Larry's Tax Law

The Build Back Better Act Was Passed in the House and Is Now in the Senate

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On November 19, 2021, HR 5376, the 2,476-page bill, commonly known as the Build Back Better Act, was passed by the U.S. House of Representatives by a vote of 220-213.

The House's vote on HR 5376 was held after the Congressional Budget Office released its cost estimates for the proposed legislation. It estimates HR 5376 will cost almost $1.7 trillion and add $367 billion to the federal deficit over 10 years.

HR 5376 started out with robust changes to our tax laws, including large increases in the corporate, individual, trust and estate income tax rates, significant increases in the capital gains tax rates, taxation of unrealized gains of the ultra-wealthy, a huge reduction in the unified credit, a tax surcharge on high income individuals, trusts and estates, expansion of the application of the net investment income tax, elimination of gift and death transfer discounts, and additional limitations on the application of the qualified business income deduction.

To the cheer of most U.S. taxpayers, HR 5376, as passed by the House, is a dwarf, in terms of the tax provisions, compared to its original form. As tax legislation, at least in its current state, it is much ado about nothing.

However, U.S. taxpayers should not get too joyful about the legislation in its current form. It will likely be substantially altered by the Senate, regaining many of its original provisions (with or without modification). In fact, Skopos Labs reports that the bill, as passed by the House, has a 10 percent chance of being in enacted into law.

HR 5376, at its heart, provides funding, establishes new programs and otherwise modifies current provisions of the law aimed at enhancing a broad array of programs, including education, childcare, healthcare and the environmental protections.

While it may not be worth spending too much time focusing on HR 5376, as its tax provisions will be drastically altered by the Senate, it is worth briefly noting what is in the bill and what may be missing.

Missing Provisions

The following provisions were originally in HR 5376, but they are nowhere to be found in the

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legislation passed by the House:

1. HR 5376 does not contain the anticipated revisions to Subchapter K. Those provisions will likely be addressed in the Senate with Senator Ron Wyden (D-Or), Chairman of the Senate Committee on Finance taking the laboring oar. We need to keep a keen eye out for these provisions as they, if enacted, will drastically change partnership taxation.
2. Section 138201 of the original HR 5376 increased the highest marginal income tax rate of individuals, trusts and estates to 39.6 percent. It was eliminated from the bill passed by the House.
3. Section 138202 of the original HR 5376 increased the highest marginal capital gains tax rate of individuals to 25 percent. This provision was eliminated from the bill passed by the House.
4. Section 138101 of the original HR 5376 reinstated the graduated corporate income tax rates and elevated the top rate to 26.5 percent (with a 3 percent surcharge for corporations with income above $10 million) and prescribed a flat tax rate for personal service corporations of 26.5 percent. This provision was eliminated in the bill passed by the House.
5. Section 138210 of the original HR 5376 eliminated (with narrow exception) discounting the value of assets transferred by gift or upon death. This provision in nowhere to be found in the bill passed by the House.
6. Currently the unified credit is $11.7 million ($10 million adjusted for inflation). Section 138207 of the original HR 5376 proposed to reduce the credit to pre-TCJA levels. Nowhere in the bill passed by the House is mention of any changes to the unified credit. Additionally, the original HR 5376 proposed havoc on the taxation of grantor trusts commonly used for estate planning purposes. None of those provisions are found in the bill passed by the House.

Tax Provisions Worthy of Note

There are several tax provisions in HR 5376 that are worthy of note, but we need to keep in mind that they may not survive or may be substantially altered in the legislative process:

1. HR 5376 retains limitations on Individual Retirement Account (IRA) and Roth IRA contributions by high-income taxpayers with large retirement account balances by prohibiting such additions and imposing an excise tax on any contributions made in excess of the applicable limits contained in Section 138301 of the bill. It also retains the increases in minimum required distributions for high-income taxpayers with large account balances contained in Section 138302 of the bill.
2. Unlike the original bill, HR 5376 restores the SALT deduction to a limited degree. It increases the deduction through 2030 from $10,000 to $80,000 ($40,000 for married filing separately and trusts and estates). Be aware, however, there is a strong movement in the Senate led by Senator Bernie Sanders (I-Vt) to limit the application of any SALT relief to taxpayers with income below specified amounts.
3. HR 5376 adds a provision that imposes a tax on the profits of large corporations. Any corporation (other than an S corporation, regulated investment company, or real estate investment trust) that for any three-year period has average annual adjusted financial statement income (to be defined in new Sec. 56A) over

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$1 billion and, in the case of corporations with foreign parents, has annual adjusted financial statement income in excess of $100 million, will be subject to a tax of 15percent of its adjusted financial statement income for the year over the amount of its corporate AMT foreign tax credit.

4. HR 5376 adds a provision that imposes a 1 percent tax based on the fair market value of any publicly traded stock of a domestic corporation that the corporation repurchases.
5. HR 5376 retains its original provisions limiting the application of Code Section 1202 to a 50 percent exclusion for taxpayers with adjusted gross income over $400,000.
6. HR 5376 amends Code Section 1411, expanding its application to income derived in the ordinary course of a trade or business for taxpayers with taxable income over $400,000 (single filers), $500,000 (married taxpayers filing jointly or surviving spouses) or $250,000 (married taxpayers filing separately).
7. HR 5376 makes permanent the Code Section 461 limitation on excess losses of noncorporate taxpayers enacted as part of the Tax Cuts and Jobs Act.
8. HR 5376 creates new Code Section 1A, imposing a surcharge (in addition to any other income tax imposed) on high-income individuals, estates and trusts. The surcharge tax is the sum of 5 percent of the amount of the taxpayer's somewhat modified adjusted gross income exceeds $10 million ($5 million for married taxpayers filing separately; $200,000 for an estate or trust), plus 3 percent of the amount of the taxpayer's adjusted gross income exceeds $25 million ($12.5 million for married taxpayers filing separately; $500,000 for an estate or trust). In the original HR 5376, the surcharge was 3 percent (rather than 5 percent) and its applied at lower income thresholds (adjusted gross income" exceeding $5,000,000 for married individuals filing jointly, heads of household and individual filers; $2,500,000 for married individuals filing separately; and $100,000 for trusts and estates).

A Provision That Has Not Received Much Press But Is Worthy of Note

Likely due to the lobbying efforts of a single or small group of S corporation shareholders, Section 138509 of HR 5376 creates a huge planning opportunity for some S corporations. It gives certain S corporations a two-year window to reorganize as partnerships without any negative tax impact.

Section 332 of the Internal Revenue Code provides that no gain or loss shall be recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation, provided that (1) the corporation receiving the property is in control, as defined in section 1504(a)(2), of the distributing corporation's stock; (2) there is a complete cancellation or redemption of all of the stock of the distributing corporation; and (3) the transfer of all the property occurs within the taxable year or the distribution is one of a series of distributions in accordance with a plan of liquidation under which the transfer of all the property is completed within three years from the close of the taxable year during which the first of the series of distributions under the plan is made.

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Under Section 138509 of HR 5376, the liquidation (provided certain requirements are satisfied) of an S corporation will be treated as a complete liquidation under Section 332(b) of the Code, and the resulting partnership will be treated as a corporation that is an 80-percent distributee (within the meaning of section 337(c) of the Code).

The corporation (including any predecessor corporation) must have been an S corporation on May 13, 1996, and thereafter through the date on which the qualified liquidation is completed.

The liquidation must occur in one or more transactions during the two-year period beginning on December 31, 2021 and must constitute the complete liquidation of the S corporation, and substantially all of the assets and liabilities of the S corporation must, as a result of the transactions, be transferred to a domestic partnership.

The S corporation must make an election in the manner as the Secretary may require not later than the due date for filing its tax return for the taxable year in which such liquidation is completed.

This provision appears to have been axed from HR 5376 by the House in its final deliberations. If it is resurrected in the Senate and somehow makes it into law, S corporations with highly appreciated assets (e.g., real estate), provided they meet the specified requirements, will have the opportunity to convert to partnership status without a tax cost. Keep an eye out for this provision as the legislative process continues.

Conclusion

I will continue to monitor the tax provisions of the pending legislation. While we had hoped to see the new law enacted well before the end of the year, like a lot of tax professionals, I am beginning to get impatient. We need to know where the tax laws are headed to assist taxpayers in planning efforts. Hopefully, lawmakers will reach consensus on the legislation soon.

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Tagged as Build Back Better Act, HR 5376, S Corporations, taxpayer provisions, U.S. House of Representatives, U.S. Senate

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