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TAX PROPOSALS INTRODUCED BY HOUSE WAYS AND MEANS COMMITTEE

THOUGHT LEADERSHIP PERSPECTIVES

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THE DEMOCRATIC MAJORITY OF THE HOUSE WAYS AND MEANS COMMITTEE HAS RELEASED TAX PROPOSALS TO BE INCLUDED IN PROPOSED BUDGET RECONCILIATION LEGISLATION.

These proposals present several new spending initiatives in the areas of infrastructure, green energy, social safety net, and prescription drugs. To raise revenue, the tax proposals include additional tax law changes.

Here are the plan's tax provisions and how they could affect you:

- **Increase the Top Tax Rate to 39.6%**
  The legislation proposes a return to a top income tax rate of 39.6%. Keep in mind, there would still be the additional Medicare tax of 0.9% on earned income and 3.8% Net Investment Income Tax on investment income for a total tax of 43.4%. This would apply to taxable years after December 31, 2021.

- **Increase Long-Term Capital Gain Rates to 25%**
  The top long-term capital gain rate would be raised to 25%. This would be effective as of the date of *introduction*, September 13, 2021. The 20% rate applies to long-term capital gains recognized before the effective date.

- **3% Surcharge**
  A new tax would be introduced, imposing a 3% tax on modified adjusted gross income over $5,000,000. For purposes of the surcharge, modified adjusted gross income is adjusted gross income less deductions allowed for investment interest. This would also apply to trusts with adjusted gross income over $100,000. The surcharge would come into effect for tax years after December 31, 2021.

- **Decrease the Estate Tax Unified Credit**
  The Estate Tax Unified Credit will revert to the 2010 level of $5,000,000 per individual, indexed for inflation. This would mean the current $11.7 million gift, estate and GST tax exemptions would decrease to $6.03 million. This decrease will be effective for gifts made and decedents passing away after December 31, 2021.

- **Tax Changes for Grantor Trusts**
  Currently, Grantor Trusts are trusts that, when properly drafted, are outside of the grantor's Estate but are still taxable to the grantor for income tax purposes. The proposal would have Grantor Trusts be includable in the estate of the grantor. The proposal would also require income tax recognition for certain transactions between the grantor and the Grantor Trust. This would include sales as well as payments to the grantor made with appreciated securities. These provisions would apply to trusts created or funded after date of enactment, and any portion of a trust established before date of enactment that is attributed to a contribution made on or after date of enactment.

- **Modification of Rules Relating to Retirement Plans**
  The House proposal would limit retirement planning for "high income taxpayers". This is defined as married filing jointly taxpayers with taxable income over $400,000. "High income taxpayers" (1) cannot make contributions to a ROTH or traditional IRA for a tax year if the total value of retirement accounts exceeds $10 million at the end of the year; and (2) must take a required minimum distribution equal to 50% of the amount of the account balance over $10 million (larger distribution required for balances over $20 million).

  Furthermore, the proposal would prohibit all after-tax contributions being converted to a ROTH, regardless of income level. These changes would apply for tax years after December 31, 2021. "High income taxpayers" also cannot make ROTH conversions from IRAs and employer-sponsored plans. Taxpayers, regardless of income level, cannot convert after-tax IRA contributions to a ROTH IRA. These changes would apply for tax years after December 31, 2031.

- **Application of Net Investment Income Tax to Trade or Business Income**
  For taxpayers with income over $400,000, the 3.8% Net Investment Income Tax will be expanded to tax the trade or business income derived in the ordinary course of a trade or business. This does not apply to wages subject to FICA. This expansion of the Net Investment Income Tax would be applicable to taxable years after December 31, 2021.

- **Valuation Rules for Certain Transfers of Nonbusiness Assets**
  The proposal seeks to limit the estate and gift tax valuation discount applied to transfers of closely held nonbusiness assets. 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. This would apply to transfers made after the date of enactment.

- **Limit Certain Section 1202 Gain Exclusion**
  For taxpayers with income over $400,000, the 1202 exclusion rate for gains realized from certain qualified small business stock will be limited to a 50% exclusion. The 50% exclusion limit applies to sales after September 13, 2021.

- **Limit Qualified Business Income (QBI) Deduction**
  The QBI deduction will be limited to $500,000 for joint filers. This applies for tax years after December 31, 2021.

- **Increase Corporate Tax Rate**
  Replace the flat corporate tax rate with a bracket system. The rates would be 18% on the first $400,000 of income, 21% on income up to $5 million, and 26.5% on income over $5 million. This would be effective for tax years after December 31, 2021.

- **Audit More Taxpayers with Income over $400,000**
  The Internal Revenue Service (IRS) has had its budget cut over the past decade. That has meant a lack of resources for tasks such as assisting taxpayers with questions and auditing tax returns. The proposal calls for increased funding for the IRS specifically for enhanced enforcement. The focus will be on auditing large corporations, businesses, estates, and high-income individuals. "High-income" is defined as income greater than $400,000.

  What could an increased audit rate mean? A greater likelihood that you could be audited. In a best-case scenario, an audit is extremely time consuming but results in no change. However, even in a no change audit, additional time will be spent by taxpayers and/or tax professionals to deal with the audit.

There is still a great deal of uncertainty as to both "if" and "when" the above tax provisions could pass. The tax proposals call for higher income taxes and lower estate and gift tax exemption. The tax proposals could also greatly change the income and estate tax treatment of grantor trusts. These significant changes merit further discussion now and could require proactive tax planning.

DURING THESE UNCERTAIN TIMES, TAKING PROACTIVE TAX PLANNING STEPS IS ESSENTIAL. WE STAND READY TO HELP YOU ADDRESS ALL OF YOUR PLANNING CONCERNS. PLEASE REACH OUT TO A MEMBER OF YOUR FAIRMAN GROUP FAMILY OFFICE SERVICE TEAM OR CONTACT OUR OFFICE TODAY.

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