The Bankler Report

September 14, 2021

INTRODUCTION

The legislative text of the House Ways and Means Committee was released on September 13, 2021. This is the Committee's starting point in the legislative process. When or if passed, the actual law will probably differ significantly from this proposal. Below is a quick summary of the major proposals:

A. Individual Taxes:

1. **Increase in top tax rate** –The top tax rate would increase from 37% to 39.6%. This rate would apply to joint filers with taxable income over $450,000, head of households over $425,000, and unmarried individuals over $400,000.

2. **New 3% tax surcharge –** This would apply to taxpayers with modified Adjusted Gross Income (AGI) in excess of $5 million (joint filers) or $2.5 million (married filing separately). Modified AGI is AGI reduced by any deduction allowed for investment interest.

3. **Increase in capital gain top tax rate** - Long-term capital gains tax rate increases from 20% to 25%. If this is passed, **the effective date will be September 13, 2021**, unless pursuant to a written binding agreement entered into before September 13, 2021.

4. **Expansion of Net Investment Income (NII) tax** – This tax, which imposes an additional tax of 3.8% on income from passive businesses, will now be imposed on active businesses as well. It will be imposed on taxpayers with more than $500,000 taxable income (joint filers), $400,000 (single filers), or $250,000 (married filing separately).

5. **Qualified Business Income (QBI) deduction** – This deduction is capped at a taxable income of $500,000 (joint filers), $400,000 (single filers), or $250,000 (married filing separately).

6. **Excess business losses –** These apply to non-corporate taxpayers and were due to expire but would now be made permanent.

B. Retirement Accounts:

1. **No contributions allowed for large accounts –** If an IRA or Roth IRA has an account balance that exceeds $10 million at the end of the prior year, no deductions are allowed if the taxpayer has taxable income in excess of $450,000 (married filing joint), $400,000 (single filers) or $425,000 (heads of households). These limits will be adjusted for inflation.

2. **New required minimum distributions for "large" accounts** – There will be a required distribution from defined contribution retirement accounts where the ending prior year consolidated account balance exceeds $10 million. Applies to the same taxpayers in #1 above (disallowing contributions to these accounts).

3. **New annual reporting** for defined contribution plans with balances exceeding $2.5 million.

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4. **Elimination of "back-door" Roth conversions**- The proposed law eliminates this strategy.

5. **Prohibit IRA investments where the issuer requires the IRA owner to meet minimum requirements** – These requirements included minimum assets, income level, or being an accredited investor. Effective for tax years beginning after December 31, 2021, but with a 2-year transition rule.

C. Business/Corporate Taxes:

1. **Increase in top tax rate** –The flat 21% corporate tax rate is replaced with a graduated structure: (i) 18% on the first $400,000 of taxable income, (ii) 21% on income up to $5 million, and (iii) 26.5% on income thereafter. The benefit of the graduated rate phases out for corporations making more than $10 million. Also, no graduated rates for personal service corporations.

2. **Interest deduction limitations –** Generally affecting large international businesses. Applies to domestic corporations whose average excess interest expense over a 3-year period exceeds $12 million.

3. **Partnership treated as aggregates and not entities for the purpose of the interest deduction.**

4. **Carried interest -** Extends from 3 to 5 years the holding period required for gains to qualify for long-term capital gain treatment.

5. **Qualified Business Income (QBI) deduction** – This deduction is capped at taxable income of $500,000 (joint filers), $400,000 (single filers), or $250,000 (married filing separately).

6. **Excess business losses –** These apply to non-corporate taxpayers and were due to expire but would now be made permanent.

7. **Permits an S corporation to reorganize into a partnership** without triggering tax on liquidation. Applies to any corporation that was an S corporation on May 13, 1996, and it must completely liquidate and transfer substantially all of its assets and liabilities to a domestic partnership during the 2-year period beginning on December 31, 2021**.**

D. Estate and Gift Taxes:

1. **Reduction in lifetime unified credit** –The unified credit exemption equivalent is reduced from $11.7 million to $5 million per individual, indexed for inflation.

2. **Qualified real property increase –** Increase in allowable reductions from $750,000 to $11.7 million for qualified real property used in a family farm or family business. This reduction allows decedents who own real property used in a farm or business to value the property for estate tax purposes based on its actual use rather than fair market value.

3. **Valuation discounts modifications** – Elimination of valuation discounts for transfer tax purposes when a taxpayer transfers nonbusiness assets. Nonbusiness assets (Family Limited Partnerships, etc.) are passive assets that are held for the production of income and not used in the active conduct of a trade or business.

4. **Changes in grantor trust rules -** This new provision would include a grantor trust in a decedent's taxable estate when the decedent is the deemed owner of the trust. Also, sales between grantor trusts and their deemed owners are treated as sales to a third party. These new provisions apply only to future trusts and future transfers.

This report only discusses specific provisions that we consider to be of general interest to business owners and is not a complete discussion of the bill's contents. As with any proposed changes in the tax laws, there may be new planning opportunities to be considered. Please feel free to contact us with your specific questions.

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