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Pending Tax Changes: House Ways and Means Committee Tax Proposals

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On September 13, 2021, the U.S. House of Representatives Ways and Means Committee released draft budget reconciliation legislation proposing a number of significant tax changes for businesses and for individuals. Some of the key proposals include:

Corporate Taxes

- Replacing the 21 percent flat corporate rate with a graduated rate structure (18 percent on taxable income under $400,000; 21 percent on taxable income of $400,000 - $5,000,000; and 26.5 percent on taxable income over $5,000,000). The benefit of the graduated rate structure would phase out for corporations making more than $10,000,000. Taxable income over $10,000,000 would be subject to an additional 3 percent of tax, up to a maximum of $287,000, in order to offset the benefit of the graduated rates.

- Increasing taxes on international income by limiting certain deductions and increasing the global intangible low-taxed income ("GILTI") tax, foreign-derived intangible income ("FDII") tax, and base-erosion and anti-abuse tax ("BEAT") rates.

- Limiting the exclusion from gross income for gains on qualified small business stock ("QSBS") under §1202. The 75% and 100% exclusion rates for QSBS gains would not apply for taxpayers with income of $400,000 or more. At this higher bracket, a 50% exclusion would still be available. These limits would apply to transactions after September 13, 2021.
    - Under an exception, the existing rules would remain in place for transactions pursuant to a written binding contract in effect on September 12, 2021 and not modified in any material respect thereafter.

- Limiting the tax advantages of using irrevocable grantor trusts for closely-held business succession planning.

Individual Taxes

- Increasing the maximum individual rate to 39.6 percent and applying this marginal rate to joint filers with taxable income over $450,000 and single filers with taxable income over $400,000.

- Increasing the maximum capital gain rate from 20 percent to 25 percent.
  - Under an exception, the existing rates would remain in place for transactions that close in 2021 pursuant to a written binding contract in effect on or before September 13, 2021 and not modified in any material respect thereafter.

- Imposing a 3 percent surtax on individuals with modified adjusted gross income over $5,000,000.

- Expanding the 3.8 percent net investment income tax to apply to all net income derived in the ordinary course of trade or business for taxpayers with taxable income greater than $500,000 for joint filers and $400,000 for single filers.

- Modifying the "carried interest" rules under §1061 to increase the holding period required for long-term capital gain treatment to five years.

- Limiting the 20 percent Qualified Business Income (Section 199A) deduction for pass-through entities to a maximum $500,000 deduction for joint filers and $400,000 deduction for single filers.

- Prohibiting IRA contributions for taxpayers with aggregate retirement account balances exceeding $10 million in the prior tax year.

- Requiring minimum distributions from IRAs with a balance over $10 million in the prior year.

- Eliminating Roth conversions for IRAs and 401(k) plans (also known as "backdoor" Roth IRAs) for joint filers with taxable income over $400,000 and single filers with taxable income over $400,000.

Estate and Gift Taxes

- Halving the current estate and gift tax exemption of $11,700,000, and replacing it with an exemption of approximately $6,000,000 per person (as indexed for inflation).

- Eliminating valuation discounts for transferring nonbusiness assets (passive assets that are held for the production of income and not used in the active conduct of a trade or business).

- Including irrevocable grantor trusts in the taxable estate of the grantor.

- Treating sales between grantors and certain grantor trusts like sales between third parties (applicable only to trusts created and sales made after the date of enactment of the new act).

Importantly, the current proposal does not include (i) a capital gains tax on death, (ii) a loss of the basis step-up on death, (iii) a decrease in the lifetime gifting exemption (below the estate tax exemption), or (iv) an increase in the estate and gift tax rate above the current 40 percent.

Will Tax Changes Be Retroactive Or Prospective?

Most of the proposed tax changes are anticipated to be effective after December 31, 2021, with exceptions such as those noted above. Although retroactivity is generally disfavored, there is precedent—the Revenue Reconciliation Act of 1993 signed on August 10, 1993 included certain tax increases made retroactive to January 1, 1993.

Although it is not yet certain which tax changes, if any, will be passed into law, taxpayers would be well-advised to consider the House proposals in their tax planning. If you have questions regarding the House Ways and Means Committee tax proposals or any other tax matters, please don't hesitate to contact your **Bodman Tax attorney**.

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