



Tax Insights
from Tax Policy Services

Senate Finance Ranking Member Wyden introduces bills dealing with carried interest, derivatives, grantor trusts, and insurance contracts

April 29, 2026

In brief

What happened?

Senate Finance Committee Ranking Member Ron Wyden (D-OR) recently re-introduced bills that would make significant changes to the current tax treatment of carried interest received by investment fund managers and tax rules related to derivatives. Senator Wyden also recently introduced two new bills that would make significant changes to tax rules related to grantor trusts and life insurance contracts. In public statements, Senator Wyden has stated that his bills seek to address “abusive” tax practices and would close tax “loopholes” that are described as benefitting high-income individuals.

Why is it relevant?

The bills proposed by Finance Ranking Member Wyden provide a marker for future legislative action that he could pursue as chairman of the Finance Committee if Democrats regain majority control of the Senate following the 2026 midterm elections. If Democrats gained control of both the House and Senate in the next Congress and approved similar measures, the only obstacle to enactment would be a potential veto by President Trump. However, the tax policy approaches in the Wyden bills could potentially have increased prospects for enactment after the 2028 elections if Democrats again gain

trifecta control of both the White House and Congress and could use reconciliation procedures to advance legislation with only Democratic support.

Observation: The potential for major shifts in approaches to tax legislation has increased in recent years, with both Republicans and Democrats securing trifecta control of the White House and Congress for at least two years in the last three presidential election year cycles. The scope of any potential swing in the direction of tax policy under a single-party trifecta, however, has been affected by the size of the House and Senate majority that either party has been able to secure and the priorities of the President. The level of support for Senator Wyden’s proposals among Democrats in Congress—under different configurations of Congressional and Executive branch control—remains to be seen.

Actions to consider

Business and individual taxpayers who could be affected by the proposed legislation should review the potential effects of the legislation and be prepared to share their views on the legislation with policymakers in both parties as political dynamics continue to evolve.

In detail

Overview

Senate Finance Committee Ranking Member Ron Wyden (D-OR) on April 16 re-introduced bills that would make significant changes to the current tax treatment of carried interest received by investment fund managers (S. 4330) and tax rules related to derivatives (S. 4331). Senator Wyden on April 14 introduced a bill (S. 4287) that would make significant changes to tax rules related to grantor trusts and on April 13 introduced a bill (S. 4279) that seeks to limit the tax benefits of certain life insurance contracts. In public statements, Senator Wyden has stated that his bills seek to address “abusive” tax practices and would close tax “loopholes” that are described as benefitting high-income individuals.

While the bills introduced by Senator Wyden have been cosponsored by some Senate Democrats, the overall level of support for these proposals among Democrats in Congress remains to be seen. The legislative priorities of any future Democratic President also will be a critical factor affecting prospects for tax legislation.

Observation: While Democratic trifecta control of the White House and both chambers of Congress could provide an opportunity to advance reconciliation legislation with only Democratic votes, the size of a potential House and Senate Democratic majority could be another key factor affecting future legislation, as was demonstrated when Democrats held narrow majorities in the 117th Congress and many significant business and individual tax increase proposals were dropped from the final version of the 2022 Inflation Reduction Act signed by then-President Joe Biden.

The Ending the Carried Interest Loophole Act (S. 4330)

Wyden’s latest carried interest proposal mirrors proposals introduced by Wyden in 2021 and 2023. The proposal would repeal Section 1061, enacted as part of the 2017 Tax Cuts and Jobs Act (TCJA), and replace it with new Section 1299, addressing both the character of income and deferral of tax with respect to carried interests.

Section 1061 extended the holding period for long-term capital gains associated with an ‘applicable partnership interest’ (API) to greater than three years. An applicable partnership interest is defined as

any interest in a partnership that is transferred to (or held by) a taxpayer in connection with the performance of substantial services in an applicable trade or business (ATB), and generally includes the interest of a partner to the extent that partner is entitled to a carried interest (i.e., an incentive structured as an allocation of future partnership profits rather than as a fee for services). An ATB is a trade or business involving regular, continuous, and substantial raising of capital and investing in or developing securities, commodities, real estate, and similar assets.

The new proposed Section 1299 would use a deemed loan construct to treat any taxpayer holding an API as recognizing current ordinary income equal to the partner's deemed compensation amount. The deemed compensation amount is imputed income that is calculated and recognized annually based on a specified rate of return on an applicable percentage of the invested capital of all partners over the partner's share of invested capital. Invested capital is intended to equate to the partner's book capital account required to be maintained under Section 704(b) but is calculated without regard to untaxed gains and losses resulting from the revaluation of partnership property. The applicable percentage is the highest percentage of profits that could be allocated with respect to the partner, consistent with the partnership agreement and determined as if all performance targets with respect to the interest had been met. The taxpayer would be concurrently treated as realizing an equivalent capital loss. The provision also would accelerate inclusion in the case of a disposition of an API.

Observation: The taxation of carried interest has been the subject of ongoing debate since 2007, with various proposals introduced by members of both parties. However, the only enacted change to the taxation of carried interest since that time has been the enactment of the Section 1061 holding period as part of the 2017 TCJA.

The Joint Committee on Taxation (JCT) estimated that Wyden's 2023 carried interest proposal, which is substantively identical to the current proposal, would raise \$63.1 billion over 10 years. By comparison, the JCT staff estimated that Section 1061 holding period provision enacted in 2017 was estimated at that time to raise only \$1.1 billion over 10 years.

In 2021, a Ways and Means Committee proposal to extend the 1061 holding period and to modify significantly the holding period rules and add other requirements was estimated by JCT staff at that time to raise \$14.1 billion over 10 years. As noted above, the Ways and Means Committee-approved carried interest provision and many other revenue-raising proposals were dropped from the House-passed version of the legislation that later was modified further by the Senate and enacted as the 2022 Inflation Reduction Act.

The Modernization of Derivatives Tax Act (S. 4331)

Senator Wyden's recently introduced bill that proposes to change the federal income tax treatment of financial derivatives—the "Modernization of Derivatives Tax Act of 2026" (MODA 2026)—is identical to Wyden's 2021 MODA proposal, except for the addition of new provisions related to real estate investment trusts (REITs).

Under MODA 2026, all financial derivatives (broadly defined) would be marked-to-market, and the resulting gain/loss would be treated as ordinary income/loss attributable to a trade or business and sourced to the country of the taxpayer's residence.

The bill also introduces the concept of an "investment hedging unit," to address situations in which the taxpayer also owns the asset underlying a financial derivative. In these situations, a taxpayer must determine whether the financial derivative and "**any portion**" of the underlying asset owned by the taxpayer have a "delta" within a certain range (negative 0.7-1.0)—i.e., if the underlying asset moves in

value by a small degree, is the FMV of the derivative expected to change (inversely) by 70% or more? If the financial derivative and the underlying asset meet the delta test, the taxpayer must timely identify the derivative and the portion of the underlying asset as an “investment hedging unit,” and mark-to-market both positions. Failure to make such a timely identification will cause the taxpayer to mark-to-market the derivative and all of the underlying asset in perpetuity (even new positions).

The regime is subject to carve-outs for hedging transactions, securities lending and similar financing transactions, employee compensatory options, and annuity contracts, intra-group stock derivatives, and commodity contracts used in the normal course of trade or business. Derivatives can be aggregated when applying delta tests. Where a contract contains both derivative and non-derivative components, the derivative component must be bifurcated and treated separately; if the derivative component cannot be separately valued, the entire contract is treated as a derivative.

Observation: MODA 2026 reflects a dramatic departure from established tax norms. In particular, the concept of ‘delta’ will be extremely complicated to implement, and the failure to do so will result in severe and permanent consequences. For example, as noted, MODA 2026 actually computes delta by affirmatively testing on an unbalanced or lopsided basis. This could have the effect of creating accidental “investment hedging units” with severe consequences.

Observation: Insurance companies currently have a character mismatch because investment gains and losses are capital while insurance reserves are ordinary. MODA 2026 is generally expected to provide relief from this character mismatch by providing that debt instruments held by insurance companies are not capital assets.

Observation: Foreign insurance companies that have made a section 953(d) election to be treated as domestic insurance companies and that are members of an affiliated group, must treat their ordinary losses but not their capital losses as dual consolidated losses (“DCLs”). MODA 2026 would therefore expand the amount of their losses that are considered DCLs.

A notable addition in the 2026 version of MODA is a set of provisions specifically tailored to REITs. The proposal permits a REIT to make an election to treat all of its fixed-rate debt instruments, contracts to acquire or sell such instruments, and interest rate derivatives as an investment hedging unit subject to the mark-to-market regime. Transition relief is provided for REITs making this election, including rules for netting built-in gains and losses across derivatives and underlying investments at the time of election. Electing REITs with capital loss carryovers are further permitted to treat as short-term capital gain, rather than ordinary income, the lesser of any net gain from their investment hedging unit during the taxable year or the sum of any previously suspended built-in loss from such investment unit plus the capital loss carryover.

Furthermore, if a REIT has made the election described above, income would be excluded for purposes of the REIT income tests to the extent the income is related to transactions that are entered to manage the risk of interest rate or price changes with respect to real estate assets eligible for the election which have been acquired or will be acquired and held in an investment hedging unit.

Observation: This provision is notable in that it ensures electing REITs would not jeopardize their REIT status by the use of the new hedging framework as well as allowing electing REITs to actively and directly engage in hedging the value their assets which are eligible for the election noted above.

The Getting Rid of Abusive Trusts Act (S. 4287)

Senator Wyden’s recently introduced bill (the GRATs Act) to modify the existing rules for grantor retained annuity trusts (or GRATs) seeks to make broad changes to common income and gift tax planning

techniques involving grantor trusts – including the income tax treatment of transactions between a grantor trust and the deemed owner of such trust and the gift tax treatment of taxes paid by the grantor on the income of such trust.

With respect to GRATs specifically, the bill would require a minimum term of fifteen years and a maximum term of the life expectancy of the annuitant plus ten years. The annuity would not be allowed to decrease during the GRAT term. The remainder interest would be required to have a minimum value at least equal to the greater of 25% of the fair market value of the property transferred to the trust or \$500,000, and not greater than the fair market value of such property. These provisions would apply to trusts created on or after the date of enactment and to any portion of a pre-existing trust attributable to a contribution made on or after that date.

The bill also would treat transfers of property for consideration between a grantor trust and the deemed owner as a sale or exchange for income tax purposes, with exceptions for fully revocable trusts, asset-backed securities trusts, and any other grantor trust identified by the Secretary as appropriate to exclude. Transfers would include any satisfaction of an annuity or discharge of debt. The legislation would further treat the grantor trust and its deemed owner as related parties under Section 267(b), disallowing recognition of any loss on a sale or exchange. These provisions would apply to transfers made after the date of enactment, meaning they could reach existing trusts.

Observation: By treating transfers of property between a grantor trust and its deemed owner as a sale or exchange for income tax purposes, the GRATs Act would effectively revoke the non-recognition treatment long provided by Revenue Ruling 85-13 (which holds that such transfers are disregarded for income tax purposes).

Finally, the bill provides that taxes paid by the deemed owner of the income of a non-fully-revocable grantor trust would be treated as a taxable gift unless the trust reimburses the owner within the same calendar year. No charitable deduction under Section 2522, marital deduction under Section 2523, annual exclusion under Section 2503(b), or exclusion for qualified transfers of tuition or medical care under Section 2503(e) would be available to reduce the deemed gift. The gift would be deemed to have occurred on the earliest of December 31 of the relevant calendar year, the day before the deemed owner's death, or the date on which the deemed owner renounces any right of reimbursement. These provisions would apply to trusts created on or after the date of enactment.

Observation: The bill does not specify whether the "taxes paid" on the income of a grantor trust is limited to Federal income taxes imposed under Chapter 1, or includes other taxes such as state income taxes, self-employment tax, net investment income tax, etc.

Observation: Taxpayers may avoid gift tax treatment if the grantor trust reimburses the grantor within the same calendar year; however, the bill is silent on whether the existence (or routine exercise) of such a reimbursement right could be viewed as a retained interest in the trust under Section 2036, potentially triggering estate tax inclusion of the trust assets.

The Protecting Proper Life Insurance from Abuse Act (S. 4279)

Senator Wyden's bill would create a new section of the Internal Revenue Code that would provide that a private placement contract (PPC) would not be treated as a life insurance or annuity contract for federal income tax purposes. A PPC is a variable life insurance or annuity contract purchased by accredited investors or qualified purchasers, as defined in securities law. A PPC also includes certain foreign-issued contracts. A contract is not a PPC if the segregated asset account held at the issuing insurance company supports at least 25 other PPCs with different holders.

If enacted, the holders of PPCs would not receive tax-free inside build-up and the beneficiaries of PPCs would not receive tax-free life insurance death benefits. In addition, insurance companies would not be permitted to deduct reserves relating to PPCs, and the income earned on PPCs would be taken into account under an accrual method of accounting. The proposal would be effective for existing and new contracts. For existing contracts, all prior earnings would be taken into account if the contract is not converted to a non-PPC or surrendered within 180 days of enactment.

The bill is substantively the same as the discussion draft released by Wyden in December 2024. The discussion draft was released after an 18-month Finance Committee investigation into the growing use of private placement life insurance (PPLI). The investigation found that PPLI policies are “promoted to ultra-wealthy Americans as tax-free hedge and private equity fund investments” and that “legislation is needed to increase oversight of PPLI and curb abuse of these products as tax avoidance by the wealthiest 1 percent of Americans.”

Observation: If enacted, the bill could result in substantial income to the holder of existing PPCs. The holder of an existing PPC would be required to recognize income from either continuing to hold the contract or from the “transition relief” provided in the bill.

Observation: The bill would have adverse impacts on insurance companies as well, which would include the denial of the tax status of the contracts as life insurance or annuity contracts, and reserve deductions, while requiring the inclusion of the income on the contracts on an accrual basis. Therefore, there may be potential repercussions to the company such as its continued qualification as a life insurance company, application of Section 848, and mismatches of income and deductions. Furthermore, any reinsurance of such contracts would need to take into account the effect of the bill, potentially disrupting commercial aspects of the reinsurance, including pricing.

Observation: Given the significant adverse effects to both policyholders and insurance companies, the result may be either the surrender of, or changes to, existing PPCs, and the discontinuance of future PPC offerings.

For more information

Links below to Senator Wyden press statements, including bill text and staff summaries

[The Ending the Carried Interest Loophole Act](#)

[The Modernization of Derivatives Tax Act](#)

[The Getting Rid of Abusive Trusts Act](#)

[The Protecting Proper Life Insurance from Abuse Act](#)

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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