



# Special Report

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A first glimpse at proposed legislation: *Responsibly Funding Our Priorities*

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## **SPECIAL REPORT:**

### *First Glimpse of Proposed Legislation*

September 16, 2021

Monday September 14, 2021, The House Ways & Means Committee released their proposed legislation titled “Responsibly Funding Our Priorities.” As written, it is estimated to raise as much as \$2.9 trillion by increasing taxes on corporations and individuals (those over \$400k of income).

NOTE: This proposed legislation. This is the first draft. Creating tax legislation is like making sausage...it’s not pleasant to watch.

*Here are some of the highlights from the 18-page Committee Summary:*

#### **CORPORATE**

##### **Increase in Corporate Tax Rate**

This provision replaces the flat corporate income tax with a graduated rate structure. The rate structure provides for a rate of 18 percent on the first \$400,000 of income; 21 percent on income up to \$5 million, and a rate of 26.5% on income thereafter. The benefit of the graduated rate phases out for corporations making more than \$10,000,000. Personal services corporations are not eligible for graduated rates. The domestic dividends received deduction is adjusted to hold constant the tax on domestic corporate-to-corporate dividends.

##### **Temporary Rule to Allow Certain S Corporations to Reorganize as Partnerships Without Tax**

This provision allows eligible S corporations to reorganize as partnerships without such reorganizations triggering tax. Eligible S corporation means any corporation that was an S corporation on May 13, 1996 (prior to the publication of current law “check the box” regulations with respect to entity classification). The eligible S corporation must completely liquidate and transfer substantially all of its assets and liabilities to a domestic partnership during the two-year period beginning on December 31, 2021.

## **INDIVIDUALS and TRUSTS**

### **Increase in Top Marginal Individual Income Tax Rate.**

The provision increases the top marginal individual income tax rate in section 1(j)(2) to 39.6%. This marginal rate applies to married individuals filing jointly with taxable income over \$450,000, to heads of households with taxable income over \$425,000, to unmarried individuals with taxable income over \$400,000, to married individuals filing separate returns with taxable income over \$225,000, and to estates and trusts with taxable income over \$12,500. The amendments made by this section apply to taxable years beginning after December 31, 2021.

### **Increase in Capital Gains Rate for Certain High Income Individuals**

The provision increases the capital gains rate in section 1(h)(1)(D) to 25%. The amendments made by this section apply to taxable years ending after the date of introduction of this Act. A transition rule provides that the preexisting statutory rate of 20% continues to apply to gains and losses for the portion of the taxable year prior to the date of introduction. Gains recognized later in the same taxable year that arise from transactions entered into before the date of introduction pursuant to a written binding contract are treated as occurring prior to the date of introduction.

### **Application of Net Investment Income Tax to Trade or Business Income of Certain High Income Individuals**

This provision amends section 1411 to expand the net investment income tax to cover net investment income derived in the ordinary course of a trade or business for taxpayers with greater than \$400,000 in taxable income (single filer) or \$500,000 (joint filer), as well as for trusts and estates. The provision clarifies that this tax is not assessed on wages on which FICA is already imposed. The amendments made by this section apply to taxable years beginning after December 31, 2021.

### **Limitation on Deduction of Qualified Business Income for Certain High Income Individuals**

The provision amends section 199A by setting the maximum allowable deduction at \$500,000 in the case of a joint return, \$400,000 for an individual return, \$250,000 for a married individual filing a separate return, and \$10,000 for a trust or estate. The amendments made by this section apply to taxable years beginning after December 31, 2021.

### **Limitations on Excess Business Losses of Noncorporate Taxpayers**

This provision amends section 461(l) to permanently disallow excess business losses (i.e., net business deductions in excess of business income) for non-corporate taxpayers. The provision allows taxpayers whose losses are disallowed to carry those losses forward to the next succeeding taxable year. The amendments made by this section apply to taxable years beginning after December 31, 2021.

### **Surcharge on High Income Individuals, Trusts, and Estates**

This provision adds section 1A, which imposes a tax equal to 3% of a taxpayer's modified adjusted gross income in excess of \$5,000,000 (or in excess of \$2,500,000 for a married individual filing

separately). For this purpose, modified adjusted gross income means adjusted gross income reduced by any deduction allowed for investment interest (as defined in section 163(d)). The amendments made by this section apply to taxable years beginning after December 31, 2021.

### **Termination of Temporary Increase in Unified Credit**

This provision terminates the temporary increase in the unified credit against estate and gift taxes, reverting the credit to its 2010 level of \$5,000,000 per individual, indexed for inflation.

### **Increase in Limitation of Estate Tax Valuation Reduction for Certain Real Property Used in Farming or Other Trades or Businesses**

This provision amends section 2032A to increase the special valuation reduction available for qualified real property used in a family farm or family business. This reduction allows decedents who own real property used in a farm or business to value the property for estate tax purposes based on its actual use rather than fair market value. This provision increases the allowable reduction from \$750,000 to \$11,700,000.

### **Certain Tax Rules Applicable to Grantor Trusts**

This provision adds section 2901, which pulls grantor trusts into a decedent's taxable estate when the decedent is the deemed owner of the trusts. Prior to this provision, taxpayers were able to use grantor trusts to push assets out of their estate while controlling the trust closely. The provision also adds a new section 1062, which treats sales between grantor trusts and their deemed owner as equivalent to sales between the owner and a third party. The amendments made by this section apply only to future trusts and future transfers.

### **Valuation Rules for Certain Transfers of Nonbusiness Assets**

This provision amends section 2031 by clarifying that when a taxpayer transfers nonbusiness assets, those assets should not be afforded a valuation discount for transfer tax purposes. Nonbusiness assets are passive assets that are held for the production of income and not used in the active conduct of a trade or business. Exceptions are provided for assets used in hedging transactions or as working capital of a business. A look-through rule provides that when a passive asset consists of a 10-percent interest in some other entity, the rule is applied by treating the holder as holding its ratable share of the assets of that other entity directly. The amendments made by this section apply to transfers after the date of the enactment of this Act.

***NOTE: The Grantor Trust rules for irrevocable trusts and the Valuation Rules changes above have been valuable tools in the wealth planning tool box for reducing a family's federal estate tax liability. It could be on the chopping box. If thinking about using either strategy, better get with it!***

## **RETIREMENT PLANNING**

### **Contribution Limit for Individual Retirement Plans of High-Income Taxpayers with Large Account Balances**

Under current law, taxpayers may make contributions to IRAs irrespective of how much they already have saved in such accounts. To avoid subsidizing retirement savings once account balances reach very high levels, the legislation creates new rules for taxpayers with very large IRA and defined contribution retirement account balances.

Specifically, the legislation prohibits further contributions to a Roth or traditional IRA for a taxable year if the total value of an individual's IRA and defined contribution retirement accounts generally exceed \$10 million as of the end of the prior taxable year. The limit on contributions would only apply to single taxpayers (or taxpayers married filing separately) with taxable income over \$400,000, married taxpayers filing jointly with taxable income over \$450,000, and heads of households with taxable income over \$425,000 (all indexed for inflation).

The legislation also adds a new annual reporting requirement for employer defined contribution plans on aggregate account balances in excess of \$2.5 million. The reporting would be to both the Internal Revenue Service and the plan participant whose balance is being reported. The provisions of this section are effective tax years beginning after December 31, 2021.

### **Increase in Minimum Required Distributions for High-Income Taxpayers with Large Retirement Account Balances.**

If an individual's combined traditional IRA, Roth IRA and defined contribution retirement account balances generally exceed \$10 million at the end of a taxable year, a minimum distribution would be required for the following year. This minimum distribution is only required if the taxpayer's taxable income is above the thresholds described in the section above (e.g., \$450,000 for a joint return). The minimum distribution generally is 50 percent of the amount by which the individual's prior year aggregate traditional IRA, Roth IRA and defined contribution account balance exceeds the \$10 million limit.

In addition, to the extent that the combined balance amount in traditional IRAs, Roth IRAs and defined contribution plans exceeds \$20 million, that excess is required to be distributed from Roth IRAs and Roth designated accounts in defined contribution plans up to the lesser of (1) the amount needed to bring the total balance in all accounts down to \$20 million or (2) the aggregate balance in the Roth IRAs and designated Roth accounts in defined contribution plans. Once the individual distributes the amount of any excess required under this 100 percent distribution rule, then the individual is allowed to determine the accounts from which to distribute to satisfy the 50 percent distribution rule above. This provision is effective tax years beginning after December 31, 2021.

### **Tax Treatment of Rollovers to Roth IRAs and Accounts**

Under current law, contributions to Roth IRAs have income limitations. For example, the income range for single taxpayers for making contributions to Roth IRAs for 2021 is \$125,000 to \$140,000. Those single taxpayers with income above \$140,000 generally are not permitted to make

Roth IRA contributions. However, in 2010, the similar income limitations for Roth IRA conversions were repealed, which allowed anyone to contribute to a Roth IRA through a conversion, irrespective of the still in-force income limitations for Roth IRA contributions. As an example, if a person exceeds the income limitation for contributions to a Roth IRA, he or she can make a nondeductible contribution to a traditional IRA – and then shortly thereafter convert the nondeductible contribution from the traditional IRA to a Roth IRA.

In order to close these so-called “back-door” Roth IRA strategies, the bill eliminates Roth conversions for both IRAs and employer-sponsored plans for single taxpayers (or taxpayers married filing separately) with taxable income over \$400,000, married taxpayers filing jointly with taxable income over \$450,000, and heads of households with taxable income over \$425,000 (all indexed for inflation). This provision applies to distributions, transfers, and contributions made in taxable years beginning after December 31, 2031. Furthermore, this section prohibits all employee after-tax contributions in qualified plans and prohibits after-tax IRA contributions from being converted to Roth regardless of income level, effective for distributions, transfers, and contributions made after December 31, 2021.

***...and now your moment of Zen***

#### **Funding of the Internal Revenue Service**

This provision appropriates \$78,935,000,000 for necessary expenses for the IRS for strengthening tax enforcement activities and increasing voluntary compliance, and modernizing information technology to effectively support enforcement activities. No use of these funds is intended to increase taxes on any taxpayer with taxable income below \$400,000. Further, \$410,000,000 is appropriated for necessary expenses for the Treasury Inspector General for Tax Administration to provide oversight of the IRS. Finally, \$157,000,000 is appropriated for the Tax Court for adjudicating tax disputes. These appropriated funds are to remain available until September 30, 2031.

*The difference between death and taxes is death doesn't get worse every time Congress meets.*

- *Will Rogers*