

# BDO KNOWS: PRIVATE CLIENT SERVICES

OCTOBER 2021 / [www.bdo.com](http://www.bdo.com)

## HOUSE RELEASES REWRITE OF BUILD BACK BETTER TAX PROPOSALS

A version of [H.R. 5376](#) (the Build Back Better Act), released on October 28, 2021 by the House Budget Committee, eliminates many of the previously proposed tax increases that would have impacted individuals.

The tax proposals eliminated in the rewrite include:

- ▶ Increase in the top marginal individual income tax rate;
- ▶ Increase in the capital gains rate for certain high income individuals;
- ▶ Limitation on the deduction of qualified business income for certain high income individuals;
- ▶ Modification of the rules for carried interests;
- ▶ Taxation of certain transfers between a deemed owner and an irrevocable grantor trust;
- ▶ Termination of the temporary increase in the estate tax basic exclusion amount;
- ▶ Inclusion of assets held in an intentionally defective grantor trust in the gross estate of the deceased deemed owner;
- ▶ Valuation rules that would have eliminated valuation discounts for certain transfers of nonbusiness assets; and
- ▶ Modifications of rules relating to retirement plans including:
  - Imposition of contribution limits for individual retirement plans of high-income taxpayers with large account balances;
  - Increase in minimum required distributions for high-income taxpayers with large retirement account balances;
  - Provisions that would have prohibited “back door” Roth IRAs; and,
  - Prohibition of IRA investments that were conditioned on the account holder qualifying as an accredited investor or investments in entities in which the owner has a substantial interest.

Other provisions remained, some unchanged and some modified as discussed below.

## Section 1202 – Qualified Small Business Stock (clarification)

Taxpayers are currently eligible for 75% and 100% exclusions for sales of qualified small business stock (QSBS). In an unexpected move, the proposed legislation would eliminate the 75% and 100% exclusions for sales of QSBS acquired after February 17, 2009, and sold after September 13, 2021, unless the sale was made pursuant to a written binding contract already in place and not materially modified thereafter. The proposed provision would apply to taxpayers whose adjusted gross income equals or exceeds \$400,000 and to trusts and estates.

Under the current 50% exclusion rules, the remaining 50% QSBS gain is taxed at 28%. The excluded QSBS gain is considered an alternative minimum tax (AMT) preference item, which, when considered along with the net investment income tax on the taxable half of the gain, results in an effective rate of 16.88% for QSBS acquired after February 17, 2009, and sold after September 13, 2021. In addition, high-income taxpayers may also be subject to the surcharge discussed below.

### **BDO Insight:**

The rewrite of the Build Back Better Act confirms that this proposed provision applies to sales and exchanges after September 13, 2021, correcting an error in the earlier draft.

## Excess Business Loss Limitation (no change)

Under a temporary provision, excess business losses (EBLs) of non-corporate taxpayers in excess of \$500,000 for joint filers (\$250,000 for all other taxpayers) are disallowed and treated as net operating losses in the following year; however, the provision is set to expire on December 31, 2026. The rewrite made no change to the initial proposal that would make the temporary provision permanent and modify how a disallowed EBL is treated. Instead of treating the disallowed loss as a net operating loss in the following year, the EBL would be treated as a deduction attributable to a taxpayer's trades or businesses when computing the EBL in the subsequent year. The proposal would be effective for taxable years beginning after December 31, 2020.

## Net Investment Income Tax (no change)

Under the current rules, net investment income does not include income derived in the ordinary course of a trade or business or income attributable to the disposition of property earned outside of a passive activity. The rewrite made no change to the proposed legislation that would eliminate those carveouts and others, while broadening the type of income subject to net investment income tax (NIIT). NIIT applies to the greater of "specified net income" or net investment income for high income individuals, estates and trusts. "Specified net income" includes net investment income even if derived in the ordinary course of a trade or business and other gross income and net gains attributable to the disposition of property, even if earned outside of a passive activity or the trade or business of trading financial instruments or commodities. Certain foreign income is includible in the definition of net investment income.

The proposed provision would apply to taxpayers whose modified adjusted gross income exceeds \$500,000 for married individuals filing jointly and surviving spouses, \$250,000 for married individuals filing separately, \$12,500 for estates and trusts and \$400,000 for all other tax filers. The proposal would be effective for taxable years beginning after December 31, 2021.

## Surcharge on High-Income Individuals, Estates and Trusts (modification)

There is currently no surcharge imposed on high-income individuals. The original Build Back Better Act proposal would have imposed a 3% surcharge on modified adjusted gross income in excess of \$2,500,000 for married individuals filing separately, \$100,000 for estates and trusts and \$5,000,000 for all other individuals. The rewrite of the Build Back Better Act would impose a 5% surcharge on modified adjusted gross income that exceeds \$5 million for married individuals filing separately, \$200,000 for estates and trusts and \$10 million for all other individuals. An additional 3% surcharge would be imposed on modified adjusted gross income in excess of \$12.5 million for married individuals filing separately, \$500,000 for estates and trusts and \$25 million for all other individuals. The proposal would be effective for taxable years beginning after December 31, 2021.

## CONTACT

### TRACI KRATISH PUMO

Tax Partner

561-207-3239 / tpumo@bdo.com

### KATHY WALTER

Tax Managing Director

206-267-7687 / kwalter@bdo.com