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2021 Legislative Update: House Ways and Means Releases Initial Draft Tax Provisions

It has now been several months since President Biden formally outlined his administration's focus and vision and the many tax initiatives required to support them in his draft 2022 Fiscal Year Budget and Greenbook Proposals. Since then, the Democrat led House and Senate have adopted Budget Reconciliation resolutions activating the process by which tax and spend legislation can be enacted by simple majority in both chambers. Over the past several days, as an initial step in this process, the House Ways and Means Committee issued over 1500 pages of draft legislation further defining the social, environmental, educational, and other programs and incentives sought by the President. Included in the voluminous release is the much-anticipated draft tax legislation required to finance the $3.5T proposed spend. <u>While this week's draft represents only the first of many steps in the legislative process, it is indicative and evidentiary of which tax policies are garnering sufficient House Democrat support to ultimately advance to the Senate for further refinement and debate.</u> The following summarizes select provisions we believe most impactful to our Pathstone client families.

Individual and Business Tax Proposals (effective January 1, 2022 unless otherwise indicated)

- <u>Effective September 14, 2021,</u> introduces a new 25% long-term capital gain tax rate applicable to income levels >$400k (single) and >$450k (joint)
- Reinstates the 39.6% top ordinary income tax rate, but applies at lower income levels >$400k (single) and >$450k (joint) than the previous law
- Introduces a 3% surtax on income >$5M (including capital gains) on individuals, trusts and estates
- Expands the application of the 3.8% net investment income tax to, and limits the section 199A business income tax deduction on, all pass-through income >$400k (single) and >$500k (joint)
- Extends the holding period requirement for carried-interest capital gains treatment from 3 to 5 years on non-real property trades or businesses partnerships and taxpayers with income >$400k
- <u>Effective September 14, 2021</u>, taxpayers with income >$400k would no longer qualify for the 100% and 75% exclusion for sales of qualified small business stock (QSBS) under Section 1202
  - Affected taxpayers would maintain the ability to benefit from the 50% exclusion
- Replaces the current 21% flat corporate tax rate with three graduated rates: 18% to $400k, 21% up to $5mil, and 26.5% >$5M
- Introduces provisions to curb excess IRA accumulations (>$10M) through greater regulation of self-directed IRAs, private investments and enhanced minimum payouts
- Extends existing constructive sale and anti-abuse rules to digital assets, and the wash sale rules to digital assets, commodities, and currencies

Estate and Gift Tax Proposals:

- <u>Effective beginning 2022</u>, accelerates the 2017 Tax Cuts and Jobs Act (TCJA) estate and gift tax exclusion 2026 sunset, cutting the current $11.7M per person exclusion roughly in half
- <u>Effective on date of enactment</u>, restrictions on the application of valuation discounts to "non-business assets" for transfer tax purposes
- <u>Effective on date of enactment</u>, new code provisions that would require grantor trusts to be included in grantor decedent's taxable estate and treat transactions between grantor and grantor trust as taxable transactions (applicable to future trusts, transfers, and transaction only)

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2021 Planning Considerations:

While these initial tax proposals exclude many of the more draconian income, capital gain and transfer tax provisions outlined in our prior communications (loss of tax basis step-up at death, $1M estate and gift exclusion, 28% corporate income tax rate, elimination of capital gain rate preferences, GRAT restrictions, etc.) it is important to note that many of these proposals originated in the Senate and may re-emerge later in the reconciliation process. Also notably absent is any mention of the $10k SALT deduction limitation, partial or temporary relief from which we expect will play an important role in advancing this proposal to the Senate. Accordingly, we continue to strongly encourage clients to finalize and execute on their planning, giving special consideration to the following opportunities:

- Reassess your wealth transfer planning goals and review existing plans.
- Expeditiously utilize current elevated $11.7M per person transfer tax exemptions.
- Accelerate the formation of new or further fund/transact with existing Grantor Trusts.
- Utilize Zero-Out Grantor Retained Annuity Trusts for high appreciation potential assets.
- Gift/sell minority interests in existing non-operating business entities to potentially capture valuation discounts.
- Expedite any necessary or desired trust modifications or decanting.
- Consider accelerating major compensatory or qualified dividend income events into 2021.
- Proceed with (or even accelerate) large, planned near-term capital gains transactions (business sales, real estate sales, prudent diversification, etc.).
    - Accelerating sales otherwise planned to occur over the next 4-16 months bear little tax risk or financial downside. Acceleration can deliver a better tax result if final legislation is either prospective or has January 1, 2022 effective date. If retroactive, or effective date of introduction no worse off than if sale occurred post enactment or later in 2022.

Note: many of the structures above may have limited windows of opportunity or could be impacted by retroactive law changes, so any planning should be closely coordinated with tax and legal counsel to help mitigate potential for unintended planning outcomes.

We will continue to monitor and report as the proposals above continue to evolve over the coming weeks. In the meantime, please contact your Pathstone client service team if you have questions or wish to discuss. We look forward to further collaborating on your planning goals and seizing any planning opportunities these changing tax laws may present.

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