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Big Potential Tax Changes on the Horizon for Clients

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The U.S. House Ways and Means Committee released proposed budget reconciliation legislation on September 13, 2021. The bill still must complete many steps in the legislative process – including passage by the full House of Representatives and the full Senate and signature by the President – before becoming law. However, the contents of the bill provide insight into the types of tax law changes that the current Congress may enact.

The current bill is long and complex, but generally seeks to finance $3.5 trillion of new government spending in part through tax increases on corporations and the wealthy. Some of its highlights are below:

Income Tax Rate Proposals for Individuals

- The top marginal ordinary rate for individuals would rise from 37% to 39.6% for single individuals with taxable incomes above $400,000 and for married individuals filing jointly with taxable incomes over $450,000. In addition to the changes above, a further 3% surtax would apply to individuals with ***adjusted gross income*** over $5,000,000. The surtax also would apply to a trust with adjusted gross income in excess of $100,000. These rate increases would be effective for taxable years beginning after calendar year 2021.
- The top capital gains rate for individuals with taxable incomes above $400,000 for single filers and above $450,000 for joint filers also would rise from 20% to 25%. Note that the increase would be effective as of the date of introduction of the bill (September 13, 2021), subject to some grandfathering for transactions that are subject to a binding contract entered into before that date and that close in 2021.
- Expansion of the 3.8% net investment income tax to cover net income derived in the ordinary course of a trade or business (e.g., from a partnership) for taxpayers with taxable income above $400,000 (for single filers) or $500,000 (for joint filers). Under this proposal, all income of taxpayers above those thresholds (including income earned through S corporations) that is not subject to self-employment tax would be subject to the net investment income tax.
- The qualified business income deduction under Section 199A of the Internal Revenue Code would be capped at $500,000 for individuals filing jointly and $400,000 for individuals filing singly.
- The carried interest holding period extended from 3 to 5 years in order to obtain capital gain treatment.

- QSBS (qualified small business stock) capital gains exclusion would be limited to 50%; currently 100% of the gain for the sale of eligible stock may be excluded up to $10 million. This change would apply to individuals with gross incomes over $400,000 and would apply to sales after the date of the bill's introduction.

Corporate and International Proposals

- The top corporate tax rate would rise from 21% to 26.5% for corporations with taxable income above a $5,000,000 threshold. There would be a new lower bracket for corporations with income below $400,000.
- Interest deductions for domestic corporations that are part of an international financial reporting group are limited to their proportionate share of the total earnings of the international financial reporting group to prevent earnings stripping. Note this provision would especially affect so-called leverage blocker structures commonly used by foreign investors in US real estate which are currently able to elect out of the existing section 163(j) interest stripping limitations.
- GILTI (Global Intangible Low Tax Income) rate increased from 10.5% to 21% (by reducing the section 250 deduction) and a country-by-country application of the GILTI regime.
- BEAT (base erosion anti-abuse tax) adjustments including rate increases to 10% for next two years and 12.5% thereafter.
- FDII (Foreign-Derived Intangible Income) adjustments including reducing the deduction from 37.5% to 21.875%.

Estate & Gift Tax Proposals

- The estate and gift tax exclusion and the generation-skipping transfer (GST) tax exemption would be cut roughly in half beginning January 1, 2022. In 2021, each individual has an estate and gift tax exclusion of up to $11.7 million and a GST exemption also of $11.7 million.
- Changes to the rules governing grantor trusts, such as causing the estate tax treatment of a grantor trust to more closely track its income tax treatment. This essentially would cause the underlying property to be included in the grantor's estate at death and potentially subject the trust assets to tax. This change would impact grantor trusts formed or funded, or additions to existing grantor trusts, after the date of the bill's enactment. The change would make grantor trusts difficult to use going forward and may especially impact grantor trusts that receive regular contributions, like insurance trusts. In addition, sales from grantor trusts to its owner would now be a taxable transaction.
- Changes to valuation methodologies, including limiting valuation discounts on transfers of non-business assets.

Retirement Accounts

- IRAs with balances in excess of $10 million: Additional contributions to an IRA would be banned once the total combined value of an individual's retirement accounts exceeds $10 million. The limit on contributions would apply to singled taxpayers with taxable incomes over $400,000 and married taxpayers filing jointly with incomes over $450,000. Individuals with retirement assets over $10 million would be forced to make withdrawals.

The bill did not contain several items that that have previously been discussed as potential tax law changes, such as the elimination of section 1031 exchanges, the step up in basis for appreciated assets held at death and the $10,000 limit on deducting state and local taxes (the SALT deduction).

It remains an open question whether this legislation will pass in its current form or at all. Please contact your Goulston & Storrs attorney with questions surrounding this advisory.