



Potential Tax Alert November 2021: **Build Back Better Act version 2.0**

About six weeks ago, we wrote a summary about some of the key personal tax elements to proposed tax law changes introduced by the US House Ways and Means Committee on September 13, 2021. Much has changed since then, and the purpose of this writing is to provide a further update based on the latest Congressional revisions to that proposal.

After a lot of back and forth both in Congress and between Congressional leaders and the White House, the most recent official iteration of a proposal was released on October 28, 2021. The complete draft legislation can be viewed [here](#). It remains as true now as it did on September 13: what will wind up in a final bill remains uncertain as Biden's Build Back Better Act (say that three times fast) will likely continue to evolve.

Of course, this Alert intends neither to be exhaustive nor tailored to any one taxpayer's unique circumstances, and we would expect that consultation with your attorney and tax advisor would be necessary and appropriate elements to any decisions contemplated in connection with the proposed legislation.

What is NOT in the Current Proposal that WAS in the Earlier Proposal: Not mentioned in this draft that were worrisome components of the initial legislative proposal:

- No proposed increases or compression in personal income tax or capital gains tax rates.
- No proposed reductions to estate and gift tax exemption levels from \$10mm indexed for inflation to \$5mm indexed for inflation (Note- the initial 2025 sunset to the current exemption thresholds remains in effect). And no proposals to eliminate the step up in income tax basis upon death.
- No proposal to restrict the formation of irrevocable grantor trusts, no proposals to make gifts to grantor trusts includable in the grantor's estate, and no proposal to require recognition of gain in the event of sale between a grantor and his grantor trust.
- No proposed forced liquidations of so-called Mega IRAs (greater than \$10mm) and no closure of the so-called back door Roth conversion loophole.

What Tax Increases ARE in the Current Proposal: At least a pair of proposals will require some careful consideration and planning if they become law:



- Beginning on Jan 1, 2022, the QSBS deduction would be cut by 50% for single owners earning over \$400,000 (and \$450,000 for married owners).
- Beginning on Jan 1, 2022, a 5% surtax will apply to taxpayers with MAGI (“modified adjusted gross income”) in excess of \$10mm (\$5mm if married filing separately) and on trusts and estates with income exceeding \$200,000. Further, an additional 3% (8% cumulatively) will apply to taxpayers with MAGI in excess of \$25mm (\$12.5mm if married filing separately) and on trusts and estates with income exceeding \$500,000. These thresholds do not distinguish between ordinary income and capital gains.

One potential solution to the QSBS proposal could be transferring shares to a trust referred to as a BDOT (“Beneficiary Deemed Owner Trust”), where the beneficiary has income less than \$400k (\$450k if married). Other solutions may also be available to mitigate consequences of this potential change.

The surtax income threshold for estates and irrevocable nongrantor trusts is disconcerting to be sure. The likely result will be that careful consideration of making distributions of DNI (distributable net income) from such trusts and estates to beneficiaries an important annual planning exercise. In the event such a trust or estate owns an asset which is to be sold for a substantial capital gain, a related party installment sale (if completed at least 2 years before the gain event) might be considered to help spread the gain over multiple years. And even though MAGI is measured *before* any charitable giving, the use of a charitable split-interest trust (e.g., a Charitable Remainder Trust) could also accomplish a similar outcome.

For both of those possible changes to the tax code, a “wait and see” approach is probably the best course of action for the moment. However, if a taxpayer has already commenced planning around grantor trust structures and funding irrevocable trusts, it may be advisable to see that plan through to completion even though it seems likely that a change in the grantor trust rules and transfer tax exemptions have been put at bay for the moment. All the reasons that made these strategies attractive remain viable, and the power of removing appreciation from one’s taxable estate remains a compelling motivator.

Surely more twists and turns will occur before Congress sorts out the final version of any tax bill. And just because certain elements have come out of the most recent legislative draft doesn’t preclude those same elements from being reinserted as the negotiations continue. In the meantime, our firm continues to closely monitor changes on the legislative landscape, and we would be delighted to talk with you and your tax and legal advisors at your convenience.

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