

## Proposed Legislation Impacts High Income Individuals and Corporations

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On September 13, 2021, the House Ways and Means Committee released proposed legislation that includes a host of tax increases focused on high-income individuals and corporations. The proposed tax changes are to be incorporated in the budget reconciliation bill known as the “Build Back Better Act.” With respect to income taxes, it would increase the top capital gains rate from 20% to 25%, raise the top individual tax rate from 37% to 39.6% and impose a 3% surtax on individuals’ income above \$5 million. With respect to estate taxes, it would cut in half the current estate and gift tax exemptions and effectively eliminate a historically popular wealth transfer planning tool – the grantor trust.

The proposed legislation is likely to be heavily debated and may undergo significant changes before it is enacted into law. However, given the far-reaching impact of the proposed changes, it is important to understand the current proposal. This article summarizes some of the major tax provisions included in the proposed legislation.

### Individuals

#### **Increase the Top Federal Marginal Rate from 37% to 39.6%**

- The proposed top federal marginal rate of 39.6% 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

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with taxable income over \$225,000; and to estates and trusts with taxable income over \$12,500. The proposed effective date is for taxable years beginning after December 31, 2021.

### **Increase the Top Federal Long-Term Capital Gains Rate from 20% to 25%**

- Historically, proceeds from the sale of capital assets held for over one year have been taxed at favorable long-term capital gains rates. The top federal long-term capital gains rate (which under current law does not apply to anyone earning less than \$400,000) would be increased from 20% to 25%. The proposed effective date for the 25% long-term capital gain rate is September 13, 2021. Under a proposed transition rule, federal long-term capital gains recognized later in the same tax year that arise from transactions entered into before the date of introduction pursuant to a written binding contract would be treated as occurring prior to September 13, 2021.

### **Expansion of the Net Investment Income Tax**

- The net investment income tax (NIIT) would apply to 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. This change would essentially subject all earnings from pass-through businesses to the 3.8% NIIT or 3.8% self-employment tax, regardless of whether the income is from passive or active activity. The proposed effective date for this change is for tax years beginning after December 31, 2021.

### **Limitation of the Qualified Business Income Deduction**

- The qualified business income (QBI) deduction generally allows eligible self-employed and pass-through business owners to deduct up to 20% of their QBI. The maximum allowable QBI deduction under Section 199A would be limited to \$500,000 for joint returns, \$400,000 for individual returns, \$250,000 for a married individual filing a separate return, and \$10,000 for a trust or estate. The proposed effective date is for taxable years beginning after December 31, 2021.

### **Surtax on High-Income Individuals**

- A surtax equal to 3% of a taxpayer's modified adjusted gross income in excess of \$5 million (or in excess of \$2.5 million for a married individual filing separately) would be imposed. The proposed effective date is for taxable years beginning after December 31, 2021.

### **Changes to the Treatment of Grantor Trusts**

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- Grantor trusts (a common estate planning vehicle used to move assets out of an individual's taxable estate) would largely be eliminated as an effective planning technique due to the inclusion of such trusts in a decedent's taxable estate. Additionally, instead of being disregarded and non-taxable, sales between grantor trusts and their deemed owner would be treated as a taxable sale. This would apply to new trusts created after the date of enactment and any new contributions to existing trusts after the date of enactment.

### Modifications to Estate Tax Valuation Rules

- The valuation rules would ignore discounts from partial ownership or lack of control of an asset in determining its value. This rule would apply to passive assets held, but not active businesses, like a family-owned and operated business. The valuation rules would apply to transfers made after the date of the enactment.

### Decrease the Estate and Gift Tax Lifetime Exemption

- The estate and gift tax lifetime exemption would be cut in half from the current inflation-adjusted \$10 million per person (\$11.7 million in 2021) to an inflation-adjusted \$5 million (i.e., approximately \$6M in 2022). The proposed change would apply to estates of decedents dying and gifts made after December 31, 2021.

### Increase the Required Minimum Distributions from Retirement Accounts

- The minimum required distributions for high-income taxpayers when the total value of an individual's IRA and defined contribution retirement accounts generally exceed \$10 million as of the end of the prior taxable year would be increased. The proposed effective date is December 31, 2021.

## Corporations

### Increase the Top Federal Corporate Tax Rate from 21% to 26.5%

- The following graduated corporate rate schedule with the top rate of 26.5% would be imposed.
  - \$0 to \$399,999 - 18%
  - \$400,000 to \$5 million - 21%
  - More than \$5 million - 26.5%

Corporations that are taxed as personal service corporations are not eligible for the graduated rates and instead are subject to a flat 26.5% rate. These tax increases are

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proposed to be effective for taxable years beginning after December 31, 2021.

### **S Corporation Reorganization**

- Certain S corporations would be allowed to reorganize as partnerships without triggering tax. The eligible S corporation would need to completely liquidate and transfer substantially all its assets and liabilities to a domestic partnership during the two-year period beginning on December 31, 2021.

Koley Jessen continues to monitor the situation and stay current on the federal and state tax issues facing businesses and individuals. If you have additional questions or concerns as the situation develops, please contact a member of the Koley Jessen Estate, Succession and Tax Department.