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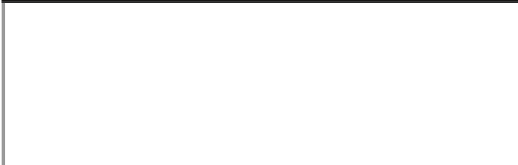

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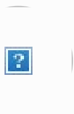
Income Tax Law Changes - What Advisors Need To Know



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I write about tax, estate and legal strategies and opportunities.

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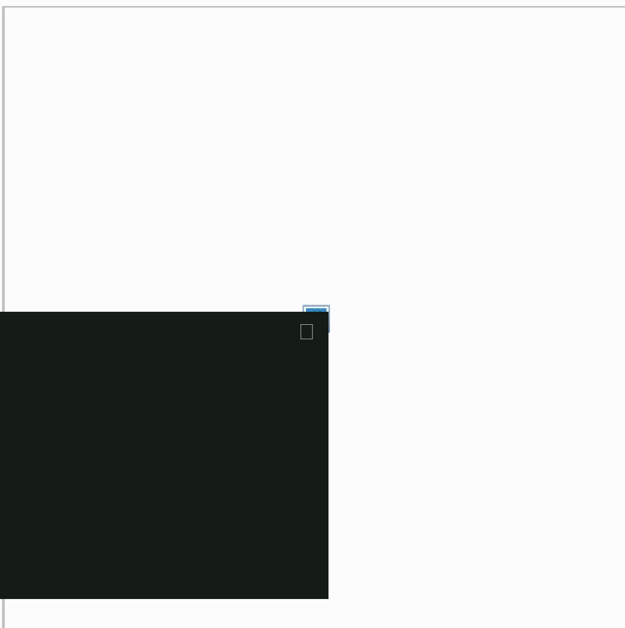

Woman sketching a business plan on a placard at a creative office GETTY

Earlier this week the House Ways and Means Committee released 881 pages of a proposed bill that would make many changes to income, estate and gift taxes. I covered changes to the Estate and Gift

Tax system in an earlier post titled Estate Tax Law Changes - What To Do Now with the assistance of my colleague, Brandon Ketron, and now we are back again to cover proposed income tax changes.

As we wait to see what changes will be made in the bill before it can satisfy a majority of US Senators and Vice President Harris, or if any substantial bill will be passed this year, the following is a brief summary of some of the most significant income tax changes, effective dates, as well as thoughts on what to do and what not to do. As the Senate gets involved, all of the following proposals are subject to change, although we should not expect to see anything more taxpayer unfriendly than as the bill currently stands.

Brandon Ketron and I recently presented a free Webinar on these new rules. You can view this 60-minute presentation by clicking HERE for the YouTube replay.

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Income Tax Rate Increases and Rate Bracket Adjustments

One of the most discussed propositions is the increase in income tax rates, bringing individual tax rates to 39.6% for ordinary income. This new rate applies to married individuals who file jointly with taxable income over $450,000, to heads of household with taxable income over $425,000, to unmarried individuals with taxable income over $400,000, to married individuals filing separate returns with taxable income over $225,000, and to trusts and estates with taxable income over $12,500, as adjusted for inflation in future tax years.

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In addition to the tax rate increases, the rate brackets will also be adjusted and those on the upper end of the 32% and 35% rate brackets may see a tax rate increase as a result.

These increases will only apply to taxable years beginning after December 31, 2021 so earn as much as you can while you can at our present historically low rates, keeping in mind that you may also pay much more in income taxes because of the limitations on the 20% Section 199A Qualified Business deduction, a 3% surcharge on ultra high earners, and the 3.8% Net Investment Income Tax that will now

apply to active business income for high earners, as described below. Put together, these changes will have a profound impact on high earners and the motivation to keep on earning. An ultra high earner subject to the surcharge could end up with a tax rate of 46.4%. Add that to a 13% state income tax for a California resident and the tax rate is close to 60%.

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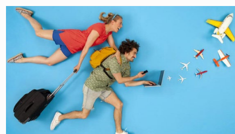

25% Capital Gain Rate

The maximum capital gains are taxed would also increase, from 20% to 25%. This new rate will be effective for sales that occur on or after Sept. 13, 2021, and will also apply to Qualified Dividends. The present rate of 20% will continue to apply to any gains and losses incurred prior to September 13, 2021, as well as any gains that originate from transactions entered into under binding written contracts prior to September 13, 2021. Therefore, gains from sales before September 13, 2021 that are reported under the installment method, even if received after September 13, 2021, will still be taxed at the 20% rate when received in the later part of 2021 and in future years as long as the sale took place before September 13, 2021 or the sale takes place on or after September 13, 2021 and was pursuant to a binding written contract that was entered into prior to September 13, 2021.

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Expansion of the 3.8% Net Investment Income Tax

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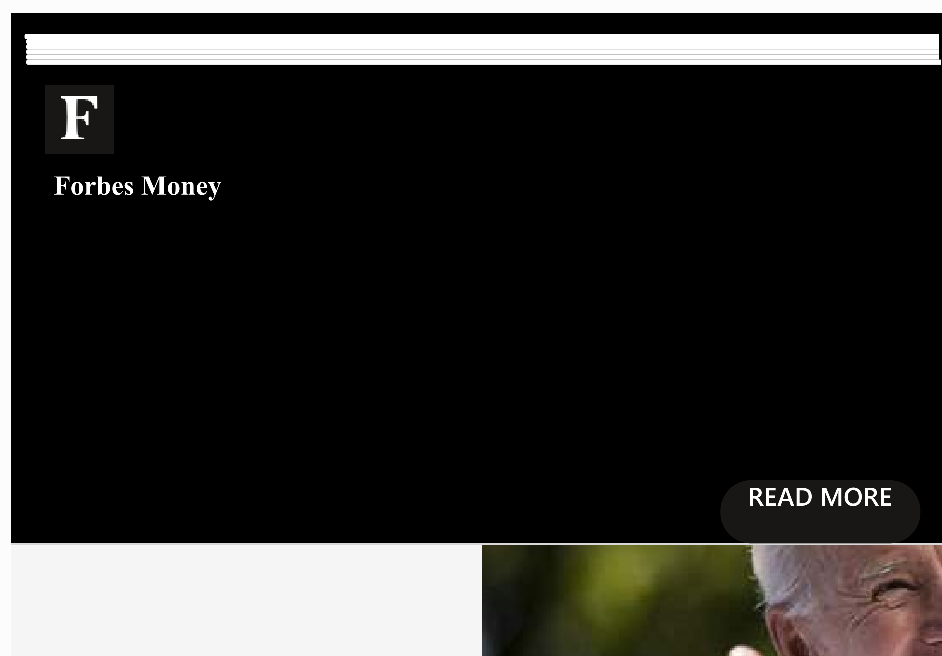
As noted above, the 3.8% Net Investment Income Tax under Internal Revenue Code Section 1411 would be changed to expand the definition of net investment income to include any income derive in the ordinary course of business for single filers with greater than $400,000 in taxable income ($500,000 for joint filers) effective January 1, 2022. Under current law, the 3.8% tax generally only applies to passive investment income (interest, dividends, gain on the sale of stock, etc.)



It is noteworthy that the Net Investment Income Tax applies to trusts and estates beginning at $ 13,050 of income in 2021 and that threshold will be slightly higher each year. Therefore most trusts and estates that have ownership of profitable businesses or ownership interests in profitable entities taxed as partnerships will be subject to the 3.8% tax unless the income received is paid out to beneficiaries, in which event the beneficiaries will be subject to tax as if they received it. S corporation income received by a trust that has made what is called an ESBT ("Electing Small Business Trust") election are taxed at the highest bracket on K-1 income from the S corporation regardless of whether it is distributed and will also be subject to the 3.8% Net Investment Income Tax. Many trusts may sell S

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corporation ownership interests to beneficiaries who are in lower brackets.

A New 3% Surcharge on High Income Individuals, Trusts and Estates

Effective January 1, 2022 a 3% tax will apply on individual taxpayers to the extent that they have Adjusted Gross Income ("AGI") in excess of $5,000,000 ($2,500,000 if married filing separately), and on trust and estate income in excess of $100,000 per trust or estate.

Since this tax applies to AGI in excess of the applicable threshold, AGI includes ordinary and capital gains, and is not reduced by charitable deductions (or any other itemized deduction). The time when this would likely apply to most taxpayers is when a business, or other large asset, is sold for a large gain. Savvy planners may consider selling to a related party under the installment method to spread out the gain over multiple tax years, although this would have to be done more than two years prior to the liquidation event to avoid acceleration of the gain when sold to a third party. Planners might also consider transferring interests that may be sold to a charitable remainder trust which can be used to spread income out over a number of years in order to avoid AGI in excess of the threshold.

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This is a much bigger issue for trusts because the tax would apply to trust income in excess of $100,000, which will make distributions of Distributable Net Income (DNI) to reduce a trust's remaining taxable income even more important. In overly simplified terms, when a trust makes a distribution of income to a beneficiary, the beneficiary will pay the tax on such income, and the trust will receive a deduction to reduce its taxable income. Fortunately, the 3% tax will only apply to the extent that income in excess of $100,000 remains in the trust after taking into account distributions made to the beneficiaries. Drafters of trust documents should take a close look at the applicable Principal and Income Act of the situs of the trust to confirm whether capital gains are treated as principal (and thus not distributable) or income. Most states permit trust documents to specify that a fiduciary will have the power to treat capital gains as income that can be distributed to beneficiaries and escape the additional 3% tax,

distributed to its beneficiaries.

Small Businesses Will Pay More Taxes In 2022

The bill would also change the 21% flat corporate income tax on 'C Corporations" to an 18% tax on the company's net income of up to $400,000, a 21% tax on net income up to $5,000,000, and a 26% tax on net income in excess of $5,000,000. This is still much lower than what the corporate tax rates were before the 2017 tax cuts, and many S corporations will be converted to C corporations if this Act passes, especially given the 3.8% Medicare tax that would be imposed on S corporation flow through income for high earners.

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High income individuals who claim the 20% 199A deduction for qualified business income deductions will be disappointed to learn about the proposed maximum deduction of $500,000 for joint returns, $400,000 for individual returns, $250,000 for a married individual filing a separate return, and $10,000 for a trust or estate. This is in addition to the permanent removal of excess business losses for non-corporate taxpayers.

All of the aforementioned business tax changes will be effective after December 31, 2021.

The IRS vs. Over $10,000,000 IRA/Pension Holders

In an effort to combat the hoarding of assets in massive IRA accounts, those who hold Roth and traditional IRA and retirement plan accounts with a combined balance that exceeds $10 million as of the end of a taxable year may not make further contributions if the account holder has taxable income over $400,000, or married taxpayers filing jointly with taxable income over $450,000.

These large account holders will be required to make a minimum distribution equal to "50% of the amount by which the individual's prior year aggregate tradition IRA, Roth IRA, and defined contribution account balance exceeds the $10 million limit". Even more extreme treatment will apply to those who have over $20,000,000 in combined accounts.

Furthermore, a loophole that allowed indirect funding of Roth IRAs

by the “backdoor Roth” technique could be eliminated for high earners.

What About Charity?

Charitable gifting does not seem to be impacted, except for what we call Grantor Charitable Lead Annuity Trusts, and with higher income tax brackets charities may receive more in donations, which would be good for charitable causes and those who work for charities. It may be time to set up the family foundation you have been considering and get it funded if you will be a high earner next year.

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The use of Charitable Remainder Trusts will be more popular to spread large gains over multiple tax years in order to avoid crossing applicable income thresholds. That being said, some of the new provisions are applied based on Adjusted Gross Income (“AGI”) thresholds, and since AGI is determined prior to deductions for charitable contributions (or any other itemized deduction) large charitable donations will not prevent taxpayers from being subject to some of the new taxes on high earners.

Miscellaneous Changes

Other changes proposed changes in the bill that are noteworthy include the following:

1. The 100% gain exclusion on the sale of Section 1202 Qualified Small Business Stock will be limited to 50% of the gain for taxpayers with AGI exceeding $400,000 unless a binding contract was entered into prior to September 13th, 2021.
2. Crypto currencies (Bitcoin, Ethereum, DOGEcoin, etc.) will be subject to the constructive and wash sale rules as of January 1, 2022, so if your crypto currency went “to the moon” and you want to lock in an offsetting position without triggering gain do so before the end of the year. If you were less fortunate and get caught “holding the bag” forget having #diamondhands! You now have until the end of the year to sell your coins to harvest the loss and immediately buy back in. You would be in the same position economically, but with the added benefit of being able to recognize the loss and offset other passive

income. This type of planning is prevented for most, if not all, other marketable securities, but somehow crypto currencies have managed to stay under the radar, until now.

3. IRAs can no long invest in entities in which the IRA owner has a 10% or greater ownership interest (this is presently 50%), or if the IRA owner is an officer. This will also be considered an IRA requirement rather than a prohibited transaction, which means that if the IRA invests even a small part of its holdings in such a business the entire IRA will be disqualified resulting in loss of creditor protection status and having taxes apply as if the IRA was liquidated. There is a proposed two year transition period of IRA's currently invested in these types of investments.
4. The IRS will receive approximately $80,000,000,000 to enforce the tax law and presumably audit many more taxpayers and bring in much more in tax revenues.
5. The employer tax credit for wages paid to employees during family and medical leave will expire in 2023 (2025 under present law).
6. S-Corporations, that elected S-Corp status prior to May 13, 1996, will be permitted to convert tax free to a partnership any time in the two years following passage of the act. Under present law this would result in deemed taxable sale of all of the assets of the S-Corporation at the time of conversion, so this will be a very good opportunity for many taxpayers. An S corporation can generally convert tax-free into a C corporation, but C corporations are not as flexible with respect to the distribution and allocation of income as an entity taxed as a partnership. This will be attractive for S corporation owners who wish to have greater flexibility and do not expect that the ability to have significant income excluded from the Net Investment Income Tax will come back any time soon.
7. There are many changes to international taxation that are better left to the international tax experts to explain.
8. Those who deal with tax-related stress by smoking tobacco products will be sad to hear of the proposed doubling of the excise taxes on cigarettes, small cigars, and roll-your-own tobacco, in addition to several other new imposed nicotine

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taxes not covered by this article.

Planning to Plan

Once we have all of the aforementioned in mind, we can begin to plan, while also recognizing that what actually occurs is likely to change.

Here are some examples of planning moves that may be considered at this time:

1. If you have an estate plan in progress get it done as soon as possible.
2. Charitable individuals who are over age 59-1/2 with large IRA's may wish to consider withdrawing monies from their IRAs and giving those monies to charity, as IRA distribution rules are changed for the worse, and to receive a dollar-for-dollar charitable deduction that is permitted this year, and may not be allowed in the future. Until 2020, only taxpayers over age 70-1/2 can transfer IRA monies to charity on a tax-free basis, and were limited to $100,000 per year.
3. Accelerating income into 2021 - Quite likely, 2021 tax rates will be much lower than 2022, and this will hopefully apply to the entire tax year.

That being the case, cash method taxpayers may accelerate income by transferring accounts receivable in late December, so that they become taxable, and may wish to defer the payment of expenses until 2022.

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It is important to remember that there are advisors and others who stand to gain economically by making recommendations and implementing changes that may backfire on their clients, so caution is advised. For many individuals and families, the best thing to do is to get all of the information and documentation organized, and to see a reputable tax advisor in order to be farther up in line to get properly positioned once changes are (if they are) ratified.

The following summary may help:

FORBES article - Planning to Plan LG chart

Comparison chart GASSMAN, CROTTY & DENICOLO, P.A.

The coming months will undoubtedly see plenty of concerned people concerned about protecting their income and assets from taxation. This will spur taxpayers across the country to reacquaint themselves with their estate planners and CPA's, and motivate people to schedule their annual financial check-up.

Forbes Crypto & Tax Webcast: Get in-depth coverage and insights on how to navigate the crypto tax landscape on September 21 at 2:30 p.m. (EST). Register here.

Follow me on LinkedIn. Check out my website or some of my other work here.

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By Suchi Rudra

In 2020, inflows into sustainable funds increased to $360 billion, up from just $30 billion in 2016[1]—and this trend is showing no signs of slowing.

"We're starting to see an evolution in how investors think about sustainability," says Sarah Kjellberg, head of U.S. sustainable ETFs at BlackRock. "It's gone from niche to necessary, and we're seeing growing interest from investors around the world. [According to] our 2020 Global Sustainable Investing Survey, 50% of respondents—across 425 clients with $25 trillion in assets—plan to double their sustainable assets under management in the next five years."

Sustainable investing combines traditional investment approaches with environmental, social and governance (ESG) insights. And one of the simplest ways to create a more sustainable portfolio is through exchange-traded funds, or ETFs, which are more accessible than ever.

"Sustainable investing used to cater to larger investors and was often considered to have high fees with high minimums, and be only values-focused and indifferent to performance," says Kjellberg. "But ETFs are helping to upend these perceptions by delivering choice, value and access to all investors—and at a fraction of the cost of traditional mutual funds."

Why invest sustainably? Consider performance—three in four sustainable equity funds beat their Morningstar category average in 2020. [2] And the ability to meet sustainable objectives. Just consider that $1 million invested in iShares ESG Aware MSCI USA ETF implies an annual reduction of carbon emissions equivalent to 43,441 miles driven by an average passenger car.[3]

SOURCES:

1. BlackRock Sustainable Investing, with data from Broadridge and Simfund. January 1, 2016–September 30, 2020.

2. Morningstar, "Sustainable Equity Funds Outperform Traditional Peers in 2020." Based on an analysis of 200 U.S. mutual funds and exchange-traded funds. Morningstar, as of December 31, 2020. Comparison of sustainable equity ETFs and mutual funds versus their respective Morningstar categories using rankings based on total return. Morningstar defines sustainable funds as those that emphasize the use of environmental, social and governance criteria to generate financial return and broader societal impact. Past performance does not guarantee future results.

3. iShares ESG Aware MSCI USA ETF (ESGU) Impact Report. Source for carbon emissions: MSCI ESG Fund Ratings provided by MSCI ESG Research LLC as of July 19, 2021, based on holdings as of May 31, 2021. The carbon emissions reduction for ESGU (98.71% carbon coverage by MSCI ESG Fund Ratings) is calculated relative to the carbon emissions of its parent index, the MSCI USA Index (99.84% carbon coverage by MSCI ESG Research). ESGU's total carbon emissions are 33.61 tons CO_2 per million dollars invested; MSCI USA's total carbon emissions are 51.11 tons CO_2 per million dollars invested. Total emissions reduction is 17.51 tons CO_2 per million dollars invested. Source for equivalents: MSCI ESG Fund Ratings with data from U.S. EPA's Greenhouse Gas Equivalencies Calculator for CO_2 and energy measures. Carbon coverage is the percentage of a portfolio's market value with Carbon Intensity data. Please refer to the MSCI ESG Fund Ratings Methodology for more information. There may be material differences between the fund's index and the parent index including without limitation holdings, index provider, methodology and performance.

4. The business involvement screens are based on revenue or percentage of revenue thresholds for certain categories and categorical exclusions for others. Please read the definition for each screen here.

5. Screens are based on revenue or percentage of revenue thresholds for certain categories (e.g., $500 million or 50%) and categorical exclusions for others (e.g., nuclear weapons). MSCI, the fund's index provider, screens companies with involvement in fossil fuels by excluding any company in the energy sector as per GICS methodology and all companies with an industry tie to fossil fuels such as thermal coal, oil and gas—in particular, reserve ownership, related revenues and power generation. Companies that meet the fossil fuel involvement screen but that derive more than 50% of revenues from alternative energy and do not have an industry tie to thermal coal or oil sands or have fossil fuel reserves used most likely for energy applications, as determined by MSCI, will be added back.

IMPORTANT INFORMATION:

Carefully consider the Funds' investment objectives, risk factors, and charges and expenses before investing. This and other information can be found in the Funds' prospectuses or, if available, the summary prospectuses, which may be obtained by visiting www.iShares.com or www.blackrock.com. Read the prospectus carefully before investing.

Investing involves risk, including possible loss of principal.

A fund's environmental, social and governance ("ESG") investment strategy limits the types and number of investment opportunities available to the fund and, as a result, the fund may underperform other funds that do not have an ESG focus. A fund's ESG investment strategy may result in the fund investing in securities or industry sectors that underperform the market as a whole or underperform other funds screened for ESG standards. In addition, companies selected by the index provider may not exhibit positive or favorable ESG characteristics.

International investing involves risks, including risks related to foreign currency, limited liquidity, less government regulation and the possibility of substantial volatility due to adverse political, economic or other developments. These risks often are heightened for investments in

emerging/developing markets and in concentrations of single countries.

Fixed income risks include interest-rate and credit risk. Typically, when interest rates rise, there is a corresponding decline in bond values. Credit risk refers to the possibility that the bond issuer will not be able to make principal and interest payments. The iShares Global Green Bond fund's green bond investment strategy limits the types and number of investment opportunities available to the Fund and, as a result, the Fund may underperform other funds that do not have a green bond focus. The Fund's green bond investment strategy may result in the Fund investing in securities or industry sectors that underperform the market as a whole or underperform other funds with a green bond focus. In addition, projects funded by green bonds may not result in direct environmental benefits.

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