



SUMMARY OF PROPOSED TAX LEGISLATION

On September 13, 2021, the House Ways and Means Committee released legislative text for proposed tax changes to be incorporated in the budget reconciliation bill known as the "Build America Back Better" act. The proposal would raise tax rates for corporations and individuals and make many other changes to the Internal Revenue Code. The following is a summary of some of the proposed changes:¹

ESTATE TAX LAW CHANGES

Reduction in Estate and Gift Tax Exemption: The current exemption against estate and gift tax (presently \$11,700,000 per person) will be intact through the end of 2021, but will be reduced to one-half of the present amount effective January 1st, 2022. This means that while a taxpayer could make gifts of up to \$11,700,000 (less any prior taxable gifts made) through the end of 2021, that amount would be cut in half thereafter. Note that taxpayers “gift off the bottom”, meaning that if they only use ½ of the current available credit (\$5,870,000), and the exemption goes down to that amount, taxpayers would have no remaining credit moving forward, other than annual inflation increases.

Certain Tax Rules Applicable to Grantor Trusts: The proposal adds section 2901, which pulls grantor trusts into a decedent’s taxable estate when the decedent is the deemed owner of the trusts. Grantor trusts have been used for years to grow and appreciate assets outside of a taxpayer’s estate for estate tax purposes while still having the trust taxed to the grantor for income tax purposes. The proposal also adds a new section 1062, which treats sales between grantor trusts and their deemed owner as equivalent to sales between the owner and a third party. The amendments made by this section apply to future trusts as well as future transfers or swaps between a taxpayer and a new or previously existing trust.

Valuation Rules for Certain Transfers of Nonbusiness Assets: This proposal amends section 2031 by clarifying that when a taxpayer transfers nonbusiness assets, those assets should not be afforded a valuation discount for transfer tax purposes. Nonbusiness assets are passive assets that are held for the production of income and not used in the active conduct of a trade or business. Exceptions are provided for assets used in hedging transactions or as working capital of a business. A look-through rule provides that when a passive asset consists of a 10 percent interest in some other entity, the rule is applied by treating the holder as holding its ratable share of the assets of that other entity directly. The amendments made by this section apply to transfers after the date of the enactment of this Act.

CORPORATIONS AND BUSINESSES

Tax rate: The proposal would replace the current flat 21% corporate tax rate with a graduated rate, starting at 18% on the first \$400,000 of income; 21% on income up to \$5 million; and 26.5% on income above \$5 million. However, the graduated rate would phase out for corporations making more than \$10 million.

Limitation on Deduction of Qualified Business Income: This provision amends section 199A which previously reduced the income tax on many types of closely held businesses by setting the maximum allowable deduction at \$500,000 in the case of a joint return, \$400,000 for an individual return, \$250,000 for a married individual filing a separate return, and \$10,000 for a trust or estate. The amendments made by this section apply to taxable years beginning after December 31, 2021.

Carried interests and capital gains: The proposal would generally extend from three to five years the holding period required for gain attributable to an applicable partnership interest to qualify for long-term capital gain treatment. The provision would retain the three-year holding period for real property trades or businesses and taxpayers with an adjusted gross income (AGI) less than \$400,000. The proposal also would extend Sec. 1061 to all assets eligible for long-term capital gain rates.

Sec. 1202 stock: The proposal would provide that the special 75% and 100% exclusion rates for gains realized from certain qualified small business stock would not apply to taxpayers with AGI equal to or exceeding \$400,000. The baseline 50% exclusion in Sec. 1202(a)(1) would remain available for all taxpayers.

INDIVIDUALS

Tax rates: The proposal would increase the top marginal individual income tax rate to 39.6%. This marginal rate would apply to married individuals filing jointly with taxable income over \$450,000; to heads of household with taxable income over \$425,000; to unmarried individuals with taxable income over \$400,000; to married individuals filing separate returns with taxable income over \$225,000; and to estates and trusts with taxable income over \$12,500.

Capital gains: The proposal would increase the 20% tax rate on capital gains to 25%. A transition rule would provide that the current statutory rate of 20% would continue to apply to gains and losses for the portion of the tax year prior to Sept. 13, 2021. Gains recognized later in the same tax year that arise from transactions entered into before Sept. 13, 2021, pursuant to a written binding contract would be treated as occurring prior to Sept. 13, 2021.

Net investment income tax: The proposal would expand the Sec. 1411 net investment income tax to cover net investment income derived in the ordinary course of a trade or business for taxpayers with greater than \$400,000 in taxable income (single filers) or \$500,000 (joint filers), as well as for trusts and estates.

High-income surcharge: The proposal would impose a tax equal to 3% of a taxpayer's modified AGI (MAGI) in excess of \$5 million (or in excess of \$2.5 million for a married individual filing separately). For this purpose, MAGI would mean AGI reduced by any deduction allowed for investment interest (as defined in Sec. 163(d)).

RETIREMENT PLANS

Contributions to IRAs: The proposal would prohibit further contributions to a Roth or traditional IRA for a tax year if the total value of an individual's IRA and defined contribution retirement accounts generally exceeds \$10 million as of the end of the prior tax year. The limit on contributions would only apply to single taxpayers (or taxpayers married filing separately) with taxable income over \$400,000, married taxpayers filing jointly with taxable income over \$450,000, and heads of household with taxable income over \$425,000 (all indexed for inflation).

RMDs: For high-income taxpayers, as defined in the preceding item, if an individual's combined traditional IRA, Roth IRA, and defined contribution retirement account balances generally exceed \$10 million at the end of a tax year, a minimum distribution would be required for the following year. The minimum distribution would generally be 50% of the amount by which the individual's prior-year aggregate traditional IRA, Roth IRA, and defined contribution account balance exceeds the \$10 million limit. To the extent that the combined balance amount in traditional IRAs, Roth IRAs, and defined contribution plans exceeds \$20 million, that excess would be required to be distributed from Roth IRAs and Roth designated accounts in defined contribution plans up to the lesser of (1) the amount needed to bring the total balance in all accounts down to \$20 million or (2) the aggregate balance in the Roth IRAs and designated Roth accounts in defined contribution plans.

Roth conversions: The proposal would eliminate Roth conversions for both IRAs and employer-sponsored plans for single taxpayers (or taxpayers married filing separately) with taxable income over \$400,000, married taxpayers filing jointly with taxable income over \$450,000, and heads of household with taxable income over \$425,000 (all indexed for inflation).

Prohibition of IRA Investments Conditioned on Account Holder's Status: The bill prohibits an IRA from holding any security if the issuer of the security requires the IRA owner to have certain minimum level of assets or income, or have completed a minimum level of education or obtained a specific license or credential. For example, the legislation prohibits IRAs from holding investments which are offered to accredited investors because those investments are securities that have not been registered under federal securities laws. IRAs holding such investments would lose their IRA status. 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.

Prohibition of Investment of IRA Assets in Entities in Which the Owner Has a Substantial Interest: To prevent self-dealing, under current law 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 bill 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.

¹ Credit Summary by House Ways and Means Committee and Journal of Accountancy, Alistair M. Nevius, J.D. September 13, 2021