OVERVIEW

The $3.5 trillion “Build Back Better” reconciliation spending program is currently working its way through the US Congress. On September 13, 2021, the US House of Representatives Committee on Ways and Means published its set of proposed revenue raisers intended to pay for the program. The proposal would substantially increase the extent to which family wealth would be subject to income, estate and gift taxes but, in many respects, is not as harsh as had been proposed by US President Joe Biden. The summary below describes those portions of the proposal that are most likely to affect individual taxpayers. It’s too early to predict which parts of the proposal will actually be enacted, but it is useful to know what possibilities are being seriously considered.
IN-DEPTH

EXCLUSION AND EXEMPTION AMOUNTS

**Proposed Change**: The current estate and gift tax exclusion amount will be cut in half from its current level ($11.7 million) and will be reduced to $5 million per individual, indexed for inflation (estimated to be $6.02 million in 2022), effective for decedent’s dying and gifts made after 2021. The generation-skipping transfer tax exemption will also be reduced in the same manner.

**Recommendation**: Individuals who have remaining exclusion amounts should consider utilizing them before the end of the year.

GRANTOR TRUSTS

**Proposed Changes**: Grantor trusts created after the law’s enactment—and contributions to pre-existing grantor trusts made after the law’s enactment—would be included in their grantors’ gross estates. Distributions from trusts subject to this new regime to anyone other than their grantors and the grantor’s spouse would be treated as taxable gifts. If the grantor ceases to be treated as the owner of any portion of trust during the lifetime of the grantor, the assets attributable to such portion shall be treated as transferred by gift. In each case, appropriate adjustments would be made to reflect any prior taxable gifts made to the trusts. This new rule does not apply to any trust that would be includable in the gross estate of the deemed owner of the trust in the absence of the new rule.

In addition, sales between a trust and the person who is deemed to be the owner of the trust (whether or not the deemed owner is the grantor of the trust) would be treated as sales to third parties (except that losses would be disallowed) unless the trust is fully revocable by the deemed owner. This provision does not apply to trusts created and funded before the law’s enactment.

**Recommendation**: Individuals who can act quickly might consider either establishing new grantor trusts or making additional gifts to existing grantor trusts before enactment date. Timely additions may be particularly important for those planning to fund premiums on trust-owned life insurance policies with future gifts. The recipient trust should provide the possibility of promptly eliminating grantor trust status in the event the effective date of the legislation predates the funding of the trust.

VALUATION RULES

**Proposed Change**: After enactment, donors and other transferors will no longer be permitted to utilize traditional valuation discounts when valuing an interest in an entity that holds non-business assets (passive assets not used in the active conduct of a trade or business) for gift or estate tax purposes.

**Recommendation**: Any contemplated gifts of interests in entities that would no longer be eligible for discounts under the proposal should be completed before enactment. Consideration should be given to using a formula based on the value of
the gifted property for gift tax purposes to limit the size of the gifts in order to minimize the tax consequences of missing the effective date of the new provision.

**INDIVIDUAL RETIREMENT ACCOUNTS (IRAS)**

**Proposed Changes:** Taxpayers with an adjusted gross income above $400,000 ($450,000 for married filing jointly) would be prohibited from completing Roth conversions starting in 2032. In addition, the proposal includes a general prohibition on Roth conversion of amounts held in qualified retirement plans, except to the extent the conversion is taxable, starting in 2022.

Taxpayers with adjusted gross incomes above $400,000 ($450,000 for married filing jointly) would be prohibited from making contributions to retirement accounts (other than SEP and SIMPLE IRAs) when the total value of all defined contribution accounts and IRAs (including inherited accounts) is $10 million or greater. Those taxpayers would also be required to receive mandatory distributions of 50% of the excess over $10 million held in retirement accounts (other than Roth accounts) and mandatory distributions of the entire excess over $20 million held in Roth accounts.

IRAs would be restricted from holding certain investments, such as private placement investments and investments in entities in which the account holder owns substantial interests either directly or constructively. In the case of a non-public company, “substantial” means ownership of 10% or more of the voting power or value of a company. IRAs also could not own an interest in a company in which the IRA owner is an officer or director. IRAs holding such investments would have until the start of 2024 to distribute or divest from such interests to avoid disqualification of the entire IRA.

**INCOME TAX**

**Proposed Changes.** Effective after December 31, 2021, the top marginal income tax rate, with the top bracket starting at $400,000 for individuals and $450,000 for married couples, would be raised to 39.6%. There would be an added 3% surtax on modified adjusted gross income above $5 million ($2.5 million for a married individual filing separately; $100,000 for estates and trusts).

The top long-term capital gains rate would be increased from 20% to 25% for taxpayers in the highest ordinary income tax bracket, effective for sales after September 13, 2021, unless the seller had a binding contract entered into before that date and the sale occurs by year-end. Taking into account the 3.8% tax on net investment income and the proposed surtax of 3%, next year’s tax on long-term capital gains and ordinary income could be as high as 31.8%. The capital gain exclusion rates for qualified small business stock (QSBS) would be limited to a 50% exclusion (down from 75% and 100%) for those earning more than $400,000.

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