

October 7, 2021

# Proposed Federal Tax Changes Take Aim at Wealthy Businesses and Individuals

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UPDATE: Many of the proposals from the previous tax bill have been removed. However, the limitation on the exclusion of gain from the sale of 1202 stock has remained in the current proposed tax bill. For the most part, the limitation has not changed. However, there are two minor changes:

1. The effective date for the limitation applies to sales and exchanges after September 13, 2021 (not “on or after September 13, 2021” as drafted in the previous bill), which means that a sale or exchange occurring on September 13, 2021 would not be affected by this new limitation.
2. The binding contract exception is applicable to a binding contract in effect on September 13, 2021 (and not September 12, 2021 as was previously drafted).

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The tax plan released last month by the Democratic-led House Ways and Means Committee would bring about extensive changes in the taxation of businesses and high-income individuals.

### Proposals Affecting Businesses

Key proposals of the plan that would impact businesses include (with endnotes providing more details):

- Increasing the corporate income tax rate from a flat 21% rate to an effective 26.5% rate <sup>1</sup>
- Increasing the 50% dividends received deduction to 60% and increasing the 65% dividends received deduction for dividends received from a 20% owned corporation to 72.5%
- Extending the holding period required for long term capital gain treatment of carried interests from three years to five years, with the three-year requirement retained for taxpayers with adjusted gross income (AGI) of less than \$400,000 and income attributable to a real property trade or business
- Removing the 100% and 75% qualified small business stock (QSBS) gain exclusions <sup>2</sup> for taxpayers with AGI of over \$400,000 <sup>3</sup> and for trusts and estates, so that these taxpayers may only exclude 50% of the gain from the sale of QSBS, effective for sales and exchanges after September 13, 2021 <sup>4</sup>
- Temporarily allowing certain S corporations <sup>5</sup> to elect to reorganize as partnerships without tax on built-in gain in S corporation assets <sup>6</sup>

### Proposals Affecting Individuals

Key proposals of the plan that would affect individuals include (with endnotes providing more details):

- Reestablishing a top individual income tax rate of 39.6% <sup>7</sup>

- Raising maximum capital gains rate from 20% to 25%, effective for sales and exchanges after September 13, 2021<sup>8</sup>, and realigning the taxable income threshold for the top capital gains rate with the taxable income threshold for the top individual income tax rate, effective for taxable years beginning after December 31, 2021
- Imposing the 3.8% net investment income tax on all income of high-income individuals<sup>9</sup> and trusts and estates (regardless of income)
- Setting the maximum 199A deduction at \$500,000 for married individuals filing jointly and surviving spouses, \$250,000 for married individuals filing separately, \$400,000 for other individuals and \$10,000 for estates and trusts
- Permanently disallowing business losses in excess of business income for noncorporate taxpayers<sup>10</sup> and making excess business losses for a year subject to the limitation in the following year<sup>11</sup>
- Imposing a 3% surtax on the modified AGI of high-income individuals, trusts and estates<sup>12</sup>
- Accelerating the expiration date of the doubled estate and gift tax exemption to December 31, 2021<sup>13</sup>
- Raising the maximum reduction in value for estate tax purposes for qualified real property used in a family farm or family business from \$750,000 to \$11,700,000<sup>14</sup>
- Pulling grantor trust assets back into the grantor's estate and generally treating distributions from grantor trusts as gifts (see [this recent article](#) for additional detail regarding this proposal)
- Disallowing discounting of nonbusiness assets in valuing transferred interests

### Proposals Affecting Retirement Plans

Key proposals of the plan relating to retirement plans are (with endnotes providing more details:

- Prohibiting contributions to IRAs by high-income individuals<sup>15</sup> with account balances of at least \$10,000,000<sup>16</sup>
- Increasing minimum required distributions for high-income individuals<sup>15</sup> whose combined retirement account balances exceed \$10,000,000 at the end of a year
- Eliminating the Roth conversion strategy (a/k/a "Backdoor Roths") for high-income individuals<sup>15</sup> beginning in 2031
- Prohibiting an IRA from holding private equity assets<sup>17</sup>
- Extending the statute of limitations for valuation of investment assets of an IRA and for prohibited transactions from 3 years to 6 years
- Prohibiting individuals from investing their IRAs in entities in which they have a 10% or greater interest or of which they are an officer or director<sup>17</sup>

Changes under the plan generally would be effective starting in 2022 (except as indicated above).

If you have questions about this proposed legislation and how it applies to your tax situation, please contact a member of Gould & Ratner's [Tax Planning Practice](#).

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<sup>1</sup>Taxable income up to \$400,000 would be taxed at 18%, taxable income from \$400,000 to \$5,000,000 would be taxed at 21%, taxable income in excess of \$5,000,000 would be taxed at 26.5%, and there would be an additional 3% tax, not to exceed \$287,000, on any taxable income in excess of \$10,000,000. Certain personal service corporations would be taxed at a flat 26.5%.

<sup>2</sup>Under current law, non-corporate taxpayers may exclude 100% of the gain from the sale of QSBS acquired after September 27, 2010, and 75% of the gain from the sale of QSBS acquired after February 17, 2009 and before September 28, 2010.

<sup>3</sup>The proposal does not differentiate between taxpayers based on filing status in this instance.

<sup>4</sup>There is an exception for a written binding contract which was in effect on September 12, 2021, and which is not later materially modified.

<sup>5</sup>S corporations that were S corporations on May 13, 1996 and all times thereafter.

<sup>6</sup>To qualify for tax-free treatment, one or more transactions constituting the complete liquidation of the S corporation and the transfer of substantially all of its assets and liabilities to a domestic partnership (e.g., an LLC) would need to occur between December 31, 2021 and December 31, 2023. Some discussion suggests that this change would also apply to S corporations formed after May 13, 1996 that were never C corporations.

<sup>7</sup>This rate would apply to married taxpayers filing jointly or surviving spouses with taxable income over \$450,000, heads of household with taxable income over \$425,000, single taxpayers with taxable income over \$400,000, married taxpayers filing separately with taxable income over \$225,000, and estates and trusts with taxable income over \$12,500. All dollar amounts are indexed for inflation after 2023.

<sup>8</sup>There is an exception if a written binding contract was entered into on or before September 13, 2021, that contract is not later materially modified, and the sale is completed in the year that contains September 13, 2021.

<sup>9</sup>Married taxpayers filing jointly or surviving spouses with modified AGI over \$500,000, married taxpayers filing separately with modified AGI over \$250,000, and all other taxpayers with modified AGI over \$400,000.

<sup>10</sup>This disallowance previously was scheduled to expire at the end of 2026.

<sup>11</sup>Under current law, disallowed excess business losses are treated as net operating losses in the following year and are not subject to the limitation on excess business losses.

<sup>12</sup>Single individuals, heads of households, married individuals filing jointly and surviving spouses with modified AGI in excess of \$5,000,000, married individuals filing separately with modified AGI in excess of \$2,500,000, and estates and trusts with modified AGI in excess of \$100,000. Dollar amounts are not indexed for inflation.

<sup>13</sup>Previously schedule to expire on December 31, 2025. The basic exclusion amount is estimated to be \$6,020,000 for 2022.

<sup>14</sup>Both dollar amounts are indexed for inflation.

<sup>15</sup>Married taxpayers filing jointly or surviving spouses with adjusted taxable income over \$450,000, heads of household with adjusted taxable income over \$425,000, and single taxpayers or married taxpayers filing separately with adjusted taxable income over \$400,000. All dollar amounts are indexed for inflation after 2023.

<sup>16</sup>Indexed for inflation after 2023.

<sup>17</sup>There is a 2-year transition period for IRAs currently holding prohibited investments.