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Biden's Proposed Tax Increases – How Do they Affect Bona Fide Residents of Puerto Rico?

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The Biden Administration published its Green Book of tax proposals on May 28, 2021. The following is a brief summary of key provisions that we think are likely of interest to Act 20/22/60 grantees (as well as some corporate provisions of general interest). [We show in brackets the revenue estimates for each provision and its effective date.]

- No Mention of 933 or 937: The proposal is silent on the exemption of Puerto Rican source income for bona fide residents of Puerto Rico.
- Individual Proposals:
  - Rates on Ordinary Income: The top rate would increase from 37% to 39.6% and would apply to a lowered base (e.g., the base for married-filing-jointly returns would be dropped from $628,300 to $509,300). [Estimated to raise $132 billion over 10 years. Effective for taxable years beginning after December 31, 2021.]
  - Capital Gains Taxation: [Estimated to raise $322 billion over 10 years, with varied effective dates.]
    - Top Rate: Top rates would increase from 23.8% to 40.8%, applied to married-filing-jointly income over $1,000,000. [Effective for gains recognized after the date of announcement.]
    - Estate and Gift Appreciation: Capital gains taxation would apply to gifts and estates with appreciated property, subject to numerous exclusions, exceptions and caveats. [Effective for gains on property transferred by gift, and on property owned at death by decedents dying, after December 31, 2021, and on certain property owned by trusts, partnerships, and other non-corporate entities on January 1, 2022.]
    - Mark-to-Market Taxation after 90 Years: If certain property is held by a trust, partnership, or other non-corporate entity without a recognition even for more than 90 years (beginning 1/1/1940), it would be deemed sold at current fair market value. [Effective January 1, 2030.]
- Business Proposals:
  - Taxation of Carried Interest: [Estimated to raise $1.5 billion over 10 years. You read that right – only $1.5 billion.] [Effective for taxable years beginning after December 31, 2021.]
    - The Biden administration would tax carried interest at ordinary income rates. It's unclear at this point whether the income would be treated as ordinary income or capital gains, which could have important implications for Puerto Rican sourcing (e.g., would the income be sourced based on the residency of the taxpayer or based on where the taxpayer provides services to earn the carried interest).
    - When carried interest results from an investment by the manager-investor, it would not be taxed as ordinary income: "To the extent (1) the partner . . . contributes "invested capital". . . , and (2) . . . the partnership allocations to the invested capital [are] made in the same

manner as allocations to other capital interests held by partners . . . and . . . the allocations . . . are significant), income attributable to the invested capital would not be recharacterized."

- Self-Employment Taxes and NIIT: [Estimated to raise $237 billion over 10 years. Effective for taxable years beginning after December 31, 2021.]
  - All trade or business income of high-income taxpayers would be subject to the 3.8-percent Medicare tax, either through the NIIT or SECA tax.
  - Limited partners and LLC members who provide services and materially participate in the business would be subject to SECA tax on their distributive shares of income.
  - S corporation owners who materially participate in the business would be subject to SECA taxes on their distributive shares of business income.
- New Onshoring Incentive for the U.S. and Puerto Rico: The Biden administration would create a new general business credit equal to 10 percent of certain expenses incurred in connection with onshoring a foreign business to the U.S. or Puerto Rico (or American Samoa). The tax credit would be claimed by the U.S. taxpayer or, if Puerto Rico/ American Samoa adopt similar regimes (and the U.S. Treasury will reimburse Puerto Rico and American Samoa), by their local taxpayers. [Estimated to cost $112 billion over 10 years. Effective for expenses paid or incurred after the date of enactment.]
- Like Kind Exchange: The Biden administration would significantly curtail use of like-kind exchanges to defer gain from exchanges of real estate. [Estimated to raise $20 billion over 10 years. Effective for exchanges completed in taxable years beginning after December 31, 2021.]
- Information on Crypto Assets: "The proposal would expand the scope of information reporting by brokers who report on crypto assets to include reporting on certain beneficial owners of entities holding accounts with the broker. This would allow the United States to share such information on an automatic basis with appropriate partner jurisdictions, in order to reciprocally receive information on U.S. taxpayers that directly or through passive entities engage in crypto asset transactions outside the United States pursuant to a global automatic exchange of information framework." [Estimated to raise "negligible" revenue over 10 years. Effective for tax years beginning after December 31, 2022.]

- C Corporation Proposals:
  - Corporate Income Tax Rates: The Biden administration would raise the corporate income tax rate to 28%. Senator Joe Manchin, who can play kingmaker on these issues, has indicated that 25% is the right rate. [Estimated to raise $858 billion over 10 years. Generally effective for taxable years beginning after December 31, 2021. For taxable years beginning after January 1, 2021 and before January 1, 2022, the tax rate would be equal to 21 percent plus 7 percent times the portion of the taxable year that occurs in 2022.]
  - Inversions: The Biden administration would make it easier to for the inversion rules to apply. Those rules apply when a US corporation becomes a foreign corporation, but still has significant U.S. ownership and operations. Under current law, if at least 80% of the pre-inversion shareholders of the corporation continue their ownership post-inversion, the foreign corporation is treated as a U.S.

corporation. That percentage would be dropped to 50%. A rule that treated somewhat more favorably corporations with at least 60% continuing ownership would be repealed. [Included in the GILTI revenue estimate. Effective for transactions that are completed after the date of enactment.]

- FDII: FDII would be repealed. [Estimated to raise $0 because $124 billion of savings to be reinvested to provide additional support for research and development. Effective for taxable years beginning after December 31, 2021."]
- GILTI: [Estimated to raise $533 billion over 10 years. Effective for taxable years beginning after December 31, 2021.]
  - The exemption from GILTI of 10% of the CFC's QBAI would be eliminated. All CFC income would be subject to the GILTI minimum tax.
  - The rate on GILTI would be increased from 10.5% to 21% (if the US corporate income tax rate ends up being 28%; if the rate adopted is instead 25%, the GILTI rate would be 18.75%).
  - GILTI would be applied on a jurisdiction-by-jurisdiction basis. Under the existing rules, if CFC1 earns $100 in a 40% rate country and CFC2 earns $100 in a 0% rate country, all of that income could be excluded from GILTI because the blended rate (20%) exceeds 90% of the current U.S. rate (i.e., 90% of 21% is 18.9%). Under the Biden proposal CFC1's income would be exempt, but CFC2's income would be subject to full GILTI.
  - The exemption from GILTI for certain foreign income from foreign oil and gas extraction would be repealed.
- Subpart F: The Biden proposal would repeal the high-tax exemption to subpart F. [Included in the GILTI revenue estimate. Effective for taxable years beginning after December 31, 2021.]
- BEAT Replaced with SHIELD: SHIELD would deny deductions to a U.S. company or branch that makes payments to a non-U.S. group with a low effective tax rate (21% if the OECD does not agree to a lower rate as part of Pillar II). The proposal is complex and will be difficult to administer, but is designed to ensure foreign countries have an incentive to adopt rules similar to the revised U.S. GILTI regime. This is one of the few proposals that is not effective immediately. [Estimated to raise $390 billion over 10 years. Effective for taxable years beginning after December 31, 2022.]

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