



Debate continues in Congress over proposed tax changes

Negotiations continue in Washington, D.C., over the future of President Biden's agenda. Tax law changes may be ahead under two proposed laws, the Build Back Better Act (BBBA) and the Bipartisan Infrastructure Bill (BIB), also known as the Infrastructure Investment and Jobs Act. The final provisions remain to be seen, but the BBBA and, to a lesser extent, the BIB, contain a wide range of tax proposals that could affect individuals and businesses. It's also unclear when the tax changes would become effective, if one or both of the laws are enacted.

Here's a summary of many of the proposals that could change the tax landscape in the near future.

Proposed tax provisions for individual taxpayers

The current version of the BBBA includes several provisions that could affect the tax liability of individual taxpayers in ways both positive and negative, depending largely on their taxable income. Among other areas, the legislation addresses:

Individual tax rates. The top marginal tax rate would return to 39.6%, the rate that was in effect before the Tax Cuts and Jobs Act (TCJA) cut it to 37% beginning in 2018. This rate would apply to the taxable income of married couples that exceeds \$450,000, single filers that exceeds \$400,000 and married individuals filing separately that exceeds \$225,000.

A surcharge on high-income taxpayers. The BBBA would establish a new 3% tax on modified adjusted gross income above \$5 million for married taxpayers filing jointly and single filers and above \$2.5 million for married individuals filing separately.

The capital gains and qualified dividends tax rate. The maximum rate would increase from 20% to 25% for taxpayers in the 39.6% tax bracket. The Biden administration earlier had proposed to raise it as high as 39.6%.

The net investment income tax (NIIT). The BBBA would expand the NIIT to apply to the trade or business income of high-income individuals, regardless of whether they're actively involved in the business. The NIIT currently applies to certain investment income and business income only if it's passive. As a result, active business income would go from being taxed at a maximum rate of 37% under the TCJA to a maximum rate of 46.4% (the 39.6% individual income tax rate plus the 3.8% NIIT plus the 3% high-income surcharge).

This change would apply when adjusted gross income (AGI) exceeds \$500,000 for married couples filing jointly, \$250,000 for married couples filing separately and \$400,000 for other taxpayers. Business income subject to self-employment tax would be excluded.

The qualified business income (QBI) deduction. The Section 199A deduction for pass-through entities would be limited to \$500,000 for married taxpayers filing jointly, \$400,000 for single filers and \$250,000 for married taxpayers filing separately.

The qualified small business stock (QSBS) exclusion. Capital gains from the sale of QSBS held more than five years currently are 100% excludable from gross income. The BBBA would limit the exclusion to 50% for taxpayers with an AGI over \$400,000, regardless of filing status.

Retirement planning. The BBBA would prohibit IRA contributions by taxpayers whose 1) aggregate IRA and other account balances exceed \$10 million and 2) taxable income exceeds \$450,000 for married couples filing jointly or \$400,000 for single filers or married taxpayers filing separately. These taxpayers also would have to take required minimum distributions equal to 50% of the value that exceeds \$10 million and 100% of any amount over \$20 million.

Roth IRA conversions. The BBBA would prohibit certain taxpayers from first making a nondeductible contribution to a traditional IRA and then converting it to a Roth IRA (to get around restrictions on who can contribute to a Roth IRA). The proposal would apply to taxpayers with taxable income exceeding \$450,000 for married taxpayers filing jointly and \$400,000 for single filers and married taxpayers filing separately.

Child and dependent care tax credits. The American Rescue Plan Act (ARPA), enacted earlier this year, temporarily expanded both the Child Tax Credit (CTC) and the Dependent Care Tax Credit (DCTC). The BBBA would extend the CTC through 2025 and make permanent the DCTC.

Premium tax credits (PTCs). The ARPA also expanded the availability of PTCs to subsidize the purchase of health insurance for 2021 and 2022. The BBBA would permanently expand the credits.

Banking activity reporting. The Biden administration has proposed requiring financial institutions to annually report the total amount of funds that go in and out of bank, loan and investment accounts (personal and business) that hold a value of at least \$600. Reporting also would be required if the aggregate flow in and out of an account is at least \$600 in a year.

As Democrats weigh including this proposal in one of the bills, it has received pushback from banks and privacy advocates. A revised version includes a \$10,000 threshold, and exemptions for some common transactions, such as payments from payroll processors and mortgage payments, also are under consideration.

Proposed tax provisions for businesses

The BBBA and BIB would also bring dramatic changes to the tax landscape for some businesses. In particular, their tax bills could be influenced by proposals related to the following:

The corporate tax rate. The BBBA would replace the TCJA's flat rate of 21% with a graduated rate structure. The first \$400,000 of income would be subject to an 18% rate, with the 21% rate retained for income between \$400,000 and \$5 million. The graduated corporate rate would max out at 26.5% for income exceeding \$5 million.

Personal service corporations and corporations with taxable income exceeding \$10 million would be subject to a flat 26.5% rate. The pre-TCJA top corporate tax rate was 35%.

Excess business losses. The TCJA limits the amount of excess business losses that pass-through entities and sole proprietors can use to offset ordinary income to \$250,000, or \$500,000 for married taxpayers filing jointly, adjusted for inflation. The limit is set to expire at the end of 2025, but the BBBA would make it permanent.

The bill also would create a new carryforward for unused excess business losses, rather than carrying them forward as net operating losses.

The business interest deduction. Internal Revenue Code Section 163(j) limits the deduction for business interest incurred by both corporate and noncorporate taxpayers. Under the proposal, the limit wouldn't apply to partnerships and S corporations at the entity level. It instead would apply to the partners and shareholders.

Research and experimentation expenses. Under the TCJA, research and experimentation expenditures incurred in 2022 and later years aren't immediately deductible; rather, they generally must be amortized over five years. The BBBA would delay the effective date for the amortization requirement to 2026.

The employee retention credit. The BIB would terminate this credit earlier than originally planned. Instead of being available for all of 2021, it would no longer be available for the fourth quarter, except for recovery startup businesses.

Carried interest. Currently, carried interests are taxed as short-term capital gains unless the gains were on property held for at least three years. The BBBA would extend the holding period to qualify for long-term capital gain treatment to five years — except for real estate businesses and taxpayers with less than \$400,000 of AGI. The carried interest rules also would be expanded to cover all property treated as generating capital gains.

International transactions. The BBBA includes numerous proposals that would change the taxation of cross-border transactions and trim some of the tax advantages enjoyed by multinational corporations. For example, it would reduce the deductions for global intangible low-taxed income (GILTI) and foreign-derived intangible income. It would determine GILTI and foreign tax credit limits on a country-by-country basis. It also would make changes to the base erosion and anti-abuse tax.

Estate tax provisions

The BBBA would be much less taxpayer-friendly than the TCJA when it comes to gift and estate taxes and strategies. Most notably:

The gift and estate tax exemption. The TCJA doubled the gift and estate tax exemption to \$10 million through 2025. That amount is annually adjusted for inflation (for 2021, it's \$11.7 million). The BBBA would return the exemption to its pre-TCJA limit of \$5 million in 2022. The amount would continue to be adjusted annually for inflation.

Grantor trusts. The assets in these trusts would no longer be excluded from a taxable estate if the deceased is deemed the owner of the trust. In addition, sales between individuals and their grantor trusts would be taxed as if they were transfers between the individual and a third party. And distributions from a grantor trust to an individual other than the grantor or the grantor's spouse would be treated as a taxable gift from the grantor.

Valuation discounts. Taxpayers would no longer be able to claim discounts for gift and estate tax purposes on transfers of interests in entities that hold nonbusiness assets (that is, passive assets held for the production of income and not used for an active trade or business). For example, discounts couldn't be used to reduce the value of transferred interests in family-owned entities that hold securities.

Note: An earlier proposal to end the stepped-up basis tax break on inherited assets is no longer in the current version of the BBBA.

Stay tuned

It's impossible to say which proposals will survive the ongoing negotiations intact. We'll keep you up to date if and when the final legislation is enacted. In the meantime, contact us if you have concerns about how the proposed tax provisions may affect you personally or your business.