

THE BUILD BACK BETTER ACT: PROHIBITION OF IRA INVESTMENTS CONDITIONED ON ACCOUNT HOLDER'S STATUS; PROHIBITION OF INVESTMENT OF IRA ASSETS IN ENTITIES IN WHICH THE OWNER HAS A SUBSTANTIAL INTEREST

Under a House Ways and Means Committee-drafted tax provision of the Build Back Better Act (the \$3.5 Trillion Budget Reconciliation Bill currently winding its way through House and Senate committees), Individual Retirement Accounts (which, in most cases, would be self-directed IRAs) would be barred from holding any asset for which the investor must have, under SEC rules, “a specified minimum amount of income or assets, a specified minimum level of education, or ... a specific license or credential” to invest in. IRAs holding such investments would lose their IRA status. Another House Ways and Means Committee-drafted provision would prohibit investment of IRA assets in entities in which the owner has a substantial interest.

Section 138312

The House Ways and Means drafted Section 138312 (*Prohibition of IRA Investments Conditioned on Account Holder's Status*) would effectively bars IRAs from investing in virtually any company that isn't publicly traded on an exchange such as NASDAQ or the New York Stock Exchange, as under Securities and Exchange Commission (SEC) rules, securities of those non-publicly traded companies are available only to “accredited investors,” which the SEC defines as investors having a net worth of at least \$1 million, excluding the value of a principal residence, or an income of at least \$200,000 a year or \$300,000 with a spouse (and a few other specific income/wealth based qualifications) or otherwise falling within a recently added category of non-wealthy professionals that includes brokers and registered investment advisers. Section 138312 would generally take effect for tax years beginning after December 31, 2021, but there is a 2-year transition period for IRAs already holding such investments.

Section 138314

To prevent self-dealing, under current prohibited transaction rules, an IRA owner cannot invest his or her IRA assets in a corporation, partnership, trust, or estate in which he or she has a 50 percent or greater interest. However, an IRA owner can invest IRA assets in a business in which he or she owns, for example, one-third of the business while also acting as the CEO. The House Ways and Means drafted Section 138314 adjusts the 50 percent threshold to 10 percent for investments that are not tradable on an established securities market, regardless of whether the IRA owner has a direct or indirect interest. The bill also prevents investing in an entity in which the IRA owner is an officer. Further, the bill modifies the rule to be an IRA requirement, rather than a prohibited transaction rule (i.e., in order to be an IRA, it must meet this requirement). This section generally takes effect for tax years beginning after December 31, 2021, but there is a 2-year transition period for IRAs already holding these investments.

Legislative Status of the Bill

The draft bill advanced out of the House Ways and Means Committee to the House Budget Committee, which on September 25th reported the legislation to the House of Representatives with a favorable recommendation. The draft bill is now with the House Rules Committee, where significant changes are likely to be made before the legislation goes to the House floor for a full vote. Further, the House is expected to try to resolve major differences between their product and the Senate's version before voting on the bill. If it passes the House, the bill will proceed to the Senate with an expected vote sometime in the fall of this year.

Take Action

With most of the discussion in the House and Senate committees focused on corporate and capital gains taxes, there appears to be little understanding around the impact these particular retirement plan provisions will have on ordinary taxpayers. You may write to your Members of Congress and Senators urging them to remove Section 138312 and Section 138314 from the legislative draft text proposed by the House Ways and Means Committee to the House Reconciliation bill. Following are several points you may wish to make to your congressmen:

- These limitations on IRA investment choice are “under-the-radar” provisions that have never been publicly vetted and will have unintended and adverse impacts on you and other Americans who wish to save for a secure retirement through Main Street investments. Middle-class investors, who were just recently allowed to invest in these startups thanks to liberalized accredited investor rules, would be locked out of building wealth in these companies through their retirement plans.
- The legislation negatively impacts the ability of small businesses that employ everyday Americans to obtain the funding necessary to operate and grow their business and create jobs. The proposed legislation eliminates the ability of suitable investors to participate in private capital-raising transactions through their IRAs, a source of funding on which many of these small businesses rely.
- The legislation will ultimately increase the wealth gap (which is in direct opposition to the legislation’s stated goals) because it would limit the ability of many Americans, whose investable funds are almost exclusively in their retirement accounts, to invest in these private investments.
- The legislation negatively impacts your ability to save for a secure retirement by limiting your choice and ability to diversify your retirement savings outside of the stock market.
- The legislation will likely cause you significant negative financial consequences by forcing you to sell or liquidate existing IRA investments at a depressed price by a publicized date certain, and may also cause significant negative tax consequences (including early distribution penalties) by forcing you to distribute in-kind from your IRA any investments that you are unable to sell or liquidate.

In the subject line of any correspondence with your congressmen, you may wish to consider including the wording “Sections 138312/138314 of \$3.5T Infrastructure Bill.” This will make it easier for congressional aides to track public opinion against the proposals. You may contact your U.S. Congressional Representative at <https://www.house.gov/representatives/find-your-representative> and your U.S. Senators at <https://www.senate.gov/senators/senators-contact.htm>.
