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House Ways and Means Tax Overhaul Notes

September 13th, 2021, the House Ways and Means committee released language for view to the public. The 881-page document addresses the details of the proposed tax changes first introduced by President Biden back in April. The document covers a massive amount of changes that would amend a large amount of the tax code.

As I have mentioned before, this is just proposed language and will likely be modified prior to passing, if it passes. This is the most detailed we have seen thus far given the current objectives of the majority party. I do think much of this will be dramatically modified, removed, or changed before anything becomes law.

Items that are noticeably missing from original proposal

- Step up in basis revocation
- Real estate capital gain changes – e.g. 1031 exchanges
- Repeal of SALT limitation ($10K)
- Reinstalling first time home buyer credit
- Any changes to Social Security and the underfunding of the trust
- Changes to permanent insurance
- Flat contribution rate for 401Ks

Items that have a short window for planning

- Estate planning and gifting
- Intentionally defective grantor trust formation and funding
- Roth conversions
- C Corp distributions at lower tax rates
- Wash sale to book losses in crypto or other digital assets

I have placed the notes in order of priority I perceive relevant to this group.

- **Individual tax rate increase**
  - Original proposal from white house was increase to 39.6% for anyone making greater than $400K bringing the brackets much lower than currently and increasing the rate at the same time
  - The way the text is written in the document they are proposing amending the last two rows of the bracket tax table, or n section 1(j)(2)(A)-1(j)(2)(E)
  - Married filing jointly (MFJ) – Widowers likely this rate also
    - Current – top rate 37% on anything above $622K
    - Proposed – top rate of **39% on anything above $450K**
    - **$400K - $450K will be increased to 35% from ~32.25%**
  - Single
    - Current – top rate 37% on anything above $518K
    - Proposed – **top rate of 39% on anything above $400K**
  - Head of Household
    - Current – top rate 37% on anything above $523K
    - Proposed – **top rate of 39% on anything above $425K**
  - Married filing separately (MFS)
    - Current – top rate 37% on anything above $314K
    - Proposed – **top rate of 39% on anything above $225K**
  - Trust and estates moved to 39.6% on anything above $12.5K in income, previously 37%
    - *DK Comment: Plays into the other estate planning strategies discussed in previous emails. Not enough of a significant cost when factoring the other proposed estate changes*
  - <u>Effective after 12/31/2021 – Begins in 2022</u>
- **Capital gains rate increase**
  - Original proposal from White House was making long term capital gains rate taxed at new proposed 39.6% for any individual who had AGI greater than $1M+ in any one year
  - New proposal would have capital gains tax brackets "realigned" to ordinary income tax brackets
    - **This means that capital gains would be taxed at 39.6% for individual filers who make more than $400K and MFJ filers who make more than $450K**
  - This takes the proposed $1M threshold and drops it dramatically making for more people required to pay ordinary rates on capital gains
  - This also does not include any state tax assessed on capital investments
  - *DK Comment: I have been saying this for a while, but the changes to capital gains and income rates as proposed dramatically increases the penalty for being married. As two separate individuals, together but not legally married, there would be a huge incentive to never get married as the tax increases would go from $800K separately to $450K married. Seems odd to me to penalize people so dramatically for being married.*
  - <u>Effective 09/13/2021</u>
    - *DK Comment: If this passes, all transactions prior to 09/13/2021 will use the old law and 20%, anything sold after today would be under the new law and the much higher capital gain tax rates.*

- **Corporate tax rate changes – C-Corps**
  - Original proposal from White House was 28% flat
  - Current proposal is a tiered structure for C Corps
    - Under $400K in net profits – **18% (3% reduction)**
    - $400K - $5M net profits – **21% (Level)**
    - $5M+ net profits – **26.5% (5.5% increase)**
  - Effective 12/31/2021
- **S-Corp Owner-Operator tax increases**
  - Original proposal from White House did not address. S Corp owners are not taxed for Social Security and Medicare on the profits of their business. They must pay themselves a fair wage and pay those taxes on that portion of their compensation.
  - Multiple changes proposed here
    - First, a net investment surtax of 3.8% would now be applied to all profits who have owners with the following AGI
      - Married $500K
      - Single $400K
    - Second, the 199A (20% deduction from 2017) would be capped for any owner at a max of $500K for married and $400K for single
      - So unlike the first net investment surtax (3.8%), where income above those amounts means you pay the tax, this is the "max" deduction allowed
        - So that means $2.5M of income is the max for married and $2M of income for single before the phaseout impacts
  - Effective 12/31/2021
- **New additional surtax on trusts and ultra-high income**
  - Not explicitly mentioned in original language.
  - **The tax would be a new 3% surtax** on any individual who earns more than $5M in income in any one year
    - The $5M applies to single and MFJ
    - Married filing separately the surtax would be assessed on any income above $2.5M
  - The 3% surtax would also apply to any trust which generated income greater than $100K
    - *DK Comment: The referenced codes appear to speak to irrevocable trusts but it does not explicitly exclude revocable trust, even though those are currently treated as a disregarded entity. I would be shocked if this ended up impacting revocable trusts.*
  - Effective 12/31/2021
- **Limits on excess business losses made permanent law**
  - Never explicitly mentioned, but thought to be an objective
  - This was already a law and now will be permanent
  - Effectively not able to take business losses beyond a certain threshold and use to offset other areas of income
  - Effective 12/31/2021
- **Estate tax limitation reduced in half**

  - Always a strong target of the White House, this was expected to come in around where it did.
  - The new limits will fall from $11.7M to $5M per life
    - Inflation adjustments will still apply
  - There will be a carve out for farming real property which will allow inner family farming transfers of real property up to $11.7M
  - Effective 12/31/2021
  - *DK Comment: There is still time to plan and gift prior to year end to lock in the higher amount*
- **Intentionally Defective Grantor Trusts (IDGTs) mostly nullified**
  - Always a strong target of the White House, this was listed as an objective.
  - New law would disallow grantor trusts to exist going forward
    - Any existing grantor trusts would have to have sold assets to this trust prior to this becoming law
  - Options are given that hence forth a grantor must cease to receive benefit or will no longer be able to fund these trusts
  - All swap provisions will be disallowed going forward when discussing moving different assets in and out of trusts
  - Effective on enactment of law
- **Minority interest valuation discounts eliminated**
  - Never explicitly mentioned.
  - Ownership of non-business assets would no longer be able to be discounted to benefit estate transfer
  - Effective on enactment of law
- **Elimination of Roth conversions for high income earners**
  - Never mentioned in original language
  - **New law would eliminate the ability for anyone in the highest tax bracket to execute a Roth conversion**
    - That again is $450K MFJ, $425K Head of Household, and $400K single
  - Effective 12/31/2031
    - *DK Comment: Originally, I thought this might have been a typo giving a decade to convert traditional IRAs to Roths. I think it is by design and would be a strategy for the current administration to receive more taxes now, with a "convert while supplies last" policy.*
- **Elimination of backdoor Roth**
  - Never mentioned in original language. This is a way to fund Roth accounts for certain individuals
  - The proposed law would eliminate the ability to convert "taxable" retirement contributions effective the first day of January
  - Essentially eliminating the ability to convert a backdoor Roth
  - Effective 12/31/2021
- **Retirement account restrictions and additional mandatory distributions**
  - Never mentioned in original language. These are new restrictions designed to prevent larger IRA accounts
  - Anyone who meets the below requirements will no longer be permitted to contribute to a retirement account
    - Two requirements must be met to be subject to these restrictions

            - Must be in the higher tax bracket $450K MFJ, $425K Head of Household, and $400K single AND
            - Must have an accounted valued at more than $10M
        - *DK Comment: This seems so odd to tie this to the income threshold which could be adjusted to avoid a massive distribution. My guess is this is language that will be adjusted*
    - This only applies to Roths and Traditional IRAs, SEPs, 401Ks, pensions, etc. are not under the same guidelines
    - All accounts with over $10M and under $20M would have to distribute 50% of the excess in the following year
        - Ex: $18M in an IRA means there is $8M excess, under this law $4M would have to be withdrawn
    - All accounts with over $20M would have to withdraw 100% of the excess
        - Ex: $25M, $5M must come out to take the account to the $10M-$20M range, then half of the other excess $5M would have to come out for a total of $10M withdrawn in a year
    - There do not appear to be age restrictions on when these RMDs would be required meaning if an investor had a large IRA they would be forced to take the income
    - *DK Comment: This seems in response to Peter Thiel's billion dollar Roth IRA which was new worthy a few months back.*
    - Effective 12/31/2021
- **Self-directed IRA new investment restrictions**
    - Never mentioned in original language. These are new restrictions designed to limit what people can invest in within qualified accounts
    - No longer will it be possible for officers, owners, directors, or similar persons to invest in their own companies if they own more than 10% of the company, previously this was 50%
    - Also, IRAs would no longer be able to purchase any security "if the issuer has income, assets, education, or licensing requirements."
        - This essentially eliminates the ability to fund private placements in IRAs or other third-party offerings
    - These restrictions seem to only address IRAs, 401Ks seem to be left alone. However, would need to have access to a 401K or bear the costs of starting one for a "new" business venture
        - *DK Comment: This means that the ROBS via 401K strategy would still be allowed giving the ability for a businesses owner to use retirement funds to start a business.*
    - Effective 12/31/2021 with a two year window to divest of current "bad investments"
- **Caregiver credit for child care centers**
    - An objective in the original proposal
    - Child care workers and child care employees would be eligible for a 50% refundable credit
    - Must operate one or more eligible care facilities
    - Effective 12/31/2021
- **Section 1202 exclusion rates**

  - Not mentioned directly in original proposal. This is a tax election which supports small start ups allowing investors to exclude capital gains up to $10M. This was increased from 50% - 100% exclusion under President Obama
  - This would amend section 1202 to only allow the 100% (and 75% dependent on when invested) exclusion rates for those taxpayers who's adjusted gross income (AGI) was **below $400K for the year**
    - Highly unlikely as generally the companies that achieve the other requirements for this provision have been held for a long time and tend to have substantial gains
    - *DK Comment: This should increase the value of planning if an investor can spread out their sale over a number of years and can flex down their AGI in any given year*
  - The baseline 50% exclusion will remain, so investors will still be able to receive a benefit for investing in riskier start ups
  - Effective 09/13/2021
- **Aggregation rules when owning multiple companies or businesses**
  - Mentioned indirectly in original proposal. Current aggregation rules governed through control group and affiliated service tax law requires owners to aggregate businesses when they check certain boxes
  - New law would expand provisions that require companies to be treated as a single entity for tax purposes
    - Would be difficult for an existing business owner to compartmentalize a new business venture they were starting
  - Effective on date of enactment
- **Wash sale rule expansion to commodities, currencies, and digital assets aka crypto currency**
  - The wash sale is a rule that applies to the sale of investments which disallows an investor from selling a position, realizing a loss for tax purposes and immediately buying it back. The investor must wait 31 days before purchasing the investment back.
  - This rule did not apply to commodities and crypto currencies
  - Effective after 12/31/2021
- **Constructive sale provision expansion to "digital assets" aka crypto currency**
  - Constructive sales are a way to hedge a position without selling right away, and are restricted under Section 1259
  - This would expand rules governing financial assets, stocks and bonds, to crypto currency, and other "digital assets"
  - Effective after 12/31/2021
- **Extension of the Child Tax Credit payments**
  - This was an objective and, in the plan, since the beginning
  - This act would extend the additional monthly child tax credits through the end of 2022
  - Effective now – 12/31/2022