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House Democrats Release Details on Proposed Tax Increases

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Democrats on the House Ways and Means Committee have released a package of tax provisions (Ways and Means Proposal) that, if enacted, would provide funding for the infrastructure legislation that has been making headlines all summer (Infrastructure Legislation).

The changes to the current tax laws in the Ways and Means Proposal, which was released on Monday, September 13, 2021, are expected to raise over $2 trillion toward the $3.5 trillion required by the Democrats' version of the Infrastructure Legislation. Although the new provisions generally focus on increasing tax rates for high-earning individuals and corporations, tax professionals are already noting that the Ways and Means Proposal is significantly less harsh than any of the tax proposals that were released earlier in the year, including President Biden's American Jobs Plan and the related "Greenbook."

One way that the Ways and Means Proposal shows moderation is by making smaller changes to key provisions compared with previous proposals. For example, the increases to corporate, individual and capital gains rates are not as severe as in those previous proposals. The Ways and Means Proposal also abandons some of the more controversial features of earlier proposals, such as the elimination of the step-up in the basis of a taxpayer's assets at death and limitations on like-kind exchanges.

Some new provisions that may be of interest to our clients are summarized below:

Changes to Tax Rates

- The Ways and Means Proposal would increase the top marginal corporate income tax rate to 26.5%.
- The top marginal income tax rate for individuals, trusts and estates would be increased to 39.6%.
- The long-term capital gains rate would be increased to 25% for transactions taking place on or after Monday, September 13, 2021. Under a transition rule, transactions that take place after that date under an already binding contract would remain subject to the current rate of 20%. The 25% rate would also apply to qualified dividends.
- A new "surcharge" of 3% would be applied to certain income of a non-corporate taxpayer in excess of $5 million (or $2.5 million for separate filers).

International Tax Changes

- The Ways and Means Proposal would effectively increase the tax rate on GILTI (global intangible low-taxed income) to 16.5625% and would require GILTI to be calculated on a country-by-country basis. In addition, the existing GILTI rules would be modified to allow for the carryover of net tested losses. And the percentage of a foreign tax credit that could be applied against GILTI would be increased from 80% to 95% (or 100% for U.S. territories). The amount of QBAI (qualified business asset investment) allowed (which effectively shelters a portion of a corporation's GILTI from tax) would be reduced to 5% from 10% (except for U.S. territories).
- Several changes are proposed with respect to the BEAT (base erosion and anti-abuse tax), including an increase of the BEAT rate to 12.5% starting in 2024, and then to 15% starting in 2026 and afterward. The controversial exception from the BEAT for cost of goods sold would be eliminated. The Ways and Means Proposal would make a number of additional changes to the BEAT, including changes to the calculation of "modified taxable income" and an exception for payments to foreign persons that are subject to a foreign rate of tax at least as much as the relevant BEAT rate.

- Under the Ways and Means Proposal, foreign tax credit limitations would be calculated on a country-by-country basis, and the foreign branch income basket would be eliminated. The period for which foreign tax credits could be carried forward would be reduced to 5 years (compared with 10 years under current law) and carrybacks would be repealed (compared with 1 year under current law).
- The deduction for FDII (foreign derived intangible income) would effectively be reduced to 20.7%, but would not be eliminated as provided by earlier proposals.
- Payments of "portfolio interest" by a U.S. corporate borrower to a foreign lender would be disqualified from an exception from withholding tax if the lender owns 10% or more of the borrower's stock, determined by vote or value (and not just by vote, as under current law).

Changes Affecting Individuals

- The estate and gift tax lifetime credit would be reduced to the amount that was in effect before the enactment of the *Tax Cuts and Jobs Act of 2017* – that is, $5 million indexed for inflation since 2010.
- Assets in a grantor trust would be added back to the estate and be subject to estate tax on the grantor's death, and sales between a grantor trust and its owner would be subject to tax.
- The Ways and Means Proposal contains several provisions that would apply to IRAs and certain other defined contribution plans. Contributions to IRAs by certain high-earning taxpayers would be prohibited if the balance in those accounts at the end of the previous taxable year exceeded $10 million, and such taxpayers would be required to make minimum distributions equal to 50% of the amount in excess of $10 million and 100% of the amount in excess of $20 million. In addition, IRAs would be prohibited from holding investments that are available only to accredited investors or investors who must meet certain other requirements. The Ways and Means Proposal would also tighten rules that restrict a taxpayer's ability to invest IRA funds in a corporation that the taxpayer owns or in which the taxpayer is an officer.

Other Significant Changes

- The capital gains holding period for carried interests would be extended to five years, from three. The holding period would remain three years for a taxpayer with adjusted gross income of less than $400,000 and with respect to income attributable to a real property trade or business.
- The Ways and Means Proposal would make the limitation on excess business losses for non-corporate taxpayers permanent and would allow a carryforward for losses disallowed under this provision.
- The 199A deduction would be limited to $500,000 for joint filers, $400,000 for an individual filer, $250,000 for a separate filer, and $10,000 for a trust or estate.
- S corporations that were in existence on May 13, 1996, will be permitted to reorganize as partnerships without triggering tax as long as the reorganization is completed by December 31, 2023.
- The constructive sale and wash sale rules would be extended to apply to digital assets such as cryptocurrencies.
- Approximately $80 billion would be appropriated to the IRS over the next 10 years for various purposes, including to increase enforcement efforts against taxpayers with over $400,000 of income.

Conclusion

The Ways and Means Proposal offers a broad variety of tax changes that are generally intended to increase taxes. Although the Ways and Means Proposal represents a significant step back from tax proposals released earlier this year, several prominent Republicans have already come out against it. In any case, this year's tax proposals are only at the beginning of the process to become law. Although the

Infrastructure Legislation is popular, the provisions to fund it are sure to be unpopular. The Democrats are likely to have to use the reconciliation process to raise funds for the Infrastructure Legislation.

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