

# Tax Happenings - Present Status of Proposed Legislation (And What You Might Do About It)

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## Overview

Earlier this week the U.S. House Ways and Means Committee released the legislative text (Amendment in the Nature of a Substitute to the Committee Print Offered by Mr. Neal of Massachusetts) that includes proposed tax changes to be included in the budget reconciliation bill – the massive “porkulus” spending bill to accompany the infrastructure bill that is a separate piece of legislation. While there are likely still many permutations remaining, and it’s still possible that the entire spending bills could go down flames, if the current proposals move forward as is what can be done to prepare for their impact?

I will be covering the most recent developments at my October 8 conference in Laramie, Wyoming. You may attend either in person or online. I will provide at that event the then present status of tax proposals and what planning steps should be undertaken in advance of possible changes in the tax laws. You can learn more about that conference and register

here: <https://www.washburnlaw.edu/employers/cle/farmranchplanning.html>

Tax provisions in the committees and associated planning steps – it’s the topic of today’s post.

## Income Tax Rates

As of today, the proposal continues to be to raise the top marginal income tax rate (federal) to 42.6 percent. For married persons filing jointly, that rate would kick-in at a modified adjusted gross income (MAGI) exceeding \$5 million. The new 39.6 percent bracket would apply to married persons filing jointly with MAGI of approximately \$450,000 up to that \$5 million mark. For single persons the 39.6 percent rate would apply at taxable income above \$400,000. This rate would also apply to trusts and estates with taxable income exceeding \$12,500 (\$100,000 for the 42.6 percent rate). Of course, applicable state and local taxes get added on.

This higher rate would apply to tax years beginning after 2021, which means there is some time to do some tax planning associated with trusts. Depending on the type of trust and the language of the trust it might be possible to trigger income in 2021 at a lower rate. A call to your tax and estate planning professionals might be in order, particularly if you recently changed the beneficiary of a retirement plan to a trust. Some did that in light of another recent law change that eliminated “stretch” IRAs. If the higher rate actually becomes law, it would be better in many situations to have the retirement funds distributed directly to a beneficiary rather than via a trust. Sec. 138201.

## Corporate Tax Rates

Presently, the corporate tax rate is a flat 21 percent. The proposal graduates the corporate rate structure as follows: 18 percent on corporate taxable income up to \$400,000; 21 percent on taxable income between \$400,000 and \$5 million; and 26.5 percent on taxable income over \$5 million but under not exceeding \$10 million. An additional tax is added to the 26.5 percent rate for corporations with taxable income in excess of \$10 million. Sec. 138101



## **Qualified Small Business Stock**

I.R.C. §1202 stock gain exclusion provisions of 75 percent and 100 percent would be inapplicable to taxpayers with adjusted gross income (AGI) at or above \$400,000. The 50 percent exclusion would remain. Sec. 138150.

## **Capital Gain Rates**

The initial proposal to raise capital gain rates to the (newer) top marginal income tax rate of 39.6 percent appears to be dead. It looks more likely that what will move forward is a 25 percent rate. The current legislation says that the higher rate would apply to gains triggered “after date of introduction.” If have no clue what that means, other than it is sometime before 2022. Perhaps it means September 13, 2021, the date the legislative text was released.

Thankfully, it appears that the “deemed realization” rules are no longer included in the proposed legislation. That would have made death a capital gain triggering event rather than waiting for an heir to sell inherited property. Also, for now, the “stepped-up” basis at death rule (or adjustment to fair market value at death) is retained. Sec. 138202.

## **Net Investment Income Tax**

Obamacare added a 3.8 percent tax on passive sources of income under I.R.C. §1411. The current proposal is to tack this additional tax onto all trade or business income on a joint return exceeding \$500,000 (\$400,000 single). It does not apply to any earnings that are subject to FICA tax. The effect of this is to make the tax apply to distributions from S corporations, limited liability companies and partnerships with profits above the threshold. This provision specifies that it applies to tax years beginning after 2021. Sec. 138203.

## **Qualified Business Income Deduction (QBID)**

As I noted in a post last week, the current proposal is to limit the 20 percent QBID to a maximum deduction of \$500,000 for married filing joint filers (\$400,000 for single filers). For trusts and estates, the maximum QBID would be \$10,000. So, businesses operating inside trust that could generate a sizable QBID would no longer be a good idea from a tax standpoint. The legislation says nothing about limiting the amount of the deduction passed through to a patron of an agricultural or horticultural cooperative. So, a farmers QBID would be limited to \$500,000, but any amount passing through from a cooperative would not be. This provision also would be effective for tax years beginning after 2021. Sec. 138204.

## **Excess Business Losses**

The proposal would permanently disallow excess business losses for noncorporate taxpayers. Sec. 138205.

## **IRA Changes**

The proposed legislation contains contribution limits to Individual Retirement Accounts (IRAs). The limitations start to apply on retirement plan balances in excess of \$10 million as of the end of the prior tax year and where the account owner's MAGI exceeds \$450,000 on a joint return. The limitation applies to regular IRAs, Roth IRAs and defined contribution plans. In addition, owners of account balances exceeding the \$10 million threshold will be required to withdraw more from the account on an annual basis than will account owners with balances not exceeding the threshold. That excess amount as a minimum distribution for the following year would be 50 percent of the amount by which the individual's prior-year aggregate traditional IRA, Roth IRA and defined contribution account balance exceeds the \$10 million limit. A different



minimum distribution calculation is specified for combined account balances of an owner exceeding \$20 million. Secs. 138301 and 138302.

IRAs would also be barred from holding investments in nonregistered securities. For IRA accounts that hold nonregistered securities after 2021, such investments would be deemed to be distributed over a two-year transition period.

Another provision changes the existing threshold prohibiting investment by an IRA in an entity in which the IRA owner owns at least a 50 percent ownership interest to a 10 percent ownership interest for investments that are not traded on an established securities market.

Roth conversions would be eliminated for married taxpayers filing jointly with taxable income exceeding \$450,000 (\$400,000 single). Sec. 138311.

### **Exemption Equivalent of the Unified Credit**

I have written in prior articles about the proposal to “decouple” the estate and gift tax systems. They are presently “coupled” but if the proposed changes make it into law, the systems will be decoupled. There will be a credit to offset estate tax, and a separate credit to offset gift tax. Under current law, the coupled estate and gift tax credit rises with inflation through 2025. Beginning in 2026 it is scheduled to drop so that its exemption equivalent is \$5 million in 2011 dollars. The present proposal fast-forwards the 2026 law to 2022. In other words, the exemption equivalent of the unified credit would be \$5 million adjusted for inflation since 2011 – approximately \$6.2 million. Thus, for higher-wealth persons, it might be wise to start using some of the higher exemption by the end of 2021. Strategies might include the formation of a “self-settled” trust (in some states); a special power of appointment trust; or a spousal lifetime access trust. Sec. 138207.

### **Special Use Valuation**

Under current law, as I have noted in other posts, farm and ranch land (and other non-farm business property) can be valued at death for federal estate tax purposes at its use value rather than fair market value. I.R.C. §2032A. For deaths in 2021, the maximum value reduction possible is \$1,190,000. Under the current proposal the maximum reduction in value would be \$12 million. Sec. 138208.

### **Trust Planning**

I have written previously on proposals that would essentially end dynasty trusts and intentionally defective grantor trusts as well as grantor retained annuity trusts, qualified personal residence trusts and even irrevocable life insurance trusts. The provisions attacking these traditional planning methods remain.

### **Valuation**

Eliminating valuation discounting as a planning tool was a target of the Obama-Biden administration. After the valuation regulations largely eliminating such discounts was removed by the Trump Administration, the restrictions on valuation discounting are now back. This time the restrictions would be statutory and would eliminate discounts on non-business assets. Passive assets are non-business assets. That could mean that farm and ranch land under a cash lease is a passive, non-business asset in the landlord’s hands. Likewise, the value of marketable securities would not be eligible for a valuation discount.

### **Other**

The draft legislation ends the employer credit for wages paid to employees during family and medical leave for tax years beginning after 2023. Sec. 138506.

An S corporation could reorganize as a partnership tax-free. The S corporation that qualifies is one that was an S corporation as of May 13, 1996. Sec. 138509.



The Work Opportunity Tax Credit would be increased to 50 percent for the first \$10,000 of wages for all groups except youth employees. This provision would apply for persons hired before 2023. Sec. 138513.

A new payroll tax credit for compensation of “local news journalists” is created. The tax credit applies against employment taxes for each calendar quarter up to \$12,500. The credit is 50 percent for each of the first four calendar quarters (total of \$25,000) and then 30 percent thereafter. An “eligible local newspaper publisher” is one having substantially all gross receipts derived from publishing a local newspaper. “Local newspaper” means any print or digital publication if the content is original and derives from primary sources relating to news and current events. The publisher must not employ more than 750 employees during the calendar quarter during which a credit is allowed. A “local news journalist” is a person providing at least 100 hours of service during the calendar quarter. Sec. 138517.

## Conclusion

I will provide the latest up-to-date discussion of pending tax legislation and possible year-end planning steps at the conference in Laramie, WY on October 8. Again, attendance may either be in person or online.

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