Tax hike looms for top earners

By Editorial Staff *Thu, Sep 16, 2021*

The House Ways & Means Committee's budget reconciliation recommendations include, among other measures, increases in income taxes on individuals earning over $400,000.

On Monday, Sept. 13, House Ways and Means Committee Chair Richard Neal (D-MA) introduced the final portion of the committee’s budget reconciliation recommendations. The latest section—Subtitle I, Responsibly Funding Our Priorities—contains tax increases on high-income individuals, corporate and international companies and funding to increase Internal Revenue Service enforcement, among other provisions. The major changes for individuals are described below. A section by section summary of Subtitle I can be found **here**.

Once the House Ways and Means Committee and the other House committees approve their respective budget recommendations, which House Democratic leaders have requested be completed by Sept. 15, the entire package will be compiled by the House Budget Committee and then sent to the House Rules Committee for the debate process for House floor consideration.

Increase in Top Marginal Individual Income Tax Rate. The provision increases the top marginal individual income tax rate in section 1(j)(2) to 39.6%. This marginal rate applies to married individuals filing jointly with taxable income over $450,000, to heads of households 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 estates and trusts with taxable income over $12,500. The amendments made by this section apply to taxable years beginning after December 31, 2021.

Increase in Capital Gains Rate for Certain High Income Individuals. The provision increases the capital gains rate in section 1(h)(1)(D) to 25%. The amendments made by this section apply to taxable years ending after the date of introduction of this Act. A transition rule provides that the preexisting statutory rate of 20% continues to apply to gains and losses for the portion of the taxable year prior to the date of introduction. Gains recognized later in the same taxable year that arise from transactions entered into before the date of introduction pursuant to a written binding contract are treated as occurring prior to the date of introduction.

Increase in Corporate Tax Rate. This provision replaces the flat corporate income tax with a graduated rate structure. The rate structure provides for a rate of 18 percent on the first $400,000 of income; 21 percent on income up to $5 million, and a rate of 26.5% on income thereafter. The benefit of the graduated rate phases out for corporations making more than $10,000,000.

Funding of the Internal Revenue Service. This provision appropriates $78,935,000,000 for necessary expenses for the IRS for strengthening tax enforcement activities and increasing voluntary compliance, and modernizing information technology to effectively support enforcement activities. $410,000,000 is appropriated for necessary expenses for the Treasury Inspector General for Tax Administration to provide oversight of the IRS.

Prohibition of IRA Investments Conditioned on Account Holder's Status. The bill prohibits an IRA from holding any security if the issuer of the security requires the IRA owner to have certain minimum level of assets or income, or have completed a minimum level of education or obtained a specific license or credential.

Tax Treatment of Rollovers to Roth IRAs and Accounts. Under current law, contributions to Roth IRAs have income limitations. For example, the income range for single taxpayers for making contributions to Roth IRAs for 2021 is $125,000 to $140,000. Those single taxpayers with income above $140,000 generally are not permitted to make Roth IRA contributions.

However, in 2010, the similar income limitations for Roth IRA conversions were repealed, which allowed anyone to contribute to a Roth IRA through a conversion, irrespective of the still-in-force income limitations for Roth IRA contributions. As an example, if a person exceeds the income limitation for contributions to a Roth IRA, he or she can make a nondeductible contribution to a traditional IRA – and then shortly thereafter convert the nondeductible contribution from the traditional IRA to a Roth IRA.

In order to close these so-called "back-door" Roth IRA strategies, the bill eliminates Roth conversions for both IRAs and employer-sponsored plans for single taxpayers (or taxpayers married filing separately) with taxable income over $400,000, married taxpayers filing jointly with taxable income over $450,000, and heads of households with taxable income over $425,000 (all indexed for inflation). This provision applies to distributions, transfers, and contributions made in taxable years beginning after December 31, 2031.

Furthermore, this section prohibits all employee after-tax contributions in qualified plans and prohibits after-tax IRA contributions from being converted to Roth regardless of income level, effective for distributions, transfers, and contributions made after December 31, 2021.

Increase in Minimum Required Distributions for High-Income Taxpayers with Large Retirement Account Balances.

If an individual's combined traditional IRA, Roth IRA and defined contribution retirement account balances generally exceed $10 million at the end of a taxable year, a minimum distribution would be required for the following year. This minimum distribution is only required if the taxpayer's taxable income is above the thresholds described in the section above (e.g., $450,000 for a joint return). The minimum distribution generally is 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.

In addition, to the extent that the combined balance amount in traditional IRAs, Roth IRAs and defined contribution plans exceeds $20 million, that excess is required to be distributed from Roth IRAs and Roth designated accounts in defined contribution plans up to the lesser of (1) the amount needed to bring the total balance in all accounts down to $20 million or (2) the aggregate balance in the Roth IRAs and designated Roth accounts in defined contribution plans. Once the individual distributes the amount of any excess required under this 100 percent distribution rule, then the individual is allowed to determine the accounts from which to distribute to satisfy the 50 percent distribution rule above.

This provision is effective tax years beginning after December 31, 2021.

Contribution Limit for Individual Retirement Plans of High-Income Taxpayers with Large Account Balances.

Under current law, taxpayers may make contributions to IRAs irrespective of how much they already have saved in such accounts. To avoid subsidizing retirement savings once account balances reach very high levels, the legislation creates new rules for taxpayers with very large IRA and defined contribution retirement account balances.

Specifically, the legislation prohibits further contributions to a Roth or traditional IRA for a taxable year if the total value of an individual's IRA and defined contribution retirement accounts generally exceed $10 million as of the end of the prior taxable year. The limit on contributions would only apply to single taxpayers (or taxpayers married filing separately) with taxable income over $400,000, married taxpayers filing jointly with taxable income over $450,000, and heads of households with taxable income over $425,000 (all indexed for inflation).

The legislation also adds a new annual reporting requirement for employer defined contribution plans on aggregate account balances in excess of $2.5 million. The reporting would be to both the Internal Revenue Service and the plan participant whose balance is being reported.

The provisions of this section are effective tax years beginning after December 31, 2021.

Surcharge on High Income Individuals, Trusts, and Estates.

This provision adds section 1A, which imposes a tax equal to 3% of a taxpayer's modified adjusted gross income in excess of $5,000,000 (or in excess of $2,500,000 for a married individual filing separately). For this purpose, modified adjusted gross income means adjusted gross income reduced by any deduction allowed for investment interest (as defined in section 163(d)). The amendments made by this section apply to taxable years beginning after December 31, 2021.