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Wealth Planning Alert

The current tax policy debate in Congress: What you need to know

Congress is currently debating a variety of changes to individual, business, trust, and investment tax rates. The information in this Alert is intended to highlight the potential changes to tax policy that are being debated in Congress. Based on the overview of these possible changes to tax law, please consider having a conversation with a tax or legal professional to better understand the potential impact of changes to tax policy on your financial goals.

Who may be impacted?

Considering a consult with your tax and legal professionals may be worthwhile if you:

- Anticipate large ordinary income or capital gain events in the near future, such as the sale of a business;
- Deduct qualified business income or own qualified small business stock;
- Have large retirement accounts ($10 million+) or are considering a Roth conversion in future years; and/or
- Are considering doing wealth transfer planning, have an estate that would be subject to estate tax (under either current or proposed law), or have established a grantor trust (e.g., intentionally defective grantor trust, spousal lifetime access trust, irrevocable life insurance trust).

What are potential next steps?

Consult with your tax and legal professionals and financial advisors to:

- Understand which proposals may be relevant to your specific situation;
- Prioritize items that need immediate attention. Proposed effective dates vary, making some more urgent.
- Stay tuned on how the proposals evolve over the coming weeks and months. Some of the proposals will take effect when legislation is enacted, and the window of opportunity to take action may be limited.

Highlights of the House Ways & Means Committee Legislation

Below are key highlights of the legislation released by the House Ways & Means Committee on September 13, 2021. Note, this is not a comprehensive summary. This information is intended to help you understand the key components of potential tax changes under consideration in Congress.

- **Individuals**
  - Increase in Income Tax Rate for Top Bracket – The top individual income tax bracket would have a rate increase to 39.6%; this would apply to individual taxpayers with an Adjusted Gross Income (AGI) over $400,000, $450,000 for joint filers ($225,000 for married filing separate), $425,000 for Head of Household, and $12,500 for trusts and estates.
  - Increase in Capital Gains Tax Rate – The long term capital gains rate for the top bracket would increase from 20% to 25%. *Effective for transactions entered into after September 13, 2021*, unless subject to a binding written contract executed prior to this date, and closing before year-end.
  - Net Investment Income Tax Expansion – Applies the 3.8% NIIT to trade or business income for individual taxpayers with an AGI greater than $400,000 ($500,000 for joint filers) as well as trusts and estates.
  - Surcharge on High Income Individuals – Taxpayers with an AGI of $5,000,000 ($2,500,000 for married filing separate) from all sources would pay a tax of 3% on the excess income above $5,000,000.
  - Limitation on Deduction of Qualified Business Income – The bill would provide a maximum allowable deduction of $400,000 for individuals, $500,000 for joint filers, $250,000 for married filing separate, and $10,000 for an estate or trust.
  - Limitation on Excess Business Losses of Non-corporate Taxpayers –The limitation on excess business losses that was introduced in the American Rescue Plan would be made permanent (it was originally set to expire in 2027).

- **Corporations & Businesses**
  - Corporate Tax Rate – The bill would increase the top corporate tax rate to 26.5%, graduated as follows: 18% on first $400,000 income; 21% for income between $400,000 and $5,000,000; 26.5% on income greater than $5,000,000. The benefit of the graduated rates would be phased out on companies making more than $10,000,000 (i.e., flat 26.5% rate for companies making more than $10,000,000). Personal service practices, such as law firms and medical offices, would all be taxed at the highest rate of 26.5% regardless of income.

- Limitation on Deduction for Qualified Small Business Stock – The House Ways and Means proposal would eliminate the 75% and 100% deduction of capital gain allowed by Section 1202 for individual taxpayers with an AGI over $400,000 as well as trusts and estates. High income earners could still qualify for the 50% deduction. *Effective for transactions entered into after September 13, 2021*, unless subject to a binding written contract executed prior to this date, and closing before year-end.

- **Retirement** - For individual taxpayers with an income greater than $400,000 ($450,000 for joint filers):
    - Limitation on IRA Contributions – No further contributions to a Roth or traditional IRA would be allowed if the total value of an individual's IRA and defined contribution retirement accounts exceeds $10,000,000 at the end of the previous tax year.
    - Required Minimum Distribution (RMD) on Large IRAs – For IRA balances greater than $10,000,000, the bill would require an RMD equal to 50% of the amount above $10,000,000. If the balance exceeds $20,000,000, the RMD would be 100% of the amount in excess of $20,000,000. This would apply to Roth IRAs, traditional IRAs and the value of all defined contribution retirement plans.
    - Limitation on Roth Conversions – The proposal would prohibit "Back Door" Roth conversions.

- **Wealth Planning**
    - Grantor Trust Changes – The bill would change how grantor trusts are treated for estate tax purposes. Grantor trusts established after enactment would be includible in a decedent's taxable estate, sales from a grantor to a grantor trust after enactment would also be taxable, and distributions to beneficiaries would be treated as gifts.
    - Loss of Valuation Discount – The proposed bill would eliminate valuation discounts for certain transfers of assets (often used to sell or gift interests in family entities) with exceptions for operating family businesses and farms. *Effective for transfers after the date of enactment*.
    - Decrease in Estate & Gift Tax Unified Credit – The increase in the Unified Credit would return to the pre-Tax Cuts and Jobs Act of 2017's amount of $5,000,000 per person, adjusted for inflation ($5,850,000 in 2021). The existing exemption would remain in effect through the end of this year.

Takeaways

- Congress is debating changes to the tax code. The House Ways and Means Committee tax proposals are the first step in enacting sweeping changes to the tax code; however, before becoming law, the bill will need to pass the House and be reconciled with any tax law changes adopted by the Senate.
- Discuss with your advisors how proposed tax changes may impact your financial goals.

Disclosures