The Impact You May See from the Build Back Better Act's Tax Changes

The Build Back Better Act came under consideration in mid-September 2021, with several major changes that will be considered for taxes. The majority of these aspects will have a December 31, 2021 effective date as currently proposed, so making plans now to adapt to these changes can help you make a smoother transition.

1. 2.6% increase in top marginal tax rate

The bill increases top tax rates from 37% to 39.6% for individuals with taxable income exceeding $400,000 and married filing jointly above $450,000. This is a drastic acceleration of the rate that was planned for 2026, when the Tax Cuts and Jobs act of 2017 expires.

2. Changes to 3.8% NIIT (Net Investment Income Tax)

The NIIT will see broader application to all individuals with MAGI exceeding $500,000, regardless of whether the investment was in business or an active trade, rather than only passive investment activity. This can make LLC members, limited partners and S corporation active shareholders subject to the tax.

3. 3% separate income surcharge above $5 million

For those with MAGI exceeding $5 million, and trusts exceeding $2.5 million, a 3% surcharge is being added, though not treated as a tax under Subtitle A for Chapter 1 credit or for alternative minimum tax. Surcharge payments are not eligible for foreign tax credits because it is not legally an income tax.

4. Capital gains tax rate increase

Going from 20% to 25%, this increase will apply to tax years after September 13, 2021, with related changes made to FIRPTA rules. There is a transition rule that gains and losses for the part of the tax year prior to September 13, 2021, would be taxed at 20%, while the portion following that date would be at 25%.

5. No high-income Roth IRA conversions

Current laws allow you to convert traditional IRAs to Roth IRAs without any limits. The new law would eliminate this option for taxpayers who have adjusted taxable income above $400,000 or $450,000 for filing jointly.

6. New qualified business income deduction limitations

The 20% deduction from the Tax Cuts and Jobs Act in partnerships, S corps or sole proprietorships allowed taxation at rates similar to the 21% corporate rate, for unlimited levels.

The new proposal limits the deduction at $400,000 or $500,000 for filing jointly, potentially increasing tax rates for pass-through business income.

7. New corporate tax rates

C corps are currently limited to a flat 21% rate, but the proposed bill will introduce a three-step rate, with 18% on the first $400,000 of taxable income, 21% from $400,000 to $5 million and 26.5% above $5 million, with an additional 3% on taxable income exceeding $10 million.

8. Reductions in estate and gift tax exemptions

The estate and gift tax exemption would be reduced to $5 million, adjusted to $6 million after inflation. This section would accelerate the exemption increase to $10 million in the Tax Cuts and Jobs Act, which would have expired after December 31, 2025.

9. GILTI effective rate increases by 16.5%

Deductions for foreign-derived intangible income were reduced to 21.875%, which was expected to sunset at the end of 2025. This portion of the bill would accelerate that expiration to the end of 2021, creating a strong increase in GILTI rates.

10. Limited foreign-source dividend deduction

Current law allows a dividend received deduction (DRD) for a U.S. corporate shareholder who receives a specified 10%-owned foreign corporation. The proposal makes the dividend rate deduction only available when dividends are paid by controlled foreign corporations.

11. Worthless partnership interest is now a capital loss

Under current laws, in a situation where a partnership interest becomes worthless, the loss' character depends on whether it's from the sale or exchange of capital assets and whether the partner carries a share of partnership liability. The new bill makes this a simple capital loss instead.

12. Additional IRS funding

The proposal also adds funding for the IRS to expand audits, modernize IT for enforcement and strengthen tax enforcement efforts, but only if it doesn't increase taxes for those with taxable incomes under $400,000.

The proposed changes that can come into play with the Build Back Better Act can have long-reaching changes to the tax landscape, forcing many taxpayers to reevaluate their tax strategies. That being said, there can also be many additional changes made in Congress as the bill rolls forward, which can also impact how the bill is put into play.

If you have any questions, or need help figuring out how to best implement these changes, please contact Frankel Zacharia, LLC at 402.469.9100.