications such as minimum income or credentials, due to the general rule that nonpublic securities are required to be sold to accredited investors. However, there are many exceptions to the general rule that nonpublic securities are required to

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[10] Similar concerns have been raised about private placement life insurance policies. Consideration could be given to restrictions on such policies analogous to those considered for IRAs, including not only limitations on investments in non-publicly traded assets, but also limitations on amounts invested through such policies that are eligible for tax-preferred treatment. See, e.g., sections 138301 and 138302 of the September 27 Ways and Means draft.

be sold to accredited investors (including for founders' stock in Section 4(a)(2) of the Securities Act and smaller offerings in Sections 406 and 408 of Reg D, among others), and issuers often do not require such information from IRA owners in transactions involving nonpublic securities.

The RISE Act discussion draft would prohibit IRAs from holding assets acquired for less than fair market value. However, this approach would be difficult to administer since it would require IRS resources for valuation of such assets. Taxpayers could potentially also have a strong argument that assets acquired early on in a company's life cycle were indeed acquired for fair market value.

Revenue: JCT estimated that language prohibiting IRAs from holding assets whose issuers required buyers to be licensed (similar to, but not a complete ban on nonpublic assets) would raise $1.7 billion between 2022-2031. Strengthening self-dealing rules would raise $42 million between 2022-2031.

Close capital gains loophole for exchange-traded funds

Law: Under section 852(b)(6), if an exchange-traded fund (ETF) or other regulated investment company (RIC) distributes appreciated securities or other property, no gain recognition is required.

Problem: Section 852(b)(6) allows deferral and even complete avoidance of tax on gains in ways that investors investing independently and even through mutual funds cannot achieve. This causes multiple negative consequences, including extreme forms of tax avoidance such as "heartbeat trades," in which investment banks partner with ETFs to cycle large stock portfolios into funds and then quickly out of them using in-kind redemptions. These trades are called "heartbeats" because they are far larger than the fund's typical trading activity. The sole purpose of these transactions – often worth billions of dollars – is to avoid capital gains taxes. The use of in-kind redemptions as a tax avoidance strategy has been described as a "sham", a "dodge," a "swindle," and, by one fund manager, "Wall Street's dirty little secret."

The avoidance conducted by ETFs is ultimately most beneficial to high-net-worth individuals. The flow of funds into ETFs is driven disproportionately by high-net-worth individuals – recent research found that "allocations to ETFs by investment advisors of high-net-worth clients are nearly four times more than investment advisors with low or no high-net-worth clients." And, even for lower-income individuals who may invest in ETFs, the tax benefits they receive from this loophole pale in comparison to those received by wealthy individuals because lower-income people have a zero or low capital gains tax rate. Accordingly, there is no or less tax advantage to low-income investors from investing through a vehicle like an ETF that offers capital gains tax avoidance as a key part of its return to investors.

Proposal: Repeal the exemption in section 852(b)(6) for RICs that allows them to distribute appreciated property in kind to a redeeming shareholder without realizing capital gains. This measure is implemented at the entity level and would close a true loophole (i.e., unintended use of a statutory provision for tax avoidance). It would bring into the capital gains tax base substantial gains that are not currently realized due to ETFs' unintended use of section 852(b)(6) for in-kind redemptions. It is important that the Greenbook address holes in the capital gains tax

base given that other legislative proposals addressing unrealized gains largely do not address this issue.

Revenue: $205 billion over 10 years, according to JCT.

Phase out section 199A deduction above $400,000

Law: Section 199A allows individual owners of sole proprietorships, S corporations, or partnerships to deduct up to 20% of their qualified business income (QBI), plus up to 20% of real estate investment trust dividends and qualified publicly traded partnership income. Certain types of industries (primarily white-collar service providers) are subject to income-based phase-outs beginning at $207,000 for single filers.

Problem: Section 199A benefits particular industries and not others with no logical rationale and creates regulatory complexity for small businesses. The vast majority of the tax benefit goes to the top 1% of income earners (JCT estimates 61% in 2024).

Proposal: Include the Biden campaign proposal to eliminate the section 199A deduction for filers with incomes above $400,000. It would raise more revenue and be more progressive than House and Senate proposals.

The Small Business Tax Fairness Act, introduced by Senator Wyden, eliminates industry distinctions and makes all eligible for the deduction, but phases out the deduction for individuals earning $400,000 and above (excluding net capital gains). It was not scored, but JCT tables from 2018 indicated the section 199A deduction benefit to individuals earning over $500,000 was $21.4 billion in 2018 and projected to be $36.9 billion in 2024.

Making the deduction more generous below the $400,000 income threshold is unnecessary and would encourage even more filers in service industries including banking, law, and consultancy to attempt to recharacterize income to get the deduction and pose major compliance risks, especially as the Administration focuses compliance efforts and new enforcement resources on higher income filers and businesses. The September 27 Ways and Means draft would limit the total maximum deduction size to $400,000 on an individual return ($500,000 on a joint return) and raise $78.025 billion over 10 years. However, this approach would still leave in place the existing structure of a deduction that is regressive, and, if extended, would serve as a continued tax cut for wealthy filers after 2025. Since the deduction allows filers to deduct up to 20% of their QBI, an individual could make up to $2 million in QBI before being affected by the $400,000 maximum individual deduction.

Revenue: The Tax Policy Center estimated revenue from Biden's campaign proposal at $143.4 billion from 2021 to 2030.

Adopt selected reforms to pass-through entity rules

Proposal: In September 2021, Senate Finance Committee Chair Ron Wyden released a discussion draft of proposed changes to pass-through rules. In addition to the rules concerning gain recognition by RICs (Section 17) described above, consider including some of the other discussion draft proposals, particularly those related to the requirement to use remedial

allocations (Section 3), mandatory revaluations (Section 4), and mandatory basis adjustments (Sections 13 and 14).[11]

Revenue: JCT has produced estimates of the Wyden proposals suggesting that they raise revenues of more than $150 billion over ten years.

Reform nonqualified deferred compensation (NQDC)

Law: Section 409A allows for certain deferred compensation arrangements as long as they meet section 409A requirements, including limitations on distributions, timing of elections, etc.

Problem: This allows highly compensated individuals to defer income tax, and for a higher percentage of their compensation as compared to qualified plans.

Proposal: Implement section 409B, which was included in the House Republicans' initial Tax Cuts and Jobs Act (TCJA) proposal, requiring that all NQDC become includible in gross income once a substantial risk of forfeiture no longer exists (i.e., when required services for compensation have been performed).[12] Stock options would be taxable in the year vested, deferred salary would be taxable in the year earned, and continuing severance payments would be taxable in the year of separation.

Revenue: JCT estimated revenue at $16.2 billion between 2018-2027 in the TCJA draft.

Limit deductions for compensation in excess of $1 million

Law: Section 162(m) limits the ability of a public company to deduct remuneration paid to a "covered employee" to the extent remuneration exceeds $1 million. These limits do not apply to businesses that are not public companies, or in cases where remuneration in excess of $1 million is paid to a non-covered employee.

Problem: The limited scope of section 162(m) creates horizontal inequities in violation of basic tax policy principles. There is no clear tax policy rationale to have these limits apply to public companies, but not private companies, or to be limited to a subset of employees.[13]

Proposal: Expand section 162(m) to cover all employees of all corporations, as proposed in H.R. 697[14] and S. 178,[15] and consider expanding to all businesses.

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[11] We appreciate that some of the related party transactions targeted by the discussion draft would also be addressed by a proposal in the FY2023 Greenbook. See pages 11-12. We believe it is still worth exploring, however, the mandatory basis adjustment rules in the discussion draft.

[12] Although a proposal in the FY2023 Greenbook would require employers to withhold additional tax on nonqualified deferred compensation, it would leave individual deferral benefits largely intact. See page 81.

[13] There may be policy reasons other than tax policy reasons to treat public and private companies differently. There are other proposals in Congress that are worth considering that would deny deductions or other tax benefits to achieve non-tax goals. See, e.g., S. 141, the End Taxpayer Subsidies for Drug Ads Act (eliminating deductions for direct-to-consumer pharmaceutical ads), and H.R. 12, the American Jobs Act of 2011, H.R. 4199, the Jets for Vets Act of 2012 (requiring straight-line depreciation over 12 years for all corporate aircraft.)

[14] See H.R. 697, the Stop Subsidizing Multimillion Dollar Corporate Bonuses Act.

[15] See S. 178, the Stop Subsidizing Multimillion Dollar Corporate Bonuses Act.

Revenue: A press release issued in February 2021 suggested that the changes proposed in H.R. 697 and S. 178 could raise $17.8 billion over ten years. However, intervening factors, including an expansion of the scope of section 162(m) in the ARP, and the adoption of the corporate book minimum tax in the IRA, may tend to reduce revenue from these changes.

Increase excise tax on tobacco

Background: Tobacco prices are an effective public health tool. They are proven to reduce youth tobacco use: Every 10% increase in the real price of cigarettes reduces childhood smoking by approximately 7%. Federal tobacco taxes have not been increased since 2009. There are numerous different tax bases for different types of tobacco products, resulting in very different tax rates across products.

Proposal: Consider including a proposal similar to section 138504 of the September 27 Ways and Means draft. This is similar to a proposal included in several Greenbooks through and including FY2017. It would harmonize tax rates across different tobacco products and increase tax rates. The Administration has already taken the position that these proposals do not violate the pledge to avoid tax increases on those with incomes below $400,000. The inclusion of tobacco tax increases in the September 27 Ways and Means draft drew support from a wide range of health equity advocates due to its potential to improve health equity.

Revenue: JCT estimated this provision would raise $96 billion over the next decade. However, some of that revenue is attributable to a narrower nicotine tax that was part of the House-passed BBB.

Child Tax Credit (CTC)

We anticipate that, consistent with the Administration's strong support for the EITC and CTC, the Greenbook will propose reinstating through 2025, or making permanent, the EITC and CTC expansions that were enacted temporarily under the ARP and that would have been extended for one year under the House-passed BBB. We strongly support those policies. The Greenbook should also include the important improvements to the Advance CTC's design and administration, many of which were proposed in the September 27 Ways and Means draft, but that were dropped from the House-passed BBB only because the one-year extension of the monthly CTC did not provide enough time to implement a transition to these sound changes.

Adopt Advance CTC design and delivery improvements proposed in the September 27 Ways and Means draft

Law: Under the ARP, eligibility for monthly CTC payments throughout 2021 was estimated in advance – using information pulled from prior year tax returns or provided through the non-filer portal – and finalized at tax time the following year. Furthermore, children had to meet several requirements under the CTC's "qualifying child" definition in order to be claimed for the credit. These qualifying child rules remain in effect today.

Problem: Repayments of the Advance CTC were necessary for middle-income filers[16] when changes in family circumstances,[17] such as a parental separation or another event altering a child's living arrangements, led to a mismatch between a filer's estimated eligibility and their final eligibility. Widespread repayment obligations of child tax credits or allowances in other countries have led to significant hardship for families, political problems, and program instability. Furthermore, the "relationship test" and "residency test" under the qualifying child definition continue to exclude hundreds of thousands of children who live with certain extended family members or close friends, or do not live with the same caregiver(s) for more than half of the year.

Proposal: Reinstate the Advance CTC and adopt several changes to the credit's design and administration proposed in section 137103 of the September 27 Ways and Means draft, including:

- Determining eligibility for the credit on a monthly (rather than annual) basis, allowing the credit to "follow the child" when they change residences.
- Adopting a "presumptive eligibility" rule, so that when someone files their taxes (or uses the non-filer portal) and prospectively claims that they expect a child to remain in their care, all payments issued to that person throughout the year would be considered "presumptively valid" unless and until another caregiver alerts the IRS that payments should go to them instead.
- Shifting to a more inclusive "specified child" definition that includes a version of a "primary caregiver" eligibility test. Some modifications could be considered based on subsequent commentary on the Ways and Means proposal.
- Investing in a host of administrative and delivery improvements, including automatic enrollment of newborns, cross-enrollment based on other public benefits, and an expedited dispute resolution and appeals process.

Revenue: Likely small. However, other countries' experiences indicate that shifting to monthly and presumptive eligibility rules could be less expensive policies to minimize repayment risks than longer-term or permanent extension of "safe harbor" provisions.

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[16] Families with low incomes (single filers earning below $40,000 and married filers earning below $60,000) were fully protected in 2021 from all repayment obligations through a "safe harbor," but moderate-income families still faced substantial repayment risks if they were delayed in reporting changes in family circumstances to the IRS.

[17] Because the Advance CTC delivered a flat benefit amount to single filers earning less than $112,500 and married filers earning less than $150,000, low- and middle-income filers generally did not need to repay the CTC if their incomes increased in 2021.