

HOUSE PROPOSALS AFFECTING WEALTHY INDIVIDUALS

What should you consider?

Today's presenters



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Agenda

- 1) Current landscape in Washington DC
- 2) Income tax proposals affecting wealthy individuals
- 3) Income tax proposals affecting Trusts and Estates
- 4) Transfer Tax Proposals
- 5) Individual Retirement Account provisions

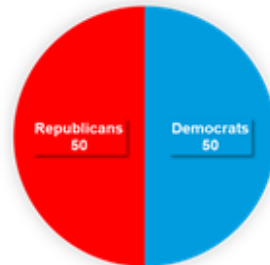
Congress “two track” approach and balance of power

Infrastructure

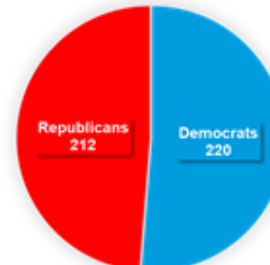
- \$1.2 trillion, which includes \$550B in new spending
- No significant tax increases
- Bipartisan approach
- Delayed vote in House



Senate



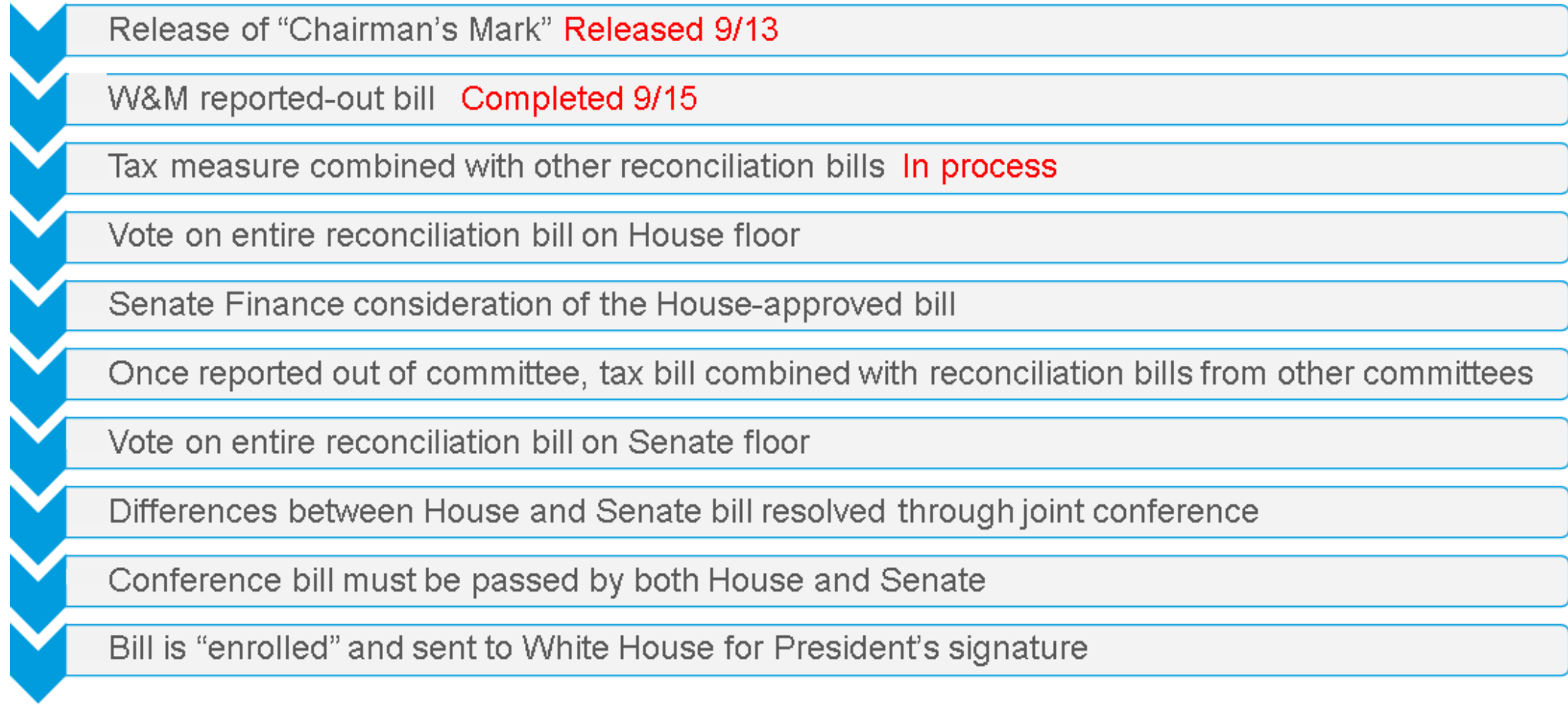
House



Reconciliation

- FY 22 budget resolution with reconciliation instructions
- W&M bill: contains over \$2T in proposed tax increases
- Senate action: TBD

Path forward – dynamic process, condensed timeframe



Flow through income tax proposals and planning

Area	Current law	Proposal
Ordinary Income Tax Rates (effective after Dec. 31, 2021)	Top marginal income tax rate for individuals, estates and trusts is 37% (\$646,150 (MFJ), \$538,475 (S)). After December 31, 2025 rates revert 39.6%.	Top marginal income tax rate for individuals, estates and trusts increased to 39.6% (\$450,000 (MFJ), \$400,000 (S)).
Qualified Business Income Deduction (effective after Dec. 31, 2021)	Qualified business income (QBI) deduction of 20% subject to limitations and taxable income phase-out for specified service trade or businesses.	QBI deduction calculated under the same rules with a deduction cap of \$500,000 (\$400,000 single).
High Income Surcharge (effective after Dec. 31, 2021)	No applicable rule.	Income tax surcharge of 3% on modified adjusted gross income (MAGI) that exceeds \$5 million (\$2.5 million MFS).
Net Investment Income Tax (effective after Dec. 31, 2021)	Net investment income (NII) tax of 3.8% on the lesser of NII or the excess of MAGI above a threshold amount. Material participation activities not subject to the tax.	Subjects "specified income" to the tax as well as traditional amounts if over high-income threshold (\$500,000 (MFJ), \$400,000 (S)). This would include "active" trade or business income.
Excess Business Loss Limitations (effective after Dec. 31, 2020)	Business losses are limited to business income plus \$500,000 (\$250,000 single) and carried forward as an NOL. (expired Dec. 31, 2025).	Business losses are subject to same limitations and carryforwards remain subject to the \$500,000 limit. (made permanent)
Carried Interest (effective after Dec. 31, 2021)	Long term capital gain treatment after 3 year holding period.	Long term capital gain treatment after 5 year holding period. Holding period is measured by latest of "specified dates" as newly defined.

Planning Opportunities

- Accelerate Income/Defer Deductions
- 1245 Recapture triggered in 2021 could still get QBI deduction
- Gains before 2022 avoid Surcharge and NIIT
- Control income after 2021
- Consider entity choice

Future Income Planning

	With QBI		Without QBI		
	Rate Difference vs 2021	All in Rate	Rate Difference vs. 2021	All in Rate	Increases
450,000 - 500,000	3.68%	31.68%	4.60%	39.60%	Ord. Rate
500,000 – 628,300	7.48%	35.48%	8.40%	43.40%	Ord. Rate, NIIT
628,300 - 2.5M	5.88%	35.48%	6.40%	43.40%	Ord. Rate, NIIT
2.5M - 5M	13.80%	43.40%	6.40%	43.40%	Ord. Rate, NIIT, QBI
Over 5M	16.80%	46.40%	9.40%	46.40%	Ord. Rate, NIIT, QBI, Surtax

- Rates presented are marginal ordinary income rates. i.e. the rate on the next dollar of income earned.
- QBI rates assume 100% of income is QBI.
- Rate difference is the difference between rates in 2021 and the current Ways and Means Proposal

Investment income tax proposals and planning

	Current law	Proposal
High Income Surcharge (effective after December 31, 2021)	No applicable rule.	Income tax surcharge of 3% on modified adjusted gross income (MAGI) that exceeds \$5 million for individuals and \$100,000 for estates and trusts.
Long Term Capital Gains (effective for transactions after Sept. 13, 2021)	Top long-term capital gains tax rate of 20% (\$501,850 (MFJ), \$445,850 (S)).	Top long-term capital gains tax rate of 25% (\$450,000 (MFJ), \$400,000 (S))
Section 1202 Exclusion (QSBS) (Effective for transactions on or after Sept. 13, 2021)	Exclusion allowed for qualified small business stock of up to 100% of the total gain depending upon acquisition date.	Exclusion limited to 50% of gain for individual taxpayers with greater than \$400,000 of taxable income. All estates and trusts are limited to 50%.
Ordinary Income Tax Rates (effective after December 31, 2021)	Top marginal income tax rate for individuals, estates and trusts is 37% (\$646,150 (MFJ), \$538,475 (S)). After December 31, 2025 rates revert 39.6%.	Top marginal income tax rate for individuals, estates and trusts increased to 39.6% (\$450,000 (MFJ), \$400,000 (S)).

Planning Opportunities

- Evaluate tax-exempt vs. taxable bonds
- Generate needed cash before the end of the year
- ROTH conversions in 2021
- Consider 1045 rollover
- Private placement life insurance

Income Tax Planning for Trusts and Estates

	Current law	Proposal
High Income Surcharge (effective after December 31, 2021)	No applicable rule.	Income tax surcharge of 3% on modified adjusted gross income (MAGI) that exceeds \$100,000 for estates and trusts.
Long Term Capital Gains (effective for transactions after Sept. 13, 2021)	Top long-term capital gains tax rate of 20% (\$13,050).	Top long-term capital gains tax rate of 25% (\$13,050).
Section 1202 Exclusion (QSBS) (Effective for transactions on or after Sept. 13, 2021)	Exclusion allowed for Qualified Small Business Stock of up to 100% of the total gain depending upon acquisition date.	Exclusion limited to 50% for all estates and trusts.
Ordinary Income Tax Rates (effective after December 31, 2021)	Top marginal income tax rate for individuals, estates and trusts is 37% (\$13,450). After December 31, 2025 rates revert 39.6%.	Top marginal income tax rate for estates and trusts increased to 39.6% (\$13,450).
Net Investment Income Tax (effective after Dec. 31, 2021)	Net investment income (NII) tax of 3.8% on the lesser of NII or the excess of MAGI above a threshold amount. Material Participation activities not subject to the tax.	Subjects "undistributed specified income" to the tax as well as traditional amounts. This would include "active" trade or business income.
Qualified Business Income Deduction (effective after Dec. 31, 2021)	Qualified business income (QBI) deduction of 20% subject to limitations and taxable income phase-out for specified service trade or businesses.	QBI deduction calculated under the same rules with a deduction cap of \$10,000.

Planning Opportunities

- Evaluate trustee
- Should the trust remain a grantor trust
- Consider trust distribution planning and use of 65-day rule (post 2021)
- Re-evaluate trusts with 1202 in mind

Estate Tax Changes

	Current law	Proposal
Exemption changes (effective for decedents and gifts after Dec. 31, 2021)	Estate tax exemption temporarily increased (\$11.7 million in 2021) until Dec. 31, 2025 when it reverts to \$5 million level as adjusted for inflation.	Exemption adjusted to an estimated amount of \$6,020,000.
Valuation Discounts (effective after date of enactment)	Discounts allowed for lack of marketability and lack of control.	Valuation discounts for certain “nonbusiness assets” held by an entity are disallowed and the transfer is treated as if the underlying assets were transferred directly.
Transfer Tax treatment of Grantor Trusts (effective after date of enactment)	An irrevocable trust may be structured so that the trust’s income is taxed to the grantor and the trust’s assets are excludible from the grantor’s estate.	Distributions and amounts in grantor trusts at death not previously subject to transfer tax includible in the grantor’s gross estate.
Income tax treatment of Grantor Trusts (effective after date of enactment)	Sales and other transfers between grantor trusts and the grantor are disregarded for income tax purposes.	Sales and other transfers would be regarded for income tax purposes.

Planning Opportunities

- Utilize exemption amount now
- Evaluate current grantor trusts for effects of rules (ILIT, SLAT, GRAT, IDGT, Grantor CLAT, BDOT, QSST, QPRT)
- Swap now
- Accelerate gifting and sales before effective date
- Consider paying off notes

Individual Retirement Account (IRA) Changes

	Current law	Proposal
Increases to required minimum distributions (RMDs) for <u>high-income taxpayers</u>* (effective for taxable years beginning after Dec. 31, 2021)	RMDs are required for traditional IRAs when a taxpayer reaches age 72 (age 70 ½ prior to 2020).	For high-income taxpayers, RMDs would also be required the year following any year in which the taxpayer's aggregate traditional IRA, Roth IRA, and defined contribution plan balances exceed \$10 million.
IRA contribution limit for <u>high-income taxpayers</u>* (effective for taxable years beginning after Dec. 31, 2021)	Taxpayers can make contributions to IRAs irrespective of their aggregate account balances.	IRA contributions would be limited for high-income taxpayers if aggregate balances in applicable retirement plan accounts exceed \$10 million.
Prohibited investments held by IRA accounts (effective for taxable years beginning after Dec. 31, 2021)	IRAs may hold investments in: 1. Non-publicly traded entities if the IRA owner holds a 10% or greater interest in the entity or for which the IRA owner is an officer or director of the entity, and 2. Securities in which the issuer requires a specified minimum amount of income or assets, a specified education level, or specific licenses or credentials in order to purchase the investment.	IRAs would no longer be able to hold these investments. If already held, 2 year window for distributing or selling the investments (with care not to fail prohibited transaction rules in any sale of the assets)

Planning Opportunities

- Lower income or IRA account balances.
- Consult an investment advisor before making investments.
- Consult a tax advisor to discuss strategies for removing disallowed assets from an IRA.

*High income is \$450,000 MFJ or \$400,000 Single

IRA Changes (cont.)

	Current law	Proposal
Treatment of rollovers/conversions to Roth IRAs and accounts (effective for taxable years beginning after Dec. 31, 2021, However, <u>some conversion provisions pertaining to high-income taxpayers, are effective for taxable years beginning after Dec. 31, 2031.</u>)	Taxpayers who exceed the income limitations on making Roth IRA contributions can contribute to Roth IRAs indirectly by making contributions to traditional IRAs or employer-sponsored plans and then converting them to Roth IRAs.	High-income taxpayers would no longer be able to convert traditional IRAs or other non-Roth accounts to a Roth IRAs or Roth-designated accounts. All taxpayers would not be able to convert any portion of an account to a Roth IRA or Roth-designated account if any portion of the traditional IRA or qualified plan account has any after-tax contributions.
Prohibited transactions involving IRA owners (effective for transactions occurring after Dec. 31, 2021 or taxes for which the three-year statute of limitation ends after Dec. 31, 2021)	IRA owners are not listed in section 4975 as “disqualified persons.” however courts and the government treat them as fiduciaries and thus disqualified. Arguments have been made that IRA owners can avoid incurring prohibited transactions. The statute of limitations for prohibited transactions is 3 years.	IRA owners would be added to the list of section 4975 “disqualified persons,” reducing their ability to engage in transactions with their IRAs without triggering prohibited transactions. The statute of limitations for prohibited transactions would be increased to 6 years.

Planning Opportunities

- Assess whether any IRA conversions should be made prior to enactment.
- Discuss contemplated transactions with a tax advisor to confirm whether the transactions are prohibited transactions



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