Wealth Management

The Crescent Group

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September 2021 Crescent Commentary

Last month, the House Committee on Ways and Means released its latest proposal on tax reform. In this commentary, we'll review some of the key points of the proposal. The information we discuss remains highly preliminary and subject to further negotiation. The final bill must receive Senate approval, although approval will likely only require a simple majority of Senate votes due to the expected use of the budget reconciliation process. Our Group remains available to discuss any of the following with you if you may be impacted.

The key tax proposals for high-income individuals include:

1) Increase the top individual tax rate 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, and to unmarried individuals with taxable income over $400,000.

2) Increase the top capital gains tax rate from 20% to 25%. The top capital gains rate currently applies to anyone earning $400,000 or more annually.

3) Surtax on high-income individuals. Imposes a 3-percent surtax on individuals with adjusted gross income in excess of $5,000,000 annually.

4) Accelerated expiration of TCJA estate and gift tax parameters. The TCJA doubled the estate and gift tax exemption to $24,000,000 for married filers. The provision is currently scheduled to expire on December 31, 2025. The House proposal moves the expirations date up to December 31, 2021.

5) Changes to the treatment of grantor trusts. 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're treated as earning the income from the trust directly. This provision applies only to future trusts and future transfers. This provision also taxes a sale from a grantor trust to its owner the same way as a normal sale of assets.

6) Modifications to estate tax valuation rules. 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. The provision is limited to passive assets, so these discounts are still permitted for family farms and businesses in the same way as current law.

7) Expands the Net Investment Income Tax to capture more income. Expands the net investment income tax to cover net 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). By closing this gap, all income, be it from wages (currently subject to 3.8% high income tax), investments (currently subject to 3.8% net investment income tax), or earnings from pass-through businesses, will be subject to the same amount of tax, for those with higher incomes.

8) Limitation on 199A deduction (permits owners of sole proprietorships, S corporations, or partnerships to deduct up to 20% of the income earned by the business). 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.

9) Limitation on Excess Business Losses for Non-corporate Taxpayers. Extends the revenue raiser in the American Rescue Plan to permanently disallow business losses beyond the taxpayer's business income. The provision currently applies until 2027. The change makes the provision permanent.

10) Carried interest. Increases the holding period for which a taxpayer must qualify for capital gains treatment from 3 to 5 years. Makes other changes that relate to complex structures to prevent taxpayers from avoiding these holding period rules.

This list includes a lot of potential changes, and our Group, along with our Wealth Planning Consultant and estate planning attorney Robert Stern, remain available to discuss any of the above with you if you may face an impact. For business owners, senior business executives, and the otherwise interested, we include the corporate tax proposals as an appendix to this Commentary. We can connect you with tax advisors if you'd like to discuss any of it in more detail.

Best regards,

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Appendix: Corporate tax reform proposals

1) Increase the top corporate tax rate to 26.5%. For small businesses (income below $400,000) the bill lowers the corporate tax rate to 18%. The 26.5% rate applies only to businesses with income in excess of $5,000,000 (and remains at 21% for businesses below that).
2) Interest deduction limitations for domestic corporations that are part of an international financial reporting group. Limits the interest deduction of certain domestic corporations in proportion to their share of the total earnings of their international financial reporting group. This prevents multinational corporate groups from shifting a disproportionate amount of their interest deduction to the United States in order to lower their U.S. tax liability (a practice known as "earnings stripping").
3) Modifications to the GILTI (minimum tax).
4) Modifications to the BEAT (base erosion anti-abuse tax). Increases the rate of the BEAT to 10% for the next two years and 12.5% thereafter. Substantially re-defines the nature of the tax to more closely approximate the Administration's SHIELD proposal, where the tax does not apply unless the taxpayer is subject to an effective rate of foreign tax that is less than the BEAT rate. The provision also removes the disallowance of tax credits under the BEAT, and changes the BEAT so it doesn't unfairly penalize companies with losses.
5) Modification to FDII (Foreign-Derived Intangible Income). Reduces the deduction from 37.5% (current) to 21.875%. This reduction is scheduled to occur in taxable years beginning after December 31, 2025, so the proposal would be an acceleration of that scheduled reduction. The deemed tangible income return (FDII's version of QBAI) remains at 10%.

Sources:

(1) United States Congress. House. Committee on Ways and Means.

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