Potential Impact on Financial Products Taxation if Build Back Better Act Provisions Advance

Insights From the BDO Asset Management Practice

The fate of President Biden's tax and economic agenda, as reflected in the Build Back Better Act (BBBA), is currently unclear. There is a possibility that pieces of it will pass separately, meaning that some of the tax proposals could be enacted in 2022. The package that cleared the House in late 2021 contained several proposals that would create significant changes in the taxation of financial products such as cryptocurrency, commodities, and foreign currencies, including the following:

Wash sale rules – The BBBA proposal would expand the scope of the wash sale rules under IRC Section 1091 to include losses on "specified assets." Such assets would include cryptocurrencies, foreign currencies, commodities and a broad array of derivatives, such as total return swaps on those assets. The existing wash sale rules only apply to stocks and securities. The proposed change would also provide related party wash sale rules, which would create significant challenges in identifying and tracking wash sales, as well as related basis adjustments. The wash sale provisions would apply to losses incurred after December 31, 2021.

Constructive sales – IRC Section 1259 would be expanded to include "digital assets" such as cryptocurrencies. Currently, the rules only cover appreciated financial positions in stocks, debt instruments and partnership interests. This change would apply prospectively to constructive sales after the date of enactment.

Total Return Swaps – IRC Section 871(m) would be expanded to include certain payments made pursuant to notional principal contracts covering publicly traded partnerships. Payments referencing "income or gain" from a publicly traded partnership would be treated as dividend equivalents, resulting in a 30% withholding tax on foreign investors. Determining the amount subject to withholding would be very challenging for brokers and other withholding agents, who would need to know how much income or gain the underlying partnership is generating. This change would be effective for applicable payments made after December 31, 2022.

We will continue to monitor potential tax legislation as it develops and provide insights if legislation progresses with any of these tax proposals included.

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