2021 Tax Bill Update
September

Provided by:

The tax proposal made public on Monday, September 20, 2021 will bring significant changes that will affect many of our clients. To keep you informed, we've synthesized the information here for your review. The closed-door negotiations now begin and a final bill is expected between October 15 - 30, 2021.

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Individual Tax Increases: High-income households will face a series of tax increases. The basic top income tax rate will increase from 37% to 39.6%, with that top bracket starting at $400,000 for individuals and $450,000 for married couples. The proposal also calls for a 3% surtax on individuals and married couples with adjusted gross incomes above $5M.

Capital Gains: The plan will increase long-term capital gains and dividends from 20% to 25%. When combined with an existing 3.8% investment income tax and the surtax, the new top rate on capital gains could be as high as 31.8%. The capital gains tax increase is proposed to be effective September 12, 2021, with special transition rules for deals with binding contracts that haven't been completed yet, according to the summary released by the committee.

Business Tax Increases: The plan would raise the corporate tax rate from 21% to 26.5%. The proposal replaces the flat corporate rate with a graduated rate structure. Firms would face an 18% rate on income up to $400,000, 21% on income up to $5M and a 26.5% rate on any income above that. The benefit of the graduated rate would phase out for firms earning more than $10M a year.

The proposal would also pare back a tax break for businesses that pay their taxes on their owners' individual tax returns. Those companies, such as partnerships and S Corps, would face caps on a deduction they got in the 2017 tax law. The plan would limit the deduction at $500,000 for joint filers, $400,000 for individuals, and $250,000 for a married person filing a separate return.

The proposal also imposes a 3.8% tax on those entities known as pass-through businesses. Currently a tax at that rate applies to wages of high-income individuals and the passive income that active business profits are exempt. Companies would also face new limits on interest deductions.

Estate and Gift Taxes: The proposal would revert the lifetime exemption from its current $11.7M per individual down to $5M each adjusted for inflation. The idea of eliminating the step-up in basis was dropped. Several provisions limit grantor trusts and valuation discounts as we know them today.

Carried Interest: The proposal increases the holding period for which the taxpayer must qualify for capital gains treatment from three to five years. It also makes other changes that relate to complex structures to prevent taxpayers from avoiding these holding period rules.

Retirement Plans, IRAs, and Roth IRAs:
Contributions to IRAs: The proposal will further prohibit contributions to a Roth or a traditional IRA for a tax year if the total value of an individual's IRA, and defined contribution retirement accounts generally exceeds $10M, as of the end of the prior tax 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 has a household with taxable income over $425,000, all indexed for inflation.

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RMDs: For high-income taxpayers, as defined in the proceeding item, if an individual's combined traditional IRA, Roth IRA, and defined contribution retirement account balances exceed $10M at the end of a tax year, a minimum distribution would be required for the following year. The minimum distribution would generally be 50% of the amount by which the individual's prior year aggregate traditional IRA, Roth IRA, and defined contribution amount balance exceeds the $10M limit. To the extent that the combined balance of traditional IRAs, Roth IRAs, and defined contribution plans exceed $20M, that excess would be required to be distributed from those delegated accounts in defined contribution plans up to the lesser of (1) the amount needed to bring the total balance in all accounts down to $20M, or (2) the aggregate balance in Roth IRAs, and designated Roth accounts, and defined contribution plans.

Roth Conversions: The proposal would eliminate Roth conversions for both IRAs and employer-sponsored plans for single taxpayers with taxable income over $400,000, married taxpayers plan filing jointly with taxable income over $450,000 and has a household with taxable income over $425,000.

Discount on Gift Transfers: This provision changes the valuation rules to ignore discounts from partial ownership or lack of control of an asset in determining its value. This rule applies only to assets that are not used in a business, i.e., real estate, investment portfolios. This provision is limited to passive assets, so these discounts are still permitted for family farms and businesses in the same way as current law.

Grantor Trust: This is the preferred vehicle in estate planning today. This provision changes the estate and gift tax rules that apply to grantor trusts, so that they are more like the income tax rules. In general, a grantor trust is a trust where the person putting assets into the trust controls it so closely that they are treated as earning the income from the trust directly. This provision also taxes a sale from a grantor trust to its owner the same way as a normal sale of assets. This provision applies only to future trusts and future transfers after the effective date.

Qualified Personal Residence Trust: A qualified personal residence trust allows a homeowner to transfer his or her homestead or a vacation property into a trust that permits the grantor to make use of the property at no rent charge for a term of years and considers the gift of the ownership interest in the home to be less than the full value of the home because of the discount attributable to the present value of the free use possessory term. After the death of the grantor, the entire value of the property held under the trust escapes estate tax and the grantor will pay rent after the possessory term of years expires, which further reduces the grantors' estate and enables the grantor to continue to use the property.

1031 Exchanges: There is no mention of a change in the proposed plan. We always like to end on a positive note.

For more information, please contact your Chamberlain Advisor Team:

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