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Build Back Better Act I, II, III: Current Version and Trusts and Estates

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Trusts and estates lawyers and advisors have been keeping a close watch on recent developments regarding the tax proposals contained in H.R. 5376, commonly known as the “Build Back Better Act” (the “Act”). Three versions of the Act have attempted to make significant changes to current gift, estate, and trust income tax law.

Following is a summary of the proposed changes in the first version initially released by the House Ways and Means Committee on September 13, which have not been included in subsequent versions released by the House Rules Committee:

- Reduction of the lifetime exemption amount to the pre-2017 Tax Cuts and Jobs Act amount, adjusted for inflation (approximately $6.03 million)
- Recognition of capital gains tax on sales to grantor trusts
- Inclusion of grantor trusts in a decedent’s estate if the grantor is the “deemed owner”
- Inclusion as taxable gifts of amounts distributed from grantor trusts to beneficiaries other than the grantor or the grantor’s spouse
- Elimination of valuation discounts on the transfer of certain types of non-business assets

The versions of the Act released by the House Rules Committee on October 28 and November 3 include the following proposals:

- **Net Investment Income Tax**. The Act expands the application of the Net Investment Income Tax to include income from an active trade or business if such income is not subject to self-employment or FICA tax. A non-grantor trust or estate falls into this expansion if it has undistributed income from an active trade or business (and other types of undistributed passive income currently subject to the Net Investment Income Tax) and its taxable income is above the highest fiduciary income tax bracket amount (which, for 2021, is $13,050). The rate of this tax remains at 3.8 percent. This provision would apply to tax years after 2021.

- **QSBS Gain Exclusion**. Non-grantor trusts and estates will be permitted to exclude from capital gains tax only up to 50 percent of eligible gain on the sale of QSBS. This provision would affect sales of such stock after September 13, 2021. Binding contracts for sales which are entered into prior to this date would be excluded from the new proposal. While a 50 percent exclusion is still beneficial, it is worth noting that anyone who invested in QSBS since September 27, 2010 did so anticipating a 100 percent capital gain exclusion.

- **Surcharge on Adjusted Gross Income**. The Act imposes a surcharge on the adjusted gross income of a non-grantor trust or estate in two stages: five percent on such income over $200,000 and an additional three percent on such income over $500,000. This provision would apply for tax years after 2021. When combined with the prior two changes, the effective tax rate for many trusts selling QSBS could be 15.9 percent instead of zero.

- **State and Local Tax Deduction.** According to an amendment to the November 3 version of the Act which was issued on November 4, a deduction up to $40,000 would be allowed for state and local taxes paid by a non-grantor trust or estate. This provision would be effective for tax year 2021 and would continue through tax year 2030.

- **Retirement Plans.** Proposed limits on contributions to IRAs and balances of applicable retirement accounts would significantly impact the amount of wealth passing to future generations from retirement plans. The Act would prohibit contributions to IRAs for individuals who have more than $10 million in applicable retirement plans, which include defined contribution plans under Sec. 401(a) or 403(a), annuity contracts under Sec. 403(b), deferred compensation plans under Sec. 457(b), or individual retirement plans. In addition, account owners (regardless of age) who hold more than $10 million in applicable retirement plans would be required to withdraw 50 percent of the excess amount each year until the account value falls below $10 million. If the aggregate value of applicable retirement plans is above $20 million, account owners would be required to withdraw first from Roth IRAs, up to the entire value of all Roth IRA accounts, if necessary. These rules would not be effective until tax year 2029.

These proposals are currently under consideration by the U.S. House of Representatives. It remains uncertain at this time as to whether any of the items proposed in prior versions of the Act will be added back to the final law. It also remains unclear as to whether there will be adjustments to the income and capital gains tax rates. Individuals and fiduciaries who may be affected by these proposals are encouraged to consult with their advisors to explore what impact, if any, these proposals may have on their specific circumstances.

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