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Legislative and Accounting Standards Update

Presented by

FEI San Antonio Chapter

June 24, 2021

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Legislative and Accounting Standards Update

June 24, 2021
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Agenda

• Recent accounting standards
• Legislative and other developments, including US Economic and tax policy update
Presenters

► Amy Grubbs, Assurance Managing Director

► Adam Guerrero, Tax Senior Manager

► Lee Sinclair, Tax Senior Manager
Recent accounting standards update
Agenda

- Credit losses (ASU 2016-13)
- Distinguishing liabilities from equity (ASU 2020-06)
- Clarifying the interactions between ASC 321, ASC 323 and ASC 815 (ASU 2020-01)
- Derivative and hedge accounting
- Share-based consideration payable to a customer (ASU 2019-08)
- Other ASUs
Credit losses (ASU 2016-13)

- FASB deferred effective dates for its new standard on credit losses for all entities except SEC filers that are not smaller reporting companies (SRCs)

- The table below shows the updated effective dates:

<table>
<thead>
<tr>
<th>Effective dates</th>
</tr>
</thead>
<tbody>
<tr>
<td>SEC filers excluding SRCs</td>
</tr>
<tr>
<td>-------------------------</td>
</tr>
<tr>
<td>2020*</td>
</tr>
</tbody>
</table>

*Early adoption is permitted in fiscal years beginning after 15 December 2018, including interim periods in those fiscal years

*Including interim periods within the fiscal year

- FASB deferred effective dates for its new standard on credit losses for all entities except SEC filers that are not smaller reporting companies (SRCs)
Credit losses (ASU 2016-13)
CECL: Q1 2020 disclosures

- Review of 100 bank Q1 2020 CECL disclosures
  - Only 21% disclosed the macroeconomic inputs used in their forecasts
  - COVID-19 disclosures
    - All qualitatively stated the pandemic impacted the allowance, but the level of detail provided varied. Some provided impact to certain hard-hit industries

Unemployment: 71
Gross Domestic Product: 58
Real estate prices (National Home Price Index or local indexes): 46
Interest rates: 19
Corporate credit spreads: 14
US equity prices: 12
Consumer Price Index (or other consumer index): 9
Oil/energy prices: 9

42% Disclosed use of a third-party forecast
21% Quantified macroeconomic inputs used in their forecasts
26% Disclosed a probability weighting of forecasts
35% Quantified their exposure to entities in industries heavily impacted by the COVID-19 pandemic (e.g., retail, travel, oil and gas)
21% Disclosed a material change to internal control over financial reporting
Credit losses (ASU 2016-13)  
Challenging practice areas and COVID-19 considerations

**Risk of loss**
- Do assets in each respective pool continue to exhibit similar risk characteristics?
- Has a loan’s risk characteristics changed due to exposure to a particular industry or geographical concentration that might have been impacted more significantly by COVID-19?
- Are we using external data in our estimates or to inform our decisions about segmentation?

**Economic forecasts**
- How will anticipated future economic conditions impacted by COVID-19 impact loss expectations?
- How will current market conditions affect the likelihood of future credit default events?
- Will entities need to consider changes to the reasonable and supportable forecast period and the method of reversion to historical information as a result of greater uncertainties in economic forecast and lack of historical information?

**Determining life of an asset**
- Will estimated prepayments need to change?
- Will modifications change the life of the asset?

**Data and model governance**
- How are we addressing data limitations that may have been identified?
- How are we addressing model limitations identified during our validation process?
- Will a greater reliance on qualitative adjustments be required?
Distinguishing liabilities from equity (ASU 2020-06)

### Effective dates for calendar-year entities

<table>
<thead>
<tr>
<th>Public business entities (PBEs) other than SRCs</th>
<th>All other entities</th>
<th>Early adoption?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1 2022</td>
<td>2024</td>
<td>Yes</td>
</tr>
</tbody>
</table>

► Early adoption:

► For all entities, early adoption is permitted for fiscal periods beginning after December 15, 2020, including interim periods within the same fiscal year

► Entities may apply the new recognition and measurement guidance to convertible securities with down-round features for fiscal years beginning after 15 December 2019 if they have not yet issued or made available for issuance financial statements that reflect the guidance in ASU 2017-11 on accounting for those securities
Distinguishing liabilities from equity (ASU 2020-06)

**Convertible instruments**

- The new guidance eliminates two of the three models in ASC 470-20 that require separate accounting for embedded conversion features.
- Only conversion features accounted for under the substantial premium model in ASC 470-20 and those that require bifurcation in accordance with ASC 815-15 will be accounted for separately.

<table>
<thead>
<tr>
<th>Legacy GAAP</th>
<th>ASU 2020-06</th>
</tr>
</thead>
<tbody>
<tr>
<td>Embedded derivative</td>
<td>Embedded derivative</td>
</tr>
<tr>
<td>Substantial premium</td>
<td>Substantial premium</td>
</tr>
<tr>
<td>Cash conversion</td>
<td></td>
</tr>
<tr>
<td>Beneficial conversion feature</td>
<td>No separate accounting for the embedded conversion feature</td>
</tr>
<tr>
<td>Traditional convertible debt</td>
<td></td>
</tr>
</tbody>
</table>
Distinguishing liabilities from equity (ASU 2020-06)

Contracts in an entity’s own equity

► The ASU also simplifies the settlement assessment for equity classification
  ► No longer have to assess whether an equity contract permits settlement in unregistered shares
    ► Equity classification is precluded if the contract explicitly requires cash settlement when registered shares are unavailable
    ► Equity classification is permitted if a contract is silent about cash settlement if registered shares are unavailable and/or permits unregistered share settlement
  ► No longer have to assess whether an equity contract requires any collateral or provides the holder with rights that rank higher than shareholder rights upon bankruptcy
  ► No longer have to consider penalty payments

► The guidance also requires freestanding equity contracts that do not meet the definition of a derivative to be subsequently measured at fair value through earnings if they are not indexed to an entity’s own equity under ASC 815-40-15
Distinguishing liabilities from equity (ASU 2020-06)

Key disclosure requirements

For both convertible instruments and equity contracts, disclose all pertinent terms and features of the instruments and information about events, conditions and circumstances that can affect how users assess the amount or timing of an entity’s future cash flows related to those instruments.

For the convertible instruments under the substantial premium model inASC 470-20, disclose the premium amount recorded as paid-in capital.

PBEs must disclose the fair value and level of the fair value hierarchy for each convertible debt instrument.

When calculating diluted earnings per share, entities will:

- Use average market price to calculate the denominator.
- Use the if-converted method for all convertible instruments.
- Include the effect of potential share settlement (if the effect is more dilutive) for instruments that may be settled in cash or shares (except for certain liability-classified share-based payment awards).
Distinguishing liabilities from equity (ASU 2020-06)

► The ASU allows entities to use a modified or full retrospective method of transition
  ► Modified method: apply the guidance to all financial instruments that are outstanding as of the beginning of the year of adoption with the cumulative effect recognized as an adjustment to the opening balance of retained earnings
  ► Full retrospective method: apply the guidance to all outstanding financial instruments for each prior reporting period presented with the cumulative effect recognized as an adjustment to the opening balance of retained earnings for the earliest period presented
  ► May irrevocably elect the fair value option under ASC 825-10 for any financial instrument that is a convertible security
The ASU was issued in response to stakeholder questions about the interactions between the accounting for investments in equity securities (ASC 321), the equity method (ASC 323) and the accounting for derivatives (ASC 815). It clarifies that:

- An entity that applies the measurement alternative in ASC 321 should consider all observable transactions, including those that result in the entity initially applying or discontinuing the use of the equity method of accounting under ASC 323.

- Certain forward contracts and purchased options to purchase equity securities, that individually or with existing investments would be accounted for under ASC 323 or the fair value option in ASC 825 upon settlement, are in the scope of ASC 321.

- The amendments in this guidance are applied prospectively.

### Effective dates for calendar-year entities

<table>
<thead>
<tr>
<th></th>
<th>PBEs</th>
<th>Non-PBEs</th>
<th>Early adoption?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1 2021</td>
<td></td>
<td>2022</td>
<td>Yes</td>
</tr>
</tbody>
</table>
Derivative and hedge accounting
Challenging practice areas and COVID-19 considerations

► Cash flow hedges
  ► Discontinue hedge accounting when hedged forecasted transaction is no longer probable of occurring by the end of the originally specified time period
  ► For discontinued hedges, determine whether amounts previously recorded in accumulated other comprehensive income (AOCI) need to be immediately reclassified into earnings or can still be deferred in AOCI
    ► Consider the exception in ASC 815 when extenuating circumstances outside the company’s control cause the forecasted transaction to be probable of occurring more than two months after the originally specified time period
    ► FASB clarified companies may apply this exception to forecasted transactions delayed due to effects of COVID-19

► Assessment of hedge effectiveness
  ► Price volatility could affect whether hedges continue to be highly effective
  ► May need to switch from a qualitative to quantitative method of assessment
  ► Changes in credit risk could affect fair value estimates of derivatives and hedge effectiveness

► Normal purchases and normal sales scope exception
ASU requires entities to measure and classify share-based payments that are granted to a customer in conjunction with a revenue arrangement and are not in exchange for a distinct good or service* in accordance with ASC 718

- Grant date fair value reduces the transaction price under ASC 606
- Changes in fair value after the grant date (e.g., for a liability-classified award) are recorded, in accordance with ASC 718, elsewhere in the income statement

<table>
<thead>
<tr>
<th>Effective dates for calendar-year entities</th>
</tr>
</thead>
<tbody>
<tr>
<td>PBES, plus other entities that have adopted ASU 2018-07</td>
</tr>
<tr>
<td>Q1 2020</td>
</tr>
</tbody>
</table>

* Share-based payments (both equity-classified and liability-classified) granted to a customer to acquire distinct goods or services are subject to ASC 718 upon adoption of ASU 2018-07

** Early adoption is permitted but cannot precede an entity’s adoption of ASU 2018-07
Other standards effective after 2020 for calendar year-end nonpublic entities

### Other ASUs

| ASU 2020-06, Debt – Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging – Contracts in Entity’s Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity’s Own Equity |
| ASU 2020-01, Investments – Equity Securities (Topic 321), Investments – Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815) – Clarifying the Interactions between Topic 321, Topic 323, and Topic 815 (a consensus of the Emerging Issues Task Force) |
| ASU 2019-12, Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes |
| ASU 2019-11, Codification Improvements to Topic 326, Financial Instruments – Credit Losses |
| ASU 2019-05, Financial Instruments – Credit Losses (Topic 326): Targeted Transition Relief |
| ASU 2019-04, Codification Improvements to Topic 326, Financial Instruments – Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments |
| ASU 2019-02, Entertainment – Films – Other Assets – Film Costs (Subtopic 926-20) and Entertainment – Broadcasters – Intangibles – Goodwill and Other (Subtopic 920-350): Improvements to Accounting for Costs of Films and License Agreements for Program Materials (a consensus of the Emerging Issues Task Force) |
| ASU 2019-01, Leases (Topic 842): Codification Improvements |

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3 ASU 2020-05 deferred the effective date for the new standard on leases for entities that are not PBEs; not NFP entities that have issued, or are conduit bond obligors for, certain securities; and not employee benefit plans that file or furnish financial statements with or to the SEC.
Other standards effective after 2020 for calendar year-end nonpublic entities

<table>
<thead>
<tr>
<th>ASU 2018-20, Leases (Topic 842): Narrow-Scope Improvements for Lessors³</th>
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<tr>
<td>ASU 2018-19, Codification Improvements to Topic 326, Financial Instruments – Credit Losses</td>
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<tr>
<td>ASU 2018-18, Collaborative Arrangements (Topic 808): Clarifying the Interaction between Topic 808 and Topic 606</td>
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<td>ASU 2018-17, Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities</td>
</tr>
<tr>
<td>ASU 2018-16, Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes</td>
</tr>
<tr>
<td>ASU 2018-12, Financial Services – Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts</td>
</tr>
<tr>
<td>ASU 2018-11, Leases (Topic 842): Targeted Improvements³</td>
</tr>
<tr>
<td>ASU 2018-10, Codification Improvements to Topic 842, Leases³</td>
</tr>
<tr>
<td>ASU 2018-01, Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842³</td>
</tr>
<tr>
<td>ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities</td>
</tr>
<tr>
<td>ASU 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment</td>
</tr>
<tr>
<td>ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments</td>
</tr>
<tr>
<td>ASU 2016-02, Leases (Topic 842.3)</td>
</tr>
</tbody>
</table>
Legislative and other developments
Agenda

► Legislative and other developments
► Reporting income taxes in an interim period
► Simplifying the accounting for income taxes (ASU 2019-12)
► Tax Basis Capital Account Reporting
Legislative and other developments
Significant legislation enacted in the current quarter

US Federal

► **Federal** – on 11 March 2021, President Biden signed the American Rescue Plan into law. The new law:

► Repeals the election under which US affiliated groups may allocate interest expense on a worldwide basis effective for tax years beginning after 31 December 2020

► Extends the $1 million cap on deductions for compensation paid to executives of publicly traded corporations to include compensation paid to the eight highest-paid individuals (rather than three highest) after the CEO and the CFO effective for tax years after 2026

► Extends the period for which companies may claim an employee retention credit
Legislative and other developments
Other considerations

US Federal

- Final regulations outline how to apply the limitation on business interest expense under IRC Section 163(j) to controlled foreign corporations (CFCs) and partnerships. The final regulations adopt, with significant revisions and clarifications, the proposed regulations issued in July 2020.

- Final regulations include guidance on the timing of income inclusion for taxpayers whose applicable financial statement (as defined in IRC Section 451 and its regulations) uses an accrual method of accounting. The regulations also address advance payments for goods, services and certain other items. Key issues addressed in the regulations include:
  - Application of IRC Section 61 before recognizing income under IRC Section 451
  - The coordination of tax items and methods with those used for financial reporting purposes
  - The application of special methods of accounting for income and optional “cost offset” methods to limit acceleration of income
Final regulations address deductibility limits under IRC Section 162(f) for fines, penalties and other amounts paid to, or at the direction of, government entities (and other identified entities), regardless of whether the taxpayer admits that it violated a law. The final regulations also address the requirements that taxpayers must satisfy to deduct payments characterized as restitution, remediation or an amount paid to comply with a law.

Final regulations address the tax treatment of carried interest under IRC Section 1061, which generally taxes gains from certain carried interest arrangements at ordinary tax rates (rather than long-term capital gains rates) if the interests were held from one to three years. The final regulations adopt the proposed regulations, with changes, and generally apply to tax years beginning on or after 19 January 2021.
Reporting income taxes in an interim period
Reporting income taxes in an interim period
Estimated annual effective tax rate (EAETR) reminders

► Estimate annual effective tax rate for full fiscal year at end of each quarter
  ► Record tax on current year-to-date basis using the EAETR
  ► Project year-end temporary differences
  ► Include tax effect of expected valuation allowance for originating deferred tax assets (DTAs) and net operating losses (NOLs)
  ► Revise estimates of annual effective tax rate at end of each quarter

► Exclude certain items from EAETR and record as discrete items:
  ► Changes in tax law or rate
  ► Changes in recognition or measurement of uncertain tax positions
  ► Discontinued operations
  ► Significant and either unusual or infrequent
Reporting income taxes in an interim period
Estimated annual effective tax rate (EAETR) reminders

- Current market conditions may affect ability to calculate the EAETR

If unable to estimate *part of* ordinary income or related tax expense
- Record tax expense applicable to item that cannot be estimated in same quarter item is reported

If unable to estimate EAETR
- Record tax expense based on the actual effective tax rate for year to date

If a separate jurisdiction anticipates a loss and tax benefit cannot be recognized
- Separately compute estimated annual effective tax rate for the jurisdiction
**Simplifying the accounting for income taxes — ASU 2019-12**

**Effects on quarterly income tax accounting**

<table>
<thead>
<tr>
<th>Amendment</th>
<th>Effect</th>
<th>Transition method</th>
</tr>
</thead>
</table>
| Eliminates exception to allocate income tax expense (benefit) to components in financial statements | ➤ When allocating income tax expense (benefit) to continuing operations, only consider income (loss) from continuing operations  
➤ Does not change total expense (benefit) for the period | Prospective                                                |
| Eliminates exception to calculate income tax for an interim period         | ➤ Income tax benefit is not limited to the benefit based on year-to-date ordinary loss if realizable  
➤ Does not change total benefit for the year | Prospective                                                |
| Aligns principle to include effects of new tax laws in the interim period that includes enactment date | ➤ All effects of tax law changes are recorded in the interim period that includes the enactment date, which accelerates the recognition of effects of a rate change in an interim period | Prospective                                                |
Simplifying the accounting for income taxes — ASU 2019-12
Eliminating exception limiting income tax benefit in an interim period

**Facts**

- Estimated ordinary loss for the year of ($20,000), made up of:
  - Q1: ($30,000), Q2: $15,000, Q3: $5,000, Q4: ($10,000)
- Estimated tax credits of $1,000
- Income tax rate of 25%
- More likely than not that tax benefit from loss and tax credits are expected to be recognizable as a deferred tax asset at the end of the year

**EAETR calculation**

<table>
<thead>
<tr>
<th>Before and after adoption</th>
<th>Tax benefit from the loss at statutory rate</th>
<th>$5,000</th>
<th>($20,000 x 25%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax benefit from the tax credits for the year</td>
<td>1,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net tax benefit</td>
<td>$6,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EAETR</td>
<td>30%</td>
<td>($6,000 / $20,000)</td>
<td></td>
</tr>
</tbody>
</table>
Simplifying the accounting for income taxes — ASU 2019-12
Example: Eliminating exception to calculating income tax expense for an interim period

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Ordinary income (loss)</th>
<th>Quarter-to-date taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Before adoption</td>
</tr>
<tr>
<td></td>
<td>Quarter</td>
<td>Year-to-date (YTD)</td>
</tr>
<tr>
<td>Q1</td>
<td>($30,000)</td>
<td>($30,000)</td>
</tr>
<tr>
<td>Q2</td>
<td>15,000</td>
<td>(15,000)</td>
</tr>
<tr>
<td>Q3</td>
<td>5,000</td>
<td>(10,000)</td>
</tr>
<tr>
<td>Q4</td>
<td>(10,000)</td>
<td>(20,000)</td>
</tr>
<tr>
<td>Year</td>
<td>($20,000)</td>
<td>($6,000)</td>
</tr>
</tbody>
</table>

* Before the adoption of ASU 2019-12, when a YTD loss exceeded the estimated ordinary loss for the year, the income tax benefit in the YTD period was limited to the amount that would be recognized if the YTD ordinary loss were the estimated loss for the year ($8,500 = ($30,000 * 25% = $7,500) + 1,000)
Other Developments
Tax Basis Capital Account Reporting
Historically, partnerships could report capital under various methodologies (e.g., tax basis, GAAP, §704(b), other)

Determination of tax basis in a partnership interest is a partner item, not a partnership item

Form 1065 instructions in 2018 required reporting of negative tax basis capital accounts

“Tax basis capital accounts” are not defined in the code or regulations

IRS released FAQs that answered some questions about computing tax basis capital and raised other questions (e.g., FAQs noted that tax basis capital accounts were generally equity calculated using tax principles and should be computed on a rollforward (contributions + income/loss - distributions) basis and include impacts from §743(b) or §734 adjustments)

Form 1065 instructions in 2019 (pre-Notice 2019-66) required reporting of tax basis capital accounts for all partnerships

Draft instructions require a rollforward of prior activity (that excludes §743(b) adjustments), with no safe harbor for estimates (like there is in a partner’s basis under §705(b)) if data is not available)
IRS released draft Form 1065 instructions on October 22, 2020 – including instructions on reporting tax capital on the Schedule K-1

- Use transactional method to compute capital account
- Alternative methods available for TY20 beginning balance for partnerships that have not previously used or maintained tax basis method capital accounts:
  - Modified outside basis method
  - Modified previously taxed capital method
  - Section 704(b) method

The amount to report as a partner’s beginning capital account under the Section 704(b) method is equal to the partner’s Section 704(b) capital account, minus the partner's share of Section 704(c) built-in gain in the partnership's assets, plus the partner's share of Section 704(c) built-in loss in the partnership's assets. Property contributed to a partnership is Section 704(c) property if, at the time of the contribution, its fair market value differs from its adjusted tax basis. Section 704(c) property also includes property with differences resulting from revaluations (reverse Section 704(c) allocations). For more information, see Sections 704(b) and 704(c) and regulations Sections 1.704-1 through 1.704-3.

- Same method must be used for all partners
- IRS/Treasury to issue notice providing penalty relief for transition year
Other items and clarifications related to Form 1065

► Per instructions for Form 1065 – schedule M-2 now should also be reported on same tax basis as the K-1s. If there are any differences between the cumulative K-1s and the M-2, a statement should be attached to explain the reason.

► A statement also have to be included for each partner k-1 to disclose which method was used to report the beginning capital on the K-1 (if applicable).

► If modified previously tax capital method is used, a statement must also be included to disclose how the partnership net liquidity value was established (FMV, 704b book value etc.). This method needs to be adopted by all partners.

► If in 2019, partnership reported using tax basis method, but included IRC 743(b) basis adjustment within the tax basis capital, then in 2020 that 743(b) basis adjustment needs to be backed out of the tax capital using the other increase/decrease line.

► If your schedule L is reported on tax basis and there is a difference between schedule L and M-2 tax basis reporting, attach a statement reconciling any differences. If schedule L is not on tax basis, then no reconciliation is required.
US economic and tax policy update
Agenda

► US economic and tax policy update
► Individual aspects of Biden proposals
Overview: COVID-19 economic impacts and response

The US Bureau of Economic Analysis (BEA) reported on February 25th that US GDP shrank 3.5% in 2020. Euro Zone 2020 GDP shrank 6.8%: Germany’s shrank 5%, France’s 8.3%, Italy’s 8.9%, and Spain’s 11%. The UK’s 2020 GDP shrank 9.9%. Japan’s shrank 4.8% and India’s 8.0%. China’s grew 2.3%. The World Bank estimates global 2020 GDP shrank 4.3%.

On April 29th, the Bureau of Economic Analysis estimated US GDP grew 6.4% in Q1 2021, up 2.1 ppts from Q4 2020. The May 10 Blue Chip Economic Indicators report forecast US GDP growth for 2021 to be 6.6%, the Euro Zone’s to be 4.1%, Germany’s 3.3%, France’s 5.3%, the UK’s 5.7%, Japan’s 2.9%, India’s 9.8%, and China’s 8.6%.

The Bureau of Labor Statistics (BLS) announced on May 7th that the April unemployment rate rose to 6.1% (from 6.0% in March) and the US economy added only 266,000 jobs (as compared to the 770,000 (revised) gain in March). The increase was significantly below the 1 million in job gains expected by many economists.

The May 13th weekly initial unemployment insurance (UI) claims number was 473,000, a decrease from last week’s 507,000 number and the lowest initial claims number since the pandemic began. The continuing claims number, which lags the initial claims number by one week, decreased slightly to 3.66 million. For the week ending April 24, total beneficiaries of all unemployment programs totaled 16.86 million, an increase of .696 million from the prior week.

On May 12th, BLS reported that US consumer prices increased by 0.8 percent in April, following a 0.6 percent increase in March. Over the past 12 months, consumer prices increased by 4.2 percent, the largest 12-month increase since a 4.9 percent increase for the period ending September 2008.

The Biden Administration began on March 31st the rollout of its $4 trillion Build Back Better Plan, with the release of the American Jobs Plan and the Made in America Tax Plan. The American Families Plan was released April 28th.
US economy by the numbers

**6.4%**
US Q1 GDP growth (annualized)
- Consumer spending rose 10.7%
- Some forecast second quarter growth up to 13% (annualized)

**6-8% real growth**
Expected for 2021 in the US
- Consumption above pre-COVID levels

**2nd quarter 2021**
Is when US expected to reach pre-COVID GDP forecasts
- Employment forecast to reach pre-pandemic levels by Q3 2022

**4.2%**
CPI Increase over last 12 months
- Largest since September 2008

**8.1m**
Job openings in March
- Up 8% for the month
- Up 20% over the last three months

**8.2m**
Fewer people employed now than in February 2020
- 63% of jobs lost due to COVID recovered

**266K job gain**
For overall economy in April
- Leisure and hospitality added 331,000 jobs
- Federal Reserve expects unemployment rate to reach 4.5% by year end

COVID relief, vaccinations/stable case counts, lifted restrictions helping drive recovery
Weekly new US jobless claims remain at elevated levels

- April unemployment rate rose to 6.1%; it was 14.8% in April 2020 and 3.5% in February 2020
- April U-6 unemployment rate fell to 10.4%; it was 22.9% in April 2020 and 7.0% in February 2020

Declining initial UI suggests labor market recovering, although slowly (new weekly jobless claims, millions)

Elevated continuing jobless claims suggests sluggish recovery (continuing jobless claims, millions)
US labor markets continue to recover; uneven industry and sector impacts

<table>
<thead>
<tr>
<th>Industry</th>
<th>Total lost jobs in March - April 2020</th>
<th>March and April lost jobs as a share of February 2020 employment</th>
<th>Total gained jobs - May 2020 through April 2021</th>
<th>Jobs recovered by March 2021 (% of job loss in March - April 2020)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leisure and hospitality</td>
<td>8,224</td>
<td>-49%</td>
<td>5,376</td>
<td>65%</td>
</tr>
<tr>
<td>Motor vehicles and parts*</td>
<td>360</td>
<td>-36%</td>
<td>252</td>
<td>70%</td>
</tr>
<tr>
<td>Other services</td>
<td>1,410</td>
<td>-24%</td>
<td>1,058</td>
<td>75%</td>
</tr>
<tr>
<td>Retail trade</td>
<td>2,375</td>
<td>-15%</td>
<td>1,975</td>
<td>83%</td>
</tr>
<tr>
<td>Construction</td>
<td>1,113</td>
<td>-15%</td>
<td>917</td>
<td>82%</td>
</tr>
<tr>
<td>Education and health services</td>
<td>2,843</td>
<td>-12%</td>
<td>1,673</td>
<td>59%</td>
</tr>
<tr>
<td>Professional and business services</td>
<td>2,387</td>
<td>-11%</td>
<td>1,639</td>
<td>69%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>1,385</td>
<td>-11%</td>
<td>870</td>
<td>63%</td>
</tr>
<tr>
<td>Transportation and warehousing</td>
<td>575</td>
<td>-10%</td>
<td>433</td>
<td>75%</td>
</tr>
<tr>
<td>Mining and logging</td>
<td>68</td>
<td>-10%</td>
<td>(7)</td>
<td>-10%</td>
</tr>
<tr>
<td>Information</td>
<td>281</td>
<td>-10%</td>
<td>54</td>
<td>19%</td>
</tr>
<tr>
<td>Wholesale trade</td>
<td>409</td>
<td>-7%</td>
<td>182</td>
<td>44%</td>
</tr>
<tr>
<td>Government</td>
<td>1,009</td>
<td>-4%</td>
<td>(235)</td>
<td>-23%</td>
</tr>
<tr>
<td>Financial activities</td>
<td>279</td>
<td>-3%</td>
<td>216</td>
<td>77%</td>
</tr>
<tr>
<td>Utilities</td>
<td>4</td>
<td>-1%</td>
<td>(3)</td>
<td>-79%</td>
</tr>
<tr>
<td>Total</td>
<td>22,361</td>
<td>-15%</td>
<td>14,147</td>
<td>63%</td>
</tr>
</tbody>
</table>
COVID may pose longer-term challenges for labor markets

**Unemployment rate, seasonally adjusted**
*October 2019 – April 2021*

- **November 2019:** 3.6%
- **February 2020:** 14.8%
- **April 2021:** 6.1%

**Labor force participation rate of working-age people who are part of the labor force**

- **November 2019:** 63.2%
- **April 2021:** 61.7%

**Underemployment rate (U6), seasonally adjusted**
*October 2019 – April 2021*

- **November 2019:** 7.0%
- **February 2020:** 22.9%
- **April 2021:** 10.4%

**Share of unemployed workers who have been unemployed 27 weeks or more**

- **April 2020:** 43.0%
- **September 2020:** 4.4%
US personal income supported by COVID relief; savings elevated

**Post-COVID income increased with COVID relief; employee compensation above pre-COVID level**

(Personal income by source, annualized, $trillions)

<table>
<thead>
<tr>
<th>Monthly</th>
<th>Transfer Payments</th>
<th>Interest &amp; dividends, other</th>
<th>Proprietor Income</th>
<th>Employee Compensation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Feb-20</td>
<td>$11.8</td>
<td>$14.9</td>
<td>$21.1</td>
<td>$20.2</td>
</tr>
<tr>
<td>Mar-20</td>
<td>$11.5</td>
<td>$13.9</td>
<td>$21.1</td>
<td>$20.2</td>
</tr>
<tr>
<td>Apr-20</td>
<td>$10.7</td>
<td>$13.2</td>
<td>$20.0</td>
<td>$20.2</td>
</tr>
<tr>
<td>May-20</td>
<td>$11.0</td>
<td>$13.0</td>
<td>$20.0</td>
<td>$20.0</td>
</tr>
<tr>
<td>Jun-20</td>
<td>$11.5</td>
<td>$14.0</td>
<td>$20.0</td>
<td>$20.0</td>
</tr>
<tr>
<td>Jul-20</td>
<td>$11.4</td>
<td>$14.2</td>
<td>$20.0</td>
<td>$20.0</td>
</tr>
<tr>
<td>Aug-20</td>
<td>$11.5</td>
<td>$14.4</td>
<td>$20.0</td>
<td>$20.0</td>
</tr>
<tr>
<td>Sep-20</td>
<td>$11.6</td>
<td>$14.6</td>
<td>$20.0</td>
<td>$20.0</td>
</tr>
<tr>
<td>Oct-20</td>
<td>$11.7</td>
<td>$14.8</td>
<td>$20.0</td>
<td>$20.0</td>
</tr>
<tr>
<td>Nov-20</td>
<td>$11.8</td>
<td>$15.0</td>
<td>$20.0</td>
<td>$20.0</td>
</tr>
<tr>
<td>Dec-20</td>
<td>$11.9</td>
<td>$15.2</td>
<td>$20.0</td>
<td>$20.0</td>
</tr>
<tr>
<td>Jan-21</td>
<td>$11.9</td>
<td>$15.4</td>
<td>$20.0</td>
<td>$20.0</td>
</tr>
<tr>
<td>Feb-21</td>
<td>$12.0</td>
<td>$15.6</td>
<td>$20.0</td>
<td>$20.0</td>
</tr>
<tr>
<td>Mar-21</td>
<td>$12.0</td>
<td>$15.8</td>
<td>$20.0</td>
<td>$20.0</td>
</tr>
</tbody>
</table>

**Post-COVID consumption above pre-COVID level; roughly $2.1 trillion in accumulated savings since pandemic**

(Personal consumption, savings, and other outlays, annualized, $trillions)

<table>
<thead>
<tr>
<th>Monthly</th>
<th>Savings</th>
<th>Taxes &amp; Other</th>
<th>Consumption</th>
</tr>
</thead>
<tbody>
<tr>
<td>Feb-20</td>
<td>$2.8</td>
<td>$14.9</td>
<td>$21.5</td>
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<tr>
<td>Mar-21</td>
<td>$2.7</td>
<td>$14.0</td>
<td>$20.0</td>
</tr>
</tbody>
</table>
Uneven recovery seen in consumer spending

Spending on goods 13.6% above pre-COVID level; spending on services 3.3% below pre-COVID level

Percentage change in consumer spending from the last quarter of 2019
### Dual goals of Federal Reserve (Fed): 1) maximum employment, and 2) price stability

#### Employment
- Although the unemployment rate fell quickly through early Fall 2020, the rate of descent is now more gradual.
- Just under 10 million currently unemployed; 8.2 million fewer people working today than pre-pandemic.
- Underemployment significant and slow to recover.
- Labor force has contracted by roughly 4 million workers; labor force participation rate roughly 2 percentage points below pre-COVID level.

#### Price stability/inflation/Fed expectations
- Inflation expectations subdued since the end of the 2008-09 financial crisis.
- Inflation remains low – below 2% target based on personal consumption expenditure (PCE) price index.
- Fed shift to average 2% inflation target provides more flexibility.
- Fed believes little near- to medium-term inflation risk despite lifting its near-term growth forecast even with recent CPI spike.

### Current state of play
- Economy is below Fed’s dual goals of price stability (2% inflation average target) and maximum employment.
- Significant upside: Accelerated vaccine administration, recently enacted COVID relief, unwinding of accumulated savings, another round of federal government spending (i.e., Build Back Better).
- Downside risks: More COVID waves, geopolitical tensions, labor-market scarring, growing fiscal imbalance, inflation.
  - Fiscal imbalance: Federal debt-to-GDP ratio projected to exceed 105% this year and reach nearly 210% by 2050.
  - Labor-market scarring: Slow decline in broad unemployment measures; difficult to bring workers back from the sidelines.
Build Back Better and beyond

### March 31
President Biden detailed the American Jobs Plan and Made in America Tax Plan in a Pittsburgh speech.

### April 28
- Individual/caregiving part of Build Back Better plan (American Families Plan) announced, with tax increases on affluent individuals.
- President Biden addressed a joint session of Congress outlining Build Back Better Plan.
- Release of President’s FY22 budget proposal, likely with Treasury green book detailing tax proposals.

### Last week of May
- Congress expected to craft an FY22 budget resolution with reconciliation instructions for Build Back Better Plan.

### June
- Target for enacting American Jobs Plan, etc. (may be optimistic).

### July-Aug
- Government funding, highway funding expire.

### Sept. 30
- Tax cliff when Sections 163(j) (interest deductibility) and 174 (expensing) changes take effect, extenders expire.

### American Jobs Plan ($2.25 trillion)
- Transportation infrastructure (roads, bridges, rail, airports, EVs, etc.) - $621 billion
- Care facilities for aging and disabled - $418 billion
- Supply chains/manufacturing - $300 billion
- Affordable and sustainable housing - $213 billion
- R&D - $180 billion
- Public schools, early learning/childcare, community colleges - $137 billion
- Clean drinking water - $111 billion
- Workforce development/safety - $110 billion
- High-speed broadband - $100 billion
- Electrical/power infrastructure - $100 billion
- VA - $18 billion

### Made in America Tax Plan (over $2 trillion over 15 years)
- Raise the corporate tax rate from 21% to 28%
- Increase global intangible low-taxed income (GILTI) rate to 21%, calculate it on a country-by-country basis (including FTCs), eliminate 10%-return-on-tangible-assets exclusion (QBAI)
- Eliminate foreign-derived intangible income (FDII) deduction
- Replace Tax Cuts and Jobs Act (TCJA) provision that “tried to stop foreign corporations from stripping profits” out of the US (base erosion and anti-abuse tax (BEAT), presumably)
- Impose a 15% minimum tax on corporations based on “book income”
- Deny “deductions to foreign corporations on payments that could allow them to strip profits out of the United States if they are based in a country that does not adopt a strong minimum tax”
- Make it “harder for US corporations to invert”
- Deny companies expense deductions for offshoring jobs, provide a credit for expenses for onshoring
- Eliminate tax preferences for fossil fuels
- “Ramp up enforcement against corporations”
- Seek a global agreement on a “strong” minimum tax on corporations (presumably in OECD)
Outlook scenarios for Build Back Better components

1. **(Jobs Plan only)**
   - Republican support for Jobs Plan (10 GOP votes in Senate needed)
     - Must be limited to roads & bridges
     - Tax increases need to be dropped

2. **(Jobs and tax)**
   - No GOP support, Democrat unity needed
     - Budget reconciliation requires support of almost all House Ds, all 50 Senate Ds
     - Still plenty of complicating factors
     - Some tax items may be dropped, some may be added
   - Tax increases could hurt Democrats in 2022, so could deficits
   - Manchin wants 25% corporate tax rate, other increases may be clipped
   - House Democrats from NY, NJ insist on SALT cap repeal
   - Made in America Tax Plan
   - Manchin wants ‘human infrastructure’ to stay separate to avoid massive bill

3. **(All)**
   - Rolled into one
     - Despite suggestions from Pelosi, Manchin that bills stay separate, Jobs & Families plans could move as one bill under reconciliation
   - American Jobs Plan
   - Made in America Tax Plan
   - Requires delicate balancing of Democratic priorities

If Families Plan or Tax Plan moves separately, reconciliation would be required, given the tax increases proposed.
<table>
<thead>
<tr>
<th>Positions on select tax issues for infrastructure proposal</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tax increases generally</strong></td>
</tr>
<tr>
<td><strong>Corporate income tax rate</strong></td>
</tr>
<tr>
<td><strong>SALT cap repeal</strong></td>
</tr>
</tbody>
</table>
What may happen and when

President Biden to release FY2022 budget proposal & green book

Congress will process an FY2022 budget resolution to unlock another round of budget reconciliation

House transportation, tax committees may start considering Jobs Plan legislation

Target for Jobs plan passage in House, set by House Speaker Pelosi: “before the August break.”

Federal debt limit reinstated after being suspended since 2019

Government funding, highway authorization expire

**Last week in May**

- All the tax proposals the Administration supports, not just in the Jobs or Families plans. FY2017 Green Book was 300 pages, covered over 100 proposals.

**June**

- More reconciliation may be possible under the FY2021 resolution. Democrats may have trouble agreeing to budget over differences over defense spending etc.

- Chairman Neal will likely put forward a draft bill (“mark”) that could get things rolling on the tax portion, possibly set some effective dates

- Underscoring how hard this is: Leaders can lose only a few House Democratic votes and no Senate Democratic votes

**July 4/August 1**

- Democrats want to avoid dynamic from a decade ago, when Republicans used leverage to force spending cuts. Must-act date is later in the summer or fall

**August 1**

- These could be a more realistic target for something to get done because Congress works best with action-forcing deadlines
Current division of power

Key economic posts:
- Treasury Secretary: Janet Yellen
- Deputy Treasury Secretary: Wally Adeyemo
- Asst. Sec. (Tax Policy): Lily Batchelder (nominated)
- Deputy Asst. Sec./Acting Asst. Sec. (Tax Policy): Mark Mazur
- Deputy Asst. Sec. (International Tax Affairs): Jose Murillo
- Deputy Asst. Sec. (Tax Analysis): Kimberly Clausberg
- Deputy Asst. Sec. (Multilateral Tax): Itai Grinberg
- Deputy Asst. Sec. (Dom. Business Tax): Tom Wes
- Deputy Asst. Sec. (Microeconomics): Natasha Sarin
- Counselor to Asst. Sec., Office of Tax Policy: Rebecca Kysar
- Office of Management and Budget Deputy Director/Acting Director: Shalanda Young
- National Economic Council Director: Brian Deese
- Special Assistant, Budget & Tax: Nadiya Beckwith-Stanley
- US Trade Representative: Katherine Tai

White House

President Biden

VP Harris

Senate

50 Democrats
- 61 for control (including VP breaking tie)
- 0
- 20
- 40
- 60

50 Republicans

Up for re-election in 2022:
- 20 Republicans
- 14 Democrats

House

219 Democrats

President’s party typically loses seats in first midterm election:
- Trump lost 40 House seats but gained 2 Senate seats in 2018
- Obama lost 63 House seats and 6 Senate seats in 2010

213 Republicans

218 for control

- Rep. Haaland (D-NM), Interior Sec.; June 1 election
- Rep. Fudge (D-OH), HUD Sec.; November 2 election
- Late Rep. Hastings (D-FL); January 11 election
- Rep. Stivers (R-OH) leaving Congress May 16
If seats stay with same party, ratio would be 222 Ds-213 Rs, narrowest House margin since 107th Congress (2001-2003)

219Ds 213Rs

219Ds 213R 37 300
$1.8t American Families Plan

- Over $300 billion in **education funding**, including to make two-year community colleges tuition-free
- $200 billion for **prekindergarten** instruction
- $225 billion for paid **family and medical leave**
- $225 billion in **childcare** funding
- $200 billion to make permanent enhanced **ACA premium tax credits**
- Extend expanded **Child Tax Credit (CTC), Earned Income Tax Credit (EITC), childcare credit**

<table>
<thead>
<tr>
<th>Increase top individual tax rate to 39.6%</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Capital gains rate increase</strong> 39.6% for incomes &gt;$1m + 3.8% Net Investment Income Tax (NIIT) = 43.4%, effective date unclear</td>
</tr>
<tr>
<td><strong>Repeal stepped up basis</strong></td>
</tr>
<tr>
<td><strong>Increase IRS enforcement</strong></td>
</tr>
<tr>
<td>End Section 1031 <strong>like-kind exchanges</strong> for gains greater than $500,000</td>
</tr>
<tr>
<td>Apply 3.8% NIIT Medicare tax consistently to incomes &gt;$400,000</td>
</tr>
<tr>
<td>Make permanent the TCJA’s 461(l) disallowance of excess business loss</td>
</tr>
</tbody>
</table>

**Healthcare:**
- Prescription drug negotiation left out
- Progressive Democrats wanted to use resulting funds to expand Medicare
- Centrist Democrats are more focused on extending ACA premium subsidies

**Capital Gains**
- By comparison, the Obama Administration’s FY2017 budget proposed to increase the rate to 24.2% so with 3.8% NIIT total 28% rate
- Lawmakers could specify date of release of proposal or bill as effective date to avoid self-off
## Comparison – campaign trail vs. White House

<table>
<thead>
<tr>
<th>Proposal</th>
<th>Candidate Biden</th>
<th>President Biden</th>
</tr>
</thead>
<tbody>
<tr>
<td>Max individual rate = 39.6%</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Max long-term capital gain (LTCG)/qualified dividend income (QDI) rate = 39.6%</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Changes to NIIT</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Changes to carried interests</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Permanent Section 461(l) loss limit</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Repeal like-kind exchanges on gains &gt;$500k</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Itemized deductions capped at 28%</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>3% limitation (Pease) on itemized deductions</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Repeal Section 199A deduction for incomes &gt;$400k</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Social Security tax on &gt;$400k+</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Step-up in basis repealed</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>
The $400,000 cut off

Candidate Biden

“As President, Biden will require corporations and the wealthiest Americans to finally pay their fair share. He won’t ask a single person making under $400,000 per year to pay a penny more in taxes, and will in fact enact more than one-dozen middle class tax cuts that will finally give working families the financial support they deserve.” https://joebiden.com/two-tax-policies/

The proposal does not actually make this demarcation point clear — is it:

- $400,000 in adjusted gross income or taxable income?
- $400,000 for singles and $400,000 for married filing jointly (MFJ)? Or $800,000 for MFJ?
- $400,000 for trusts and estates (or some other amount)?
- $400,000 for those subject to the kiddie tax (or some other amount) — does it apply to the kiddie tax?
Increasing the highest individual rate to 39.6%

The proposal
“One of the 2017 tax cut’s clearest giveaways to the wealthy was cutting the top income tax rate from 39.6 percent to 37 percent, exclusively benefitting the wealthiest households—those in the top one percent. This rate cut alone gives a couple with $2 million in taxable income an annual tax cut of more than $36,400. The President’s plan restores the top tax bracket to what it was before the 2017 law, returning the rate to 39.6 percent, applying only to those within the top one percent.”

► Mathematically, raising the rate by 2.6% will increase taxes by $36,400 with $2m taxable income.
► But what about the taxable income changes from TCJA?
► Examples of increases in taxable income:
  - Non-deductible alimony
  - Mortgage interest cap at $750k (grandfathered $1m)
  - SALT limit
  - Elimination of 2% deductions
  - Casualty/theft losses limited to disaster areas
► Examples of decreases in taxable income:
  - Pease limitation lifted
  - Section 199A deduction
Increasing the long-term capital gain and qualified dividend rate to 39.6%

The proposal
“The President’s tax reform will end one of the most unfair aspects of our tax system: that the tax rate the wealthy pay on capital gains and dividends is less than the tax rate that many middle-class families pay on their wages. Households making over $1 million—the top 0.3 percent of all households—will pay the same 39.6 percent rate on all their income, equalizing the rate paid on investment returns and wages.”

History
- With the exception of 1987-1990, LTCG rates have always been lower than the highest rate (approximately 100 years)
- QDI has existed since 2003, but historically had not had any rate preference
  - QDI was given parity with LTCG so that stock buy backs are not given a preference over dividends

Economics
- LTCG rates over ≈28% cause a decline in governmental revenue and would require modifying the step-up in basis at death rule*
- Is increasing QDI to 39.6% and keeping LTCG at a preferential rate possible?
Increasing the long-term capital gain and qualified dividend rate to 39.6%

How is the $1m threshold calculated?
- If an individual has $800,000 of wages and $300,000 of LTCG/QDI, they are presumably making more than $1m under the President's definition.
- Does the fact that the individual has income over $1m…
  - Cause $100,000 of the income to lose LTCG/QDI status, or
  - Cause the entire $300,000 to lose LTCG/QDI status?
- In this case, there is a $58,800 difference between the two approaches.

Other questions:
- One would think that it also includes unrecaptured IRC Section 1250 gain taxed at 25% and collectibles gains taxed at 28%.
- Although the proposal would apparently equalize the tax rate paid on investment returns and wages, basic tax concepts, such as holding period, capital-loss limitations, limitations on investment interest expense, and the 60%/40% split on IRC Section 1256 contracts, would remain in place for those making under $1m. Would they continue to apply for those making over $1m?
- What about investment interest expense and capital losses limitations?
Changes to the Section 1411 Net Investment Income Tax

The proposal
“… high-income workers and investors generally pay a 3.8 percent Medicare tax on their earnings, but the application is inconsistent across taxpayers due to holes in the law. The President’s tax reform would apply the taxes consistently to those making over $400,000, ensuring that all high-income Americans pay the same Medicare taxes.”

- The proposal is assumed to be taxing non-passive business operating income
- The following example assumes a married couple filing jointly:

<table>
<thead>
<tr>
<th>Income limits</th>
<th>Tax system</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGI &lt; $250,000</td>
<td>Not subject to NIIT</td>
</tr>
<tr>
<td>AGI = $250,001 — $399,999</td>
<td>Subject to current NIIT rules</td>
</tr>
<tr>
<td>AGI &gt; $400,000</td>
<td>Different NIIT rules to ensure &quot;that all high-income Americans pay the same Medicare taxes&quot;</td>
</tr>
</tbody>
</table>

- Self-employment tax is cheaper (and subject to totalization agreements with foreign countries):
  NIIT = 3.8%
  Self-Employment Contributions Act (SECA) ≈ 3.1%
Increasing the long-term capital gain and qualified dividend rate to 39.6%

The proposal
“The President would also end the special real estate tax break—that allows real estate investors to defer taxation when they exchange property—for gains greater than $500,000”

- Does this mean $500,000 per taxpayer? For example, is the exemption for spouses a total of $1m?
- Or, if real estate is sold by a partnership, does each partner get a $500,000 exemption and a partnership with 20 partners gets a $10m exemption?
- If the gain on the sale of a building is $600,000, then:
  - Is $500,000 allowed to be deferred and $100,000 taxable? or
  - If its only partly deferred, then are only part of the proceeds required to be rolled over?
  - Is the entire $600,000 taxable?
Step-up basis at death

The proposal
“…the President would eliminate the loophole that allows the wealthiest Americans to entirely escape tax on their wealth by passing it down to heirs. Today, our tax laws allow these accumulated gains to be passed down across generations untaxed, exacerbating inequality. The President’s plan will close this loophole, ending the practice of “stepping-up” the basis for gains in excess of $1 million ($2.5 million per couple when combined with existing real estate exemptions) and making sure the gains are taxed if the property is not donated to charity. The reform will be designed with protections so that family-owned businesses and farms will not have to pay taxes when given to heirs who continue to run the business.”

How is this going to work?
Deemed sale at death?
This was tried in the 1920s until the early 1940s – then it was repealed and replaced with IRC Section 691 (Income in Respect of a Decedent)

Carryover basis regime?
This was tried several times in the last 50 years, only one time did it go into effect (2010)
If basis is not-stepped up, then should basis-type attributes be retained at death and passed to estate/heirs?
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