Important Update to Tax Proposals

November 23, 2021 - New Tax Act Update

As we have previously, Katz Baskies & Wolf is sharing this update to again keep you abreast of tax law developments in Washington.

On October 1, we shared an update on the House Ways and Means Committee's initial "Build Back Better Act" proposal (dated September 13, 2021), which many will recall included sweeping changes to the estate and gift tax rules. In October we also shared an explanation of how the September 13 proposals might impact irrevocable life insurance trusts.

On November 2, we shared an update on the revised Build Back Better Act issued by the House Ways and Means Committee on October 28, 2021, which was most notable for what was not included: the revised proposed Act did not include any of the proposed gift and estate tax changes.

To update you further, on November 19, the House passed a version of the Build Back Better Act ("H.R. 5376") which closely aligns with the October 28 proposal and does not include any of the prior estate and gift tax proposed changes.

The following is a brief summary of H.R. 5376, which was passed by the House, but of course is still subject to revision by the Senate:

- Income Tax Rates. As passed, H.R. 5376 does not change the top tax rate on ordinary income (37%) or the top tax rate on long-term capital gains and qualified dividends (20%). Earlier proposals for a 39.6% top tax rate on ordinary income and a 25% top tax rate on long-term capital gains and qualified dividends were not included in H.R. 5376.
- New Surtaxes. While the top rates would not change, two new surtaxes on high earners were included in H.R. 5376, and these changes will obviously increase taxes on those with the highest levels of income.
  - First, there is a new 5% surtax on modified adjusted gross income ("MAGI") for taxpayers in excess of $10 million (as passed, the same limit would apply to single filers and to those married filing jointly) and for non-grantor trusts and estates in excess of $200,000.
  - Second, there is a new 3% surtax on MAGI for taxpayers in excess of $25 million (again, as passed, the same limit would apply to single filers and to those married filing jointly) and for non-grantor trusts and estates in excess of $500,000.
- Net Investment Income Tax ("NIIT"). Under H.R. 5376, the 3.8% NIIT would be broadly expanded. If the proposed changes in H.R. 5376 pass, the NIIT will soon apply to active business income from pass-through entities such as S corporations and partnerships for amounts in excess of $400,000 (if filing single), $500,000 (if married filing jointly), and $13,000 for non-grantor trusts and estates. Currently, the 3.8% NIIT only applies to passive income.
- State and Local Tax ("SALT"). H.R. 5376 does provide some tax relief (more so for residents of states with incomes taxes than for residents of states like Florida). The SALT deduction limit would be increased from the current $10,000 to $80,000

through December 31, 2030, with a $10,000 limit in 2031, and no cap starting in 2032. Currently, the $10,000 SALT cap is set to expire after December 31, 2025.

- IRAs and Roth IRAs. H.R. 5376 includes new contribution limitations and new minimum distribution requirements for large IRAs and Roth IRAs—those above $10 million. However, unlike prior versions of the proposed act, the version passed by the House does not include limitations on accredited investors, qualified purchasers, and closely-held investments in IRAs.
- Qualified Small Business Stock ("QSBS"). The 100% exclusion for gains on sales of QSBS – in Section 1202 of the Code - would be reduced retroactively effective as of September 14, 2021 to 50% for all non-grantor trusts and estates and 50% for individuals with adjusted gross income above $400,000. The special tax treatment of QSBS has many complications: e.g., the shares must be in a C-corporation (not an s-corporation or partnership or other pass-through entity), the company's assets must be $50 million or less at all times the company is in existence, the company must be active and not a holding company, the company cannot provide services (thus excluding banking, insurance, financing, accounting, etc.), and the stock must be held for more than 5 years by the taxpayer.
- Gift, Estate and Generation-Skipping Transfer (GST) Tax. While the September 13, 2021 version of the BBBA proposed sweeping changes to the estate and gift tax landscape, in the end H.R. 5376 includes no changes impacting most clients' estate planning.
    - Currently, the gift/estate/GST exemption amount is $11.7 million per person ($23.4 million per married couple), and is set to increase in 2022 to $12.06 million per individual ($24.12 million per married couple). This is unchanged.
    - The gift/estate/GST exemption amount is still scheduled to be reduced by 50% on December 31, 2025. This remains unchanged.
    - In H.R. 5376, there are no changes to the "grantor trust" rules. Thus, if passed as is, clients may continue to plan "as usual" with Irrevocable Life Insurance Trusts ("ILITs"), Intentionally Defective Grantor Trusts ("IDGTs"), Spousal Lifetime Access Trusts ("SLATs"), Grantor Retained Annuity Trusts ("GRATs"), and other irrevocable trust arrangements.
    - H.R. 5376 also does not include any changes to the existing law on valuation discount planning, although prior versions of the BBBA included sweeping changes to valuation discounts—such as discounts for lack of marketability and lack of control for Limited Liability Companies (LLCs), family limited partnerships (FLPs) and other entities.

We will continue to monitor the progress of this legislation in the Senate, and will advise of any changes that are made. We understand why many clients will view the "non-inclusion" of estate and gift tax changes as the opportunity to pause and reassess gifting plans that are underway. That is understandable, and for some clients adopting a "wait and see" attitude is most appropriate. For other clients, the prior proposals were a call to action for plans that were long-contemplated but never effectuated. For those clients, the changes in proposed legislation should not interrupt the finalization of plans. We look forward to discussing with you any questions you may have.

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Wishing you a Happy Thanksgiving

While there is much to be concerned about all around us, there is also so much to be grateful for. We wish you and your families a very Happy Thanksgiving, and we look forward to connecting in the coming weeks.

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