

THE BUILD BACK BETTER ACT: THE TAX PROVISIONS PASSED BY THE HOUSE AND ONES THAT DIDN'T MAKE THE CUT



ROBERT S. SCHWARTZ is a shareholder in Herold Law, P.A., of Warren, New Jersey, and Delray Beach, Florida. He has been a frequent contributor to *The Practical Tax Lawyer* and is a member of the editorial board.

On November 19, 2021, the House of Representatives passed its last version of H. R. 5376, President Biden's Build Back Better Act (BBB). As of the date of this article, it had not yet passed the Senate. There were three versions of the bill which I think are important:

1. The Budget Committee House Report 117-30, a text of 2,468 pages (September 27, 2021);
2. The Rules Committee Print 117-17, a text of 1,684 pages (October 28, 2021); and
3. The Rules Committee Print 117-18, a text of 2,135 pages (November 3, 2021) as supplemented.¹

Although the bill has not been enacted, the reader will find this review and report on the text of the three versions' tax provisions useful for future reference; for example, in contemplation of the many tax changes made by the Tax Cuts and Jobs Act (P.

L. 115-97) expiring on December 31, 2025. This article focuses on BBB federal tax changes with widespread application. Thus, for example, this article excludes coverage of the BBB's many changes to complex international tax provisions and targeted tax increase provisions such as those directed at taxpayers with large IRAs. Although no BBB tax provisions became law in 2021, some or all of them are likely to reappear in one or more future tax bills that may become law.² Upon information and belief, Rules Committee Print 117-18, as supplemented, was the text passed by the House along party lines on November 19, 2021 (House-Passed BBB).

New gross income tax

Beginning in 2022, with complex, limited exceptions, House-Passed BBB imposes a new gross income tax on Form 1040 and Form 1041 tax return

Filing status	Modified adjusted gross income (MAGI) threshold	Income tax
All individual filing status except married filing separately	MAGI exceeding \$10 million	Five percent of excess
	MAGI exceeding \$25 million	Additional three percent
Married filing separately	MAGI exceeding \$5 million	Five percent of excess
	MAGI exceeding \$12,500,000	Additional three percent
Trusts and estates	MAGI exceeding \$200,000	Five percent of excess
	MAGI exceeding \$500,000	Additional three percent

filers whose “modified adjusted gross income,” as specially defined, exceeds stated thresholds.

Ordinary income tax increases

Beginning in 2022, House Budget Committee Report 117-30 (House Budget Committee Preferred BBB) raises ordinary income taxes on families, trusts, and estates. It does not change lower taxable income brackets:

1. Married filing joint returns or surviving spouse returns: Taxable income between \$400,000 and \$450,000 is taxed at 35 percent. Taxable income over \$450,000 is taxed at 39.6 percent. By comparison, 2021 taxable income between \$418,850 and \$628,300 is taxed at 35 percent. Taxable income over \$628,300 is taxed at 37 percent.
2. Married filing separate returns: Taxable income between \$200,000 and \$225,000 is taxed at 35 percent. Taxable income over \$225,000 is taxed at 39.6 percent. By comparison, 2021 taxable income between \$209,425 and \$314,150 is taxed at 35 percent. Taxable income over \$314,150 is taxed at 37 percent.
3. Heads of household returns: Taxable income between \$200,000 and \$425,000 is taxed at 35 percent. Taxable income over \$425,000 is taxed at 39.6 percent. By comparison, 2021 taxable income between \$209,400 and \$523,600 is taxed at 35 percent. Taxable income over \$523,600 is taxed at 37 percent.
4. Unmarried individual returns: Taxable income between \$200,000 and \$400,000 is taxed at 35 percent. Taxable income over \$400,000 is taxed at 39.6 percent. By comparison, 2021 taxable income between \$209,425 and \$523,600 is taxed at 35 percent. Taxable income over \$523,600 is taxed at 37 percent.
5. Trust and estate income tax returns: Taxable income over \$12,500 is taxed at 39.6 percent. By comparison, 2021 taxable income over \$13,050 is taxed at 37 percent.

House Budget Committee Preferred BBB keeps these new brackets in place for 2026 et seq. with inflation adjustments.

Long-term capital gain and qualified dividends tax increases

For 2021, House Budget Committee Preferred BBB increases the 20 percent net (long-term) capital gains rate to as much as 25 percent without lowering the 25 percent bracket thresholds.³ House Budget Committee Preferred BBB sets forth complex blended rate transitional rules keying off capital asset sales made and qualified dividends received on or before, as compared to after, September 13, 2021.⁴ As a further refinement, sales of capital assets after September 13, 2021, and before January 1, 2022, pursuant to contracts to sell capital assets that were binding on or before September 13, 2021, are eligible for blended rate relief.⁵ Beginning in 2022, the higher 25 percent rate applies to taxpayers whose taxable incomes exceed House Budget Committee Preferred BBB lowered thresholds:

1. Married filing joint returns or surviving spouse returns taxable income exceeding \$450,000. Absent a House Budget Committee Preferred BBB, for 2021 the long-term capital gains rate increases to 20 percent once taxable income exceeds \$501,600 and, for 2022, exceeds \$517,200.
2. Married filing separate returns taxable income exceeding \$225,000. Absent a House Budget Committee Preferred BBB, for 2021 the long-term capital gains rate increases to 20 percent once taxable income exceeds \$250,800 and, for 2022, exceeds \$258,600.
3. Heads of household returns taxable income exceeding \$425,000. Absent a House Budget Committee Preferred BBB, for 2021 the long-term capital gains rate increases to 20 percent once taxable income exceeds \$473,750 and, for 2022, exceeds \$488,500.
4. Unmarried individual returns taxable income exceeding \$400,000. Absent a House Budget Committee Preferred BBB, for 2021 the long-term capital gains rate increases to 20 percent once taxable income exceeds \$445,850 and, for 2022, exceeds \$459,750.
5. Trust and estate income tax returns taxable income exceeding \$12,500. Absent a House

Budget Committee Preferred BBB, for 2021 the long-term capital gains rate increases to 20 percent once taxable income exceeds \$13,250 and, for 2022, \$13,700.

Itemized deduction for state and local taxes

Beginning in 2021 and through 2030, the House-Passed BBB increases the itemized state and local taxes paid deduction to \$80,000 for all individual filing status except married filing separately, which is increased to \$40,000. \$40,000 is the maximum deduction for trusts and estates as well. These amounts are reflected in the Amendment to Rules Committee Print 117-18 (November 4, 2021).

Estate, gift, and generation skipping transfer (GST) taxes

I refer to estate, gift, and GST taxes together as “transfer taxes.” The House Budget Committee Preferred BBB broadens the transfer tax base in a number of traditional transfer tax planning areas.

“Unified credit” or the personal exclusion amount

For decedents dying and gifts and GST transfers made beginning in 2022, the House Budget Committee Preferred BBB personal exclusion amount is cut in half. The cut of \$5 million is based on a \$10 million personal exclusion amount. The cut accelerates a one-half cut to occur under current law beginning in 2026. The House Budget Committee Preferred BBB does not change the inflation adjustment found at Code section 2002(c)(3)(B). Absent a House Budget Committee Preferred BBB, the personal exclusion amount for 2022 is \$12,060,000. Cutting that in half, the House Budget Committee Preferred BBB personal exclusion amount for 2022 is \$6,030,000.

“Farmland” valuation

The House Budget Committee Preferred BBB also increased the long-standing Code section 2032A limit on the valuation reduction that results from valuing “qualified real property” based upon its use by the decedent at the time of death (sometimes referred to as the “farm production value”) rather

than being valued at the higher, ubiquitous willing-buyer-willing-seller fair market value standard. The limit on the estate tax value reduction as would be reflected in a farm production value valuation report was \$1,190,000 for 2021 (\$750,000 as indexed for inflation from since 1997.) The limitation is increased to \$11,700,000. None of the stringent requirements associated with an estate electing the section 2032A valuation method were modified, such as the consequential presence of an IRS lien or posting bond, and possible recapture of the estate taxes avoided by a section 2032A election. Upon information and belief, use nationally of Code section 2032A has been infrequent.

Grantor trusts

Effective for trusts created after the date of its enactment and for additions after the date of its enactment to otherwise fully grandfathered trusts, new Code section 2901 states that if a trust grantor is deemed to be the owner of any portion of the trust under subpart E of part 1 of subchapter J of chapter 1, transfer taxation occurs at a given time in a given manner. Such portions of continuing deemed property ownership, typically the whole of the trust property or the trust, are commonly known as “grantor trusts.” First, to the extent a grantor is such an owner at death, the value of the portion deemed owned is included in the estate tax base at date of death or alternative valuation date value. Second, actual trust distributions out of the portion deemed owned by the grantor to one or more non-spouse beneficiaries are treated as a “transfer by gift for purposes of chapter 12.” Maybe, if the distributees are “skip persons,” a GST taxable distribution also results, but new regulations appear necessary for GST taxation.⁶ Third, to the extent a grantor ceases to be the deemed owner of a portion during lifetime, trust assets “attributable to such portion” are treated as a “transfer by gift for purposes of chapter 12.” Maybe, if there are one or more skip person beneficiaries at the time of deemed ownership cessation, there is a deemed GST taxable termination, but new regulations appear necessary for GST taxation.⁷

Another change to the grantor trust rules also is effective for trusts created after the date of enactment and for additions after the date of its enactment to otherwise fully grandfathered trusts. New Code section 1062 provides that sales by a grantor to an irrevocable grantor trust of property as to which the grantor is deemed to be the owner under subpart E of part 1 of subchapter J of chapter 1 are taxable sales. Gain is therefore realized and recognized under sections 61 and 1001. Meanwhile, Code section 267 bars the seller from reporting a taxable loss on such a sale. Sales to grantor trusts have been common, specific income tax and transfer tax advantaged transactions for many years.⁸

Valuation discounts

Effective for transfer taxable events occurring after the date of enactment, the House Budget Committee Preferred BBB amends Code section 2031 (“The value of the gross estate of the decedent shall be determined...”) by adding valuation rules in the case of estates and, expressly, gifts.⁹ The focus is on interests in non-actively traded entities within the meaning of Code section 1092. With respect to transfer taxation, taxable interests in “nonbusiness assets,” as defined, of an entity are to be identified and valued for transfer tax imposition purposes. No valuation discounts are allowed as far as the entity interests qua interests in proportion to these type of entity assets. Then, excluding “nonbusiness assets,” one values the entity interests qua interests as to which valuation discounts may be made in accordance with existing law. Besides defining “nonbusiness assets” in a way that will require fleshing out in regulations as “any passive asset which is held for the production or collection of income and is not used in the active conduct of a trade or business,” a rule is included that is intended to carve out of “passive assets” those having a value representing reasonable working capital for the business in question as of the valuation date.¹⁰

Medicare 3.8 percent excise tax

Beginning in 2022, House-Passed BBB broadens the Code section 1411 3.8 percent of “net investment income” Medicare excise tax base by adding to it the

ordinary net income of a person actively involved in a trade or business conducted as a sole proprietorship or through a pass-through entity such as a limited liability company or general partnership. BBB also increases the “modified adjusted gross income,” as specially defined, threshold amounts that are necessary to exceed for imposition of the tax.

Filing status	Modified adjusted gross income (MAGI) threshold
Single	\$400,000
Head of household	\$400,000
Married filing jointly and surviving spouse	\$500,000
Married filing separately	\$250,000
Trusts and estates	\$ 13,050

In the case of S corporations, shareholders’ income reported as wages subject to FICA taxation is excluded from the expanded 3.8 percent excise tax.

Qualified business income deduction

Code section 199A allows the owners of proprietorships and pass-through entities an income tax deduction approximately equal to 20 percent of the entity’s qualified business income. The House Budget Committee Preferred BBB would have imposed a cap on the section 199A deduction, as follows:

Filing status	Maximum deduction
Married filing jointly or surviving spouse	\$500,000
Married filing separately	\$250,000
Heads of households and single filers	\$400,000
Trusts and estates	\$ 10,000

Business net operating loss carryover deduction

The Tax Cuts and Jobs Act had included a limitation on the amount of business net operating losses that

can be carried forward to offset business taxable income in later years pursuant to detailed operating loss carryforward rules. Generally, the limitation as enacted was 80 percent of a non-corporate taxpayer's taxable income. Owing to the outbreak of COVID, this limitation on the use of business net operating loss carryforwards was suspended by Congress. The House Budget Committee Preferred BBB would have eliminated the suspension beginning with 2021.

Excise tax on stock repurchases

Under the House-Passed BBB, beginning with 2022, corporations with publicly traded stock will pay an excise tax equal to one percent of the fair market value of stock redeemed from shareholders during a year, unless the value of all shares redeemed during the year is less than \$1 million. Some readers may view this provision as a precursor of an eventual securities' trading federal excise tax. 🍷

Notes

- 1 The Office of the Clerk of the House does not update legislative text as neatly as one would like. The House bill as passed was never placed on the Senate calendar to be considered by the Senate. If not the House-Passed bill itself, the closest version of what was passed in the House is Rules Committee Print 117-18 (November 3, 2021). Using that as a base, the only changes made to Rules Committee Print 117-18 after November 3 are two Manager's Amendments: Amendment to the Rules Committee Print 117-18, a text of 9 pages (November 4, 2021), and Amendment to the Rules Committee Print 117-18, a text of 6 pages (November 18, 2021).
- 2 An analogy is the background to Code section 409A. Section 409A was passed in 2004 and greatly impacted the federal taxation of deferred compensation plans and arrangements, such as tightening the rules for cash deferral elections and non-qualified stock option grants and exercises. Two years before, Congress considered the same subject leading to two bills: the American Competitiveness and Corporate Accountability Act of 2002 (H.R. 5095), introduced on July 11, 2002, and the National Employee Savings and Trust Equity Guarantee Act of 2002 (S. 1971), approved by the Senate Finance Committee on the same day. Though not the same as section 409A, the earlier bills were harbingers of section 409A to come in about two years.
- 3 Code section 1(h)(11)(A) states that the term "net capital gain" (i.e., long-term capital gain for a taxable year) is increased for qualified dividend income as defined in Code section 1(h)(11)(B). The House Budget Committee Preferred BBB does not amend section 1(h)(11)(A) or section 1(h)(11)(B).
- 4 This blended rate approach is reminiscent of the Jobs and Growth Tax Relief Reconciliation Act of 2003 (P.L. 108-27), which had introduced lowered, graduated long-term capital gain and qualified dividends rates of five percent, 10 percent and 20 percent effective for capital asset sales made or qualified dividends received on or after May 6, 2003. The author recalls that one consequence of the May 6, 2003, cut off blended rate approach was the filing of many inaccurate 2003 Forms 1040 as many taxpayers were unaware of the significance of May 6, 2003, to the correct computation of the tax due.
- 5 This binding contract relief is reminiscent of the Tax Reform Act of 1986 (P.L. 99-514) written binding contract and other transitional relief from the repeal of the General Utilities doctrine. See section 633 of the said act, as amended by the Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647) section 1006(g). See also Notice 90-6, 1991-1 C.B. 304, Meaning of "Binding Contract" in Legislative Transitional Rules of the Revenue Reconciliation Act of 1989.
- 6 See Code section 2613 for the definition of a "skip person." The text does not refer to the GST tax. Treasury Regulation 26.2612-1(c) provides that "[i]f ... gift tax is imposed on any individual with respect to property held in a trust, the interest in property is treated as having been distributed to [the distributee] to the extent that the value of the interest is subject to gift tax." The regulation is suggestive of GST taxation by reason of section 2901 in the case of a deemed grantor trust distribution to a skip person.
- 7 Treasury Regulation 26.2612-1(b) provides in relevant part that "a taxable termination is the termination of an interest in a trust unless ... [a] transfer subject to ... gift tax occurs with respect to the property held in the trust at the time of termination and ... immediately after the termination, a person who is not a skip person has an interest in the trust." Grantor trust beneficiaries at the time of a section 2901 grantor cessation can consist of skip persons and non-skip persons. The regulation is not suggestive of GST taxation by reason of section 2901 in the case of a grantor cessation.
- 8 See, e.g., Aucutt, Ronald D., Grantor Retained Annuity Trusts (GRATs) and Sales to Grantor Trusts. *Estate Planning Course Materials Journal*, February 2018, p. 35 (Part 1); April 2018, p. 4 (Part 2); June 2018, p. 5 (Part 3).
- 9 The same GST tax considerations are relevant as at notes 6 and 7 above.
- 10 A reasonable amount of working capital has long been an issue involved in IRS determinations to impose on C corporations the 20 percent tax on excess, accumulated earnings of Code section 531. Therefore relevant should be the old section 531 cases of which there are good number. Upon information and belief there have been no, or very, very few, accumulated earnings tax decisions since 1985.