Significant Changes to the Build Back Better Act: What's In, What's Out and What's Coming

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On September 13, 2021, the House Ways and Means Committee released proposed legislation known as the "Build Back Better Act" that included a host of tax increases focused on high-income individuals and corporations at an estimated cost of $3.5 trillion (*see* article on the September 13th proposal here). On October 28, 2021, the House Budget Committee released a significantly revised version of the Build Back Better Act which retained, removed and modified several proposed tax increases focused on high-income individuals and corporations at a reduced cost of $1.75 trillion. On November 5, 2021, the Build Back Better Act passed a procedural vote in the House of Representatives. Additional modifications to the proposed legislation are likely before (and if) the Build Back Better Act is adopted. This alert, which is current as of November 10, 2021, summarizes some of the major tax provisions included in the revised proposed legislation.

What's Out? – Income Taxes

The following income tax proposals that were included in the version of the Build Back Better Act released by the House Ways and Means Committee on September 13, 2021 are not included in the latest version of the Build Back Better Act:

- Increase in the top marginal individual income tax rate.
- Increase in the capital gains rate for certain high income individuals.

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- Limitation of the qualified business income deduction for certain high income individuals.
- Increase in the top federal corporate tax rate from 21% to 26.5% (but imposes a 15% minimum tax on large corporations and 1% surcharge on certain corporate stock buybacks).
- Five-year holding period for favorable capital gains taxation of carried interests.
- Certain tax-free S corporation reorganizations.

What's Out? – Transfer Taxes (*i.e.*, Estate, Gift and GST Taxes)

The following transfer tax proposals that were included in the version of the Build Back Better Act released by the House Ways and Means Committee on September 13, 2021 are not included in the latest version of the Build Back Better Act:

- Taxation of certain transfers between a deemed owner and an irrevocable grantor trust.
- Gross estate inclusion for the deceased deemed owner of assets held in an intentionally defective grantor trust under certain circumstances.
- Decrease of the estate and gift tax lifetime exemption.
- Prohibition on valuation discounts for certain transfers of nonbusiness assets.

What's In? – Income and Transfer Taxes

The most recent iteration of the Build Back Better Act does not implement changes to the transfer tax system. The income tax provisions that remain in the most recent rewrite are as follows:

- Expansion of the Net Investment Income Tax

  Under current law, a net investment income tax ("NIIT") of 3.8% is imposed on net investment income. The term "net investment income" does not include income (i) derived in the ordinary course of a trade or business, or (ii) income attributable to the disposition of property outside of a "passive activity." The proposed legislation removes the foregoing exceptions so that the NIIT applies to essentially all earnings from pass-through businesses, both passive and active, for taxpayers with modified adjusted gross income in excess of $400,000 for single filers, $500,000 for joint filers, and $12,500 for trusts and estates. The NIIT would apply to income not already subject to FICA taxes. Net operating losses would no longer be accounted for in determining net investment income. The proposed effective date for this change is for tax years beginning after December 31, 2021.

- Limitation of the Small Business Stock Exclusion

The special 75% and 100% exclusion rates under Section 1202 would not be available to taxpayers with adjusted gross incomes in excess of $400,000, or any estate or trust. The baseline 50% exclusion would remain available to all taxpayers. The amendments made by this section are proposed to apply for sales of qualified small business stock acquired after February 17, 2009, and sold after September 13, 2021, subject to a binding contract exception.

- Limitation on Excess Business Losses

  The temporary limitation on excess business losses (*i.e.*, net business deductions in excess of business income) set to expire after 2025 would become permanent. In addition, carryforward losses would be treated as excess business losses rather than net operating losses. In effect, this means the largest net operating loss that can be carried forward from any one year is limited to $500,000. The proposed effective date would be for tax years beginning after December 31, 2020.

- Corporate Minimum Tax

  A corporate minimum tax of 15% for certain large corporations reporting profits in excess of $1 billion for the year would be imposed.

- Limited Contributions and Accelerated Required Minimum Distributions (RMDs) for Certain Retirement Accounts; Backdoor IRAs Prohibited

  Taxpayers with taxable income in excess of $450,000 for joint filers and $400,000 for single filers would be prohibited from making additional contributions to individual retirement accounts ("IRAs") once balance exceeds $10 million. In addition, such owners of large IRAs would be forced to take RMDs at an accelerated rate.

  In addition, the use of so-called "Backdoor Roth IRAs" would be prohibited. Under current law, the Backdoor Roth IRA allows a taxpayer phased-out of making contributions to a Roth IRA due to certain high income thresholds to make nondeductible contributions to a traditional IRA, then later covert such IRA to a Roth IRA. Distributions from traditional IRAs are taxed at ordinary income rates, whereas distributions from Roth IRAs are generally tax-free.

- Substantial Tax Credits Offered for Investment in Affordable Housing, Green Energy Projects and Electric Vehicles.

What's Still In, But Modified?

- Surtax on High-Income Individuals, Trusts and Estates

  A surtax equal to 5% would be imposed on a taxpayer's modified adjusted gross income in excess of: (i) $10 million for single and joint filers; (ii) $5 million for a married individual filing separately; and (iii) $200,000 for an estate or trust.

  An additional surtax of 3% (8% total surtax) would be imposed on a taxpayer's modified adjusted gross income in excess of: (i) $25 million for single and joint filers; (ii) $12.5 million for a married individual filing separately; and (iii) $500,000 for an estate or trust.

  For the above income thresholds, modified adjusted gross income means adjusted gross income reduced by any deduction allowed for investment interest. For an estate or trust, the income thresholds are based on adjusted gross income as determined under Section 67 (e).

  The proposed effective date for these surtaxes is for taxable years beginning after December 31, 2021.

- Excise tax on Repurchase of Public Traded Corporate Stock

  A 1% excise tax on publicly traded US corporations for the value of any of its stock that is repurchased by the corporation would be imposed. The proposed effective date for this excise tax is for tax years beginning after December 31, 2021.

- Increase on State and Local Tax Deduction

  The cap on state and local tax (SALT) deductions would be increased from $10,000 to $80,000 through 2030. The SALT deduction cap would return to $10,000 for 2031 and then expire. The proposed effective date would apply retroactively to tax years beginning after December 31, 2020.

- Additional Enforcement Funding for the IRS

  The IRS would be appropriated nearly $79 billion to modernize its operations and increase enforcement activities on taxpayers with income in excess of $400,000.

What's Next?

The Build Back Better Act will continue to make its way through the legislative process, which will likely result in varying iterations of the proposed legislation before the legislation is put to a vote. Certain provisions that have been removed from the September 13, 2021 House Ways and Means Committee version of the bill could be included in a later version to stay within the boundaries of certain budgetary rules to ensure compliance with the budget reconciliation process.

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, Business Succession and Tax Practice Group.