

Proposed Build Back Better Act

October 20, 2021

Highlights

- ✓ Proposed Bill Includes Several Changes Affecting All Taxpayers
- ✓ Proposals Significantly Impact Estates, Trusts, and High-Net Worth Individuals
- ✓ Fate of Bill Uncertain, But Steps Taken Now Can Help Minimize Tax Impact If Proposals Become Law

Inside

Estates and Trusts.....	1
Miscellaneous Provisions Impacting Planning.....	5
Retirement Plans.....	7
Compliance and IRS Enforcement	8

SPECIAL REPORT

Planning Ideas to Consider Now

Congress and the Biden Administration are locked in ongoing negotiations over the budget reconciliation bill, the Build Back Better Act (BBBA), which, if enacted in its present form, would significantly impact planning for estates and high-net worth individuals. The final form and effective dates of these proposals are subject to change as the proposal makes its way through Congress and provisions and effective dates are altered to gain legislative approval or to achieve revenue goals. As a result, planning for clients can be challenging. Flexible planning and preparedness are key. Planners should build in ways to unwind this planning with formula clauses, disclaimers, and trust rescissions.

Any such planning must be revisited upon final enactment. Planners must be able to react quickly as it is possible that there may be insufficient time to implement planning following enactment depending on when the provisions are effective. Planners must be prepared to revisit strategies, undo plans, and re-draft documents.

This Wolters Kluwer Tax Briefing provides an overview of the BBBA provisions impacting planning for high-net worth individuals, trusts, and estates. Several members of the Wolters Kluwer Financial and Estate Planning Advisory Board have offered planning ideas to implement *now* in light of the current pending legislation.


ESTATES AND TRUSTS

Exclusion Amount

Currently, the estate and gift tax basic exclusion amount and generation-skipping transfer (GST) tax exemption amount is \$10 million, as adjusted for inflation (\$11.7 million for 2021) for decedents dying and gifts and GSTs made after 2017 and before 2026 per changes made by the Tax Cuts and Jobs Act (TCJA). The increased amounts are to sunset in 2026 and revert back to \$5 million, as adjusted for inflation. The BBBA would accelerate the sunset of the increased amount to 2022. In 2022, the basic exclusion amount and the GST exemption amount would be approximately \$6 million, as adjusted for inflation (in 2017, the amounts were \$5.49 million as adjusted for inflation and were to have been \$5.6 million in 2018, but for changes made by TCJA (Rev. Proc. 2017-58, prior to being superseded by Rev. Proc. 2018-18)).

The sunset acceleration gives rise to a “use it or lose it” scenario. Planners cannot use part of the exclusion or GST exemption now and preserve the balance. The full \$11.7 million must be used before the exclusion/exemption reverts back to \$5 million as adjusted for inflation. So, what can be done now?




 **COMMENT.** Julie Welch, CPA, PFS, PFP®, AEP® (Distinguished), Meara Welch Browne, P.C., Leawood, KS, advises to gift it now—don't delay. She also suggests giving appreciated stock to a family member in a lower tax rate bracket, such as a child or grandchild. This will be especially beneficial if the appreciated stock will be sold and that person stays in the 0% capital gains tax bracket, leaving more after-tax income in the family. However, she cautions that transfers to a child subject to the kiddie tax will not achieve tax savings if the child's investment income exceeds the \$2,200 threshold amount for 2021. Gifts to a parent can also be beneficial if the parent has a net worth less than the proposed new lifetime exemption.

“Planners should build in ways to unwind this planning with formula clauses, disclaimers, and trust rescissions”.

In addition, she advises to consider not splitting gifts if gifting more than the proposed new lifetime exemption (i.e., \$5 million, as adjusted), but less than the current exemption (\$11.7 million). For example, a married couple gifting \$10 million might be better off having one spouse gift the entire amount, so the other spouse has remaining lifetime exemption, even if the lifetime exemption is lowered. This would allow future tax-free gifts up to the other spouse's remaining lifetime exemption.


And, most importantly, advisors should review estate planning documents ASAP.

 **COMMENT.** Sidney Kess CPA, JD, of Counsel to Kostelanetz & Fink and Senior Consultant, Citrin Cooperman, both of New York, NY, notes that contributing to 529 plans using the five-year rule can be a good estate planning strategy for individuals who can afford it. For example, by December 31, 2021, a grandparent with five grandchildren can contribute up to \$375,000 (\$15,000 annual gift tax exclusion in 2021 x 5 for the five-year rule x 5 grandchildren) to 529 plans. A married couple can double this to remove \$750,000 from their estates.

He further reminds planners not to forget the unlimited gift tax exclusion for the payment of another's

tuition or medical expenses. The payments must be made directly to the educational organization or care provider. The medical or educational exclusion is allowed without regard to the relationship between the taxpayer and the donee for whom the payment is made.

Lastly, he cautions planners to monitor income and estate tax implications on the state level. Many state income taxes are tied to federal rules, he notes. Some states with an estate tax have their own exemptions, but those could be changed, thereby affecting estate planning for those domiciled there.

 **COMMENT.** Martin M. Shenkman, CPA, MBA, PFS, AEP® (Distinguished), JD, Martin M. Shenkman, PC, Fort Lee, NJ, advises that planning for individuals who have not used their full exemption might entail using as much exemption as is appropriate as soon as possible. “Appropriate” requires consideration of the individual's budget and cash flow needs, sources of income and other cash inflows, and the nature of trusts, if any. If an individual has created a self-settled trust in a state that permits such trusts (there are now 19), that individual is considered a discretionary beneficiary of the trust. That might make it feasible to gift more assets to a trust now. Be certain to evaluate the additional risks that a self-settled trust might add to the planning, especially if an individual does not live in a state that permits such trusts.

He further notes that there are other variations of trust planning (e.g., hybrid-DAPT (domestic asset protection trust), special power of appointment trust, among many) that might be considered. Married taxpayers could create a trust of which their spouse is a beneficiary, a so-called spousal lifetime access trust (SLAT). If such a trust is created, the grantor spouse might indirectly benefit from distributions made to the other spouse. But, SLATs are not an assured solution to every issue. Divorce or premature death could shut off access to such a trust creating financial issues for the grantor spouse.


Noting that unprecedented amounts of wealth are being transferred to trusts in anticipation of possible estate tax law changes, he advises planners to be certain to include charitable beneficiaries in these trusts. Otherwise, it may be difficult for successor generations who are beneficiaries of the

trust to continue the legacy of the parent (or other benefactor's) charitable giving.

Any trust planning must take into account the effective date provisions of the new grantor trust provisions of proposed Code Sec. 2901 detailed below. The trusts should be set up as soon as possible to avoid inclusion in the grantor's gross estate should the Code Sec. 2901 effective date be prospective rather than retroactive.

Code Sec. 2032A Special Valuation

Code Sec. 2032A allows an estate to value property used in a family farm or business based on its current use, rather than its highest and best use. In 2021, the aggregate decrease in the property's value may not exceed \$1,190,000 (\$750,000 as adjusted for inflation). The BBBA would increase the allowable decrease to \$11.7 million (the 2021 basic exclusion amount) and index it for inflation for the estates of decedents dying after December 31, 2021.

 **COMMENT.** *This provision continues the Congressional effort to preserve the family farm or business from the impact of the estate tax. The number of farms that would benefit is fairly limited, although many family businesses would likely benefit from the increase.*

Valuation Discounts

Discounting assets transferred for estate and gift tax purposes has long been a crucial part of estate planning. A sought-after limit on discounts would be implemented by the BBBA by effectively eliminating discounts on "nonbusiness assets." Code Sec. 2031(d) defines a nonbusiness asset as "any passive asset which (1) is held for the production or collection of income and (2) is not used in the active conduct of a trade or business."


There would be an exception for certain passive assets if the assets are (1) stock in a trade or account receivable under Code Sec. 1221(a)(1) or (4) or used as a hedge with respect to those assets; (2) real property used in a trade or business in which the transferor materially participates; or (3) held as part of the "reasonably working capital needs" of a trade or business.

The following are considered passive assets:

- Cash or cash equivalents
- Corporate stock or any equity, profits, or capital interest in a partnership
- Evidence of indebtedness, option, forward or futures contract, notional principal contract, or derivative
- Foreign currency

- Interest in a real estate investment trust, a common trust fund, a regulated investment company, a publicly traded partnership, or any other equity interest that can be converted into, or exchanged for money, stocks and other interests, any foreign currency, an interest in a precious metal, or any other asset specified by the IRS
- Interest in a precious metal, unless that metal is used or held in the active conduct of a trade or business
- Annuity
- Real property
- Asset, other than a patent, trademark, or copyright, which produces royalty income
- Commodity
- Collectible
- Personal property or a position in personal property
- Any other asset identified in regulations.


In addition, look-through rules would prevent discounts on nonbusiness assets held by a lower-tier entity.

 **COMMENT.** *Martin Shenkman cautions that the change in the discount rules will eliminate the use of family limited partnerships (FLPs) and limited liability companies (LLCs) for discounting marketable securities and possibly other assets. Any person who may benefit from using planning that maximizes valuation discounts should begin doing so immediately.*


The change to valuation discounts would be effective for transfers made after the date of enactment.

Grantor Trusts


The latest legislative proposals would effectively eradicate the benefits of the long-favored estate planning vehicle—the grantor trust. Two new Code Sections are proposed that would align the income tax and transfer tax treatment of grantor trusts. Proposed new Code Sec. 2901 would cause any portion of a grantor trust of which the grantor is the deemed owner to be included in the gross estate of the grantor upon death. Any distribution made during the grantor's life to beneficiaries other than to the grantor or the grantor's spouse (except for a discharge of an obligation of the grantor) would be treated as a transfer by gift for gift tax purposes.

 **COMMENT.** *Martin Shenkman notes that there is increased interest in using non-grantor trusts in planning as a result of the proposed restrictions on grantor trusts. He advises planners considering such trusts to include Code Sec. 642(c) language when adding charitable beneficiaries to non-grantor trusts to ensure that the donation comes out of gross income.*

Further, if the grantor ceases to be treated as the deemed owner during life, then all assets of the trust would be considered a transfer by gift subject to the gift tax. This proposed section does provide for a proper adjustment for amounts included in the grantor's gross estate or treated as a gift on distribution to account for amounts previously treated as taxable gifts at the time of transfer to the trust to prevent double taxation.


 **COMMENT.** Martin Shenkman opines that although grantor retained annuity trusts (GRATs) and qualified personal residence trusts (QPRTs) are not expressly mentioned in the proposal, both seem to be eliminated by the proposed changes. First, if a GRAT is created to leverage wealth out of the grantor's estate after enactment of the new legislation, the entirety of the GRAT will be included in the grantor's estate if death occurs during the GRAT term. Under current law, only a portion of the GRAT assets will assuredly be included in the estate (determined by dividing the GRAT annuity payment by the mandated federal interest rate under Code Sec. 7520 in the year of death). Also, distributions from a grantor trust during the life of the deemed owner are taxable gifts. Finally, the assets of a grantor trust are deemed to be a gift if the grantor trust income tax status is "turned off" (e.g., by the grantor relinquishing the right to substitute trust assets).

What does that mean now? It means that this may be the last opportunity to complete GRATs if they will benefit a client's planning. If the client has not used all of their exemption, an outright gift to an irrevocable trust before enactment of the new law might be better planning to safeguard the exemption. If the client has used all of their exemption, then GRATs might provide a valuable technique to leverage additional wealth out of their estate without triggering current gift tax costs (since GRATs can be "zeroed out" with no current gift value). Planners might consider a different type of GRAT if their client's death is imminent. Perhaps a ladder of GRATs (e.g., 4, 6, 8, and 12-year GRATs instead of the traditional 2-year GRAT) might be advantageous to lock in the GRAT technique and current historically low-interest rates.


 **COMMENT.** Lee Slavutin, MD, CLU, AEP® (Distinguished), Stern Slavutin-2, Inc., New York, NY, observes that the popular irrevocable life insurance

trust (ILIT) is commonly structured as a grantor trust under Code Sec. 677. While the proposal will undermine their use, pre-funding premiums now before enactment would protect existing ILITs and prevent tainting by contributions after enactment. Without clear language under proposed Code Sec. 2901 that would fully grandfather existing ILITs and contributions made after enactment, it appears there will be unintended adverse tax effects on existing ILITs.

It is possible that loans to the insurance trust will not be treated as contributions under Code Sec. 2901, if it is enacted. If that is the case, then split-dollar loans and premium financing may be methods for funding a grandfathered insurance trust after the date of enactment, without tainting the trust.

 **COMMENT.** Martin Shenkman remarks that new ILITs may have to be structured as non-grantor trusts to avoid the proposed estate inclusion. That, however, will present a raft of problems. First, this will require that the trust expressly prohibit trust income being used to pay for life insurance premiums on the grantor's life as the settlor of the trust. Second, for existing grandfathered trusts, no new gifts should be made to the ILIT or a portion of the trust assets (i.e., insurance proceeds) will also be included in the estate. Thus, future premium needs will have to be addressed with loans to the trust. That will also raise other issues, such as whether the IRS will respect the transactions as loans.

The second new section, Code Sec. 1062, would cause transactions between grantor trusts and grantors to be recognized for income tax purposes resulting in the realization and recognition of gain. This would have a chilling impact on installment note sales to grantor trusts and GRATs, for example, by disregarding deemed ownership for purposes of determining whether a transfer is a sale or exchange. This provision would not apply to a grantor's fully revocable trust. Additionally, the proposals would apply the Code Sec. 267 related-party loss rules to the relationship between a grantor trust and its deemed owner.

 **COMMENT.** Martin Shenkman observes that the common technique of selling an existing life insurance policy to an ILIT to keep the insurance proceeds out of the policy owner's estate under the proposal would generate gain and new assets added to the

ILIT would be included in the grantor’s estate. If, instead, the new ILIT is structured as a non-grantor trust, it may be excluded from the grantor’s estate, but the sale may still trigger gain.

As of now, the effective date of proposed new Code Secs. 2901 and 1062 would apply to trusts created on or after the date of enactment and to any portion of a trust created before the date of enactment that is attributable to a contribution made to the trust on or after that date.

MISCELLANEOUS PROVISIONS IMPACTING PLANNING

Income Tax Rates

Effective for tax years beginning after 2021, the highest ordinary income tax rates applicable for individual taxable income would be increased to 39.6 percent. The current 37-percent rate bracket would be eliminated and replaced with a 39.6-percent bracket, which would begin at a lower threshold amount.

Proposed 2022 39.6% Rate Bracket Threshold Amount	
Filing Status	Proposed 2022 Amount
Single	\$400,000
Married Filing Jointly.....	450,000
Married Filing Separately	225,000
Head of Household.....	425,000
Estates and Trusts.....	12,500

COMMENT. *Sidney Kess notes income deferral or acceleration (and deduction acceleration or deferral) depends on the taxpayer’s income. For those below the level for projected tax increases in 2022, income deferral and deduction acceleration for 2021 year-end planning continues to make sense. Those likely to be subject to higher tax rates in 2022 may want to reverse this strategy (e.g., realizing income in 2021 that will be taxed at a lower rate than if received in 2022).*

COMMENT. *Like Sidney Kess, Julie Welch advocates doing “reverse income tax planning.” She suggests accelerating income into 2021 for high-income taxpayers. Cash-basis taxpayers can send invoices and collect payment before the end of the year. In addition, taxpayers should consider a Roth*

IRA conversion in 2021. Another strategy is to request that employers pre-pay an upcoming bonus in 2021, instead of 2022.

She also suggests that business deductions, such as equipment and furniture purchases, be deferred to 2022. Cash-basis taxpayers should consider the deferral of expense payments until 2022.

Taxpayers should consider doing a back-door Roth IRA contribution and conversion before December 31, 2021 (see discussion below). However, Sidney Kess warns that for seniors on Medicare, modified adjusted gross income in 2021 will determine whether and to what extent there is a surcharge on Part B and Part D.


Julie further notes that required minimum distributions (RMDs) from qualified retirement plans and IRAs, which were suspended for 2020, are effective for 2021. This means individuals who reached their starting date, as well as beneficiaries who need to take RMDs, should do so in 2021. For those who turned age 72 in 2021, the first RMD should be taken before December 31, 2021. This avoids bunching two years of RMDs into 2022 and accelerates income into the lower-tax rate year. Note the new RMD tables, which reduce RMDs because of greater life expectancies factored into the tables, become effective in 2022, but the old tables apply to any RMD taken by April 1, 2022.

COMMENT. *Martin Shenkman notes that this increase in income tax rates, as well as other income tax rate changes discussed below, have critical importance to estate planning. The highest rate applies to estates and trusts with taxable income over \$12,500. That is a tiny fraction of the income level at which the highest rates apply to individuals, e.g., the family members who may be beneficiaries of an irrevocable trust. For estates and trusts in 2021, it may be worth accelerating income while rates are lower. For so-called complex or non-grantor trusts that pay their own income tax (e.g., a credit shelter trust funded on the death of a spouse), distributions may carry out income to the beneficiary and, thus, be taxed at a lower rate. So, the benefits of a possibly lower tax rate should be weighed against the provision of funds outright to a beneficiary (is the beneficiary responsible?) and the inclusion of those funds in the beneficiary’s estate if the distributed funds are not spent.*

Consider the implications of this to an accumulation trust created after the Secure Act. The Secure Act changed the rules applicable to retirement plans effectively eliminating the stretch-IRA. As a result, some taxpayers made funds payable to trusts to protect the beneficiaries of their plan assets. However, if all plan assets are distributed at the end of the 10th year following the plan holder's death, those funds are more likely to hit the new highest rate.

Income Tax Surcharge

The BBBA would apply a three-percent tax on the modified adjusted gross income of individuals, estates, and trusts in excess of certain amounts. For single filers, heads of households, and joint filers, that threshold amount is \$5 million. For married taxpayers filing separate returns, it is \$2.5 million and for estates and trusts, it is \$100,000. Modified adjusted gross income is adjusted gross income reduced by the deduction for investment interest, which is not allowed in calculating adjusted gross income. However, the threshold is reduced by foreign earned income of foreign housing amounts excluded from income. The three-percent surcharge would be effective for tax years beginning after 2021.

 **COMMENT.** *Martin Shenkman notes that the \$100,000 threshold for trusts and estates will subject trust income to a very high 42.6-percent rate (39.6 percent tax rates plus three-percent surcharge). State and local taxes (and other proposed changes) may make that effective tax rate even higher. Consider the impact of this in light of retirement assets paid to trusts. Many plan holders might have changed beneficiaries to trusts because of the Secure Act's elimination of the stretch IRA. The Secure Act requires the payout of the full plan balance at the end of the 10th year following the death of the plan holder. That will, for many plans, result in a tax rate*


of 42.6 percent on those plan balances. If the funds were instead distributed to a beneficiary, the marginal tax bracket might be only 22 percent, or about half. That is a tremendous difference and naming trusts as beneficiaries will require careful consideration. The benefits the protection a trust can provide a beneficiary must be weighed against an individual beneficiary's possibly lower income tax rate.

Capital Gain Rates

Under current law, graduated rates apply to individuals' long-term capital gains and qualified dividends depending upon the amount of taxable income. The "breakpoints" at which the rate increases from zero percent to 15 percent to 20 percent are adjusted annually for inflation and are projected to be as shown in the table below for 2022.

Under the proposal, the top 20-percent rate would be replaced with a 25-percent rate. Additionally, the "breakpoint" for the beginning of the new 25-percent bracket would be lowered to align with the income amounts applicable for the new 39.6-percent ordinary income bracket (discussed above). The low-end "breakpoints" for the 15-percent bracket would not be affected.

The proposal to increase the top rate to 25 percent would take effect for tax years ending after September 13, 2021. However, a transition rule applies to tax years that include September 13, 2021 (for example, calendar-year taxpayers) that makes the 20-percent rate applicable for sales and exchanges before September 13, 2021, and the 25-percent rate applicable to sales and exchanges after that date.


 **COMMENT.** *Sidney Kess notes that planners should consider using an installment sale for sales of property so that gain may be spread out over several years and, perhaps, bring the taxpayer's taxable income down so that the applicable rate on the gain is 15 or 20 percent, rather than 25 percent.*

2022 Projected Long-Term Capital Gains and Qualified Dividends Rates for Taxpayers with Taxable Income in the Specified Ranges Under Current Law

	0%	15%	20%
Married filing jointly	\$0 – \$83,350	\$83,351 – \$517,200	over \$517,200
Married filing separately	\$0 – \$41,675	\$41,676 – \$258,600	over \$258,600
Head of household	\$0 – \$55,800	\$55,801 – \$488,500	over \$488,500
Unmarried	\$0 – \$41,675	\$41,676 – \$459,750	over \$459,750
Estates and trusts	\$0 – \$ 2,800	\$2,801 – \$ 13,700	over \$ 13,700

Net Investment Income Tax


The proposed legislation expands the scope of the net investment income (NII) tax to apply to all business income. Effectively, taxpayers who are S corporation shareholders, limited partners, and LLC members not currently subject to the NII tax on income received from these entities because they materially participate in the trade or business would no longer be exempt from the 3.8-percent tax. The NII tax would not apply to income in which FICA is already imposed. The proposal is effective for tax years beginning after 2021.

 **COMMENT.** *Martin Shenkman notes that this provision will eliminate the planning approach used by many of paying distributions from the pass-through entity in lieu of higher salary and mitigates one of the advantages of the S corporation structure. Taxpayers should reassess the legal structure of their business entities if these changes are enacted. Since S corporations require special provisions in trust instruments (as only certain types of trusts are allowed to hold S corporation stock), those special provisions may no longer be necessary. Buy-sell agreements or valuations for buy out or other purposes may all have to be reassessed for estate planning purposes.*

Code Sec. 199A Qualified Business Income Deduction

For tax years beginning after 2017 and before 2026, taxpayers are allowed a 20-percent deduction on the qualified business income from an S Corporation, partnership, or sole proprietorship, subject to limitations based upon the taxpayer's taxable income. Current law specifically excluded income earned by certain businesses, such as law, medicine, and others. The proposed legislation would also place a cap on the amount of the deduction and substantially limit Code Sec. 199A deductions for wealthy taxpayers, effective for tax years beginning after 2021.

The deduction limitations are \$500,000 for joint filers or surviving spouses, \$250,000 for married filing separately, \$10,000 for estates or trusts, and \$400,000 for all other taxpayers. These amounts are not adjusted for inflation.

 **COMMENT.** *Martin Shenkman notes that the \$10,000 cap for trusts is incredibly harsh and will effectively eliminate the benefit for trust-owned real estate and other trust-owned qualifying business interests. Now, planners will need to consider what happens when evaluating gifts to trusts of rental*

real estate or other business interests that would qualify for the Code Sec. 199A deduction for qualified business income as those interests will now be subject to the severe \$10,000 limitation.

RETIREMENT PLANS

IRA Restrictions for High-Balance Plans


The BBBA would target high-income taxpayers with \$10 million retirement plan balances with changes effective for tax years beginning after December 31, 2021. For purposes of the limit, a "high-income taxpayer" is one who is subject to the new 39.6-percent income tax rate (or the 25-percent rate on long-term capital gains).

Contributions. The BBBA would prohibit contributions by these individuals to a Roth or traditional IRA for a tax year if the total value of the individual's IRA and defined contribution retirement accounts exceed \$10 million as of the end of the prior tax year. Note that 401(k), 403(b), and 457(b) balances would be included. Amounts rolled over into the account (including amounts received upon death, divorce, or separation) would not be subject to this limit.

RMDs. RMDs would be increased to 50 percent for these high-income individuals for aggregate vested balances between \$10 and \$20 million. Note that the total RMD amount may come out of any IRA or employer plan, the way normal IRA RMDs can come out of any IRA. To the extent the aggregate balance exceeds \$20 million, the excess amount must 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, the individual is allowed to determine the accounts from which to distribute to satisfy the 50-percent distribution rule above. This provision would be effective for tax years beginning after December 31, 2021.

 **COMMENT.** *Robert S. Keebler, CPA/PFS, MST, AEP® (Distinguished), Keebler & Associates LLP, Green Bay, WI, notes that income management will be key for taxpayers who want to stay under the income thresholds. He also suggests that small business owners consider adopting defined benefit plans because they are not subject to these new "mega-RMDs."*

He further notes if retirement accounts have to be limited to a \$10,000,000 cap, it makes sense to fill them with Roth IRAs which are substantially more tax efficient and estate tax friendly than traditional IRAs. Conversions make even more sense if cash is available from outside of the IRA or qualified account to pay the tax. Completing Roth conversions in 2021 has several important benefits including gain recognition at 2021's lower tax rates, no income recognized in 2022 or otherwise in the future, tax-free growth until distribution (e.g., 11/1/21 to 12/30/22), and no regular RMDs imposed on Roth IRAs during the owner's life.

Back-Door Roths

“Back-door Roths” are Roth accounts that use conversions to avoid the Roth IRA adjusted gross income contribution limit and the employer plan elective deferral limits through after-tax contributions that are converted to designated Roth accounts. The BBBA would eliminate Roth conversions for both IRAs and employer-sponsored plans for high-income taxpayers. Note this change would apply to distributions, transfers, and contributions made in tax years beginning after December 31, 2021.

In addition, regardless of income level, all employee after-tax contributions in qualified plans would be prohibited and they are prohibited from being converted to Roth accounts. This change would be effective for distributions, transfers, and contributions made after December 31, 2021.

Investments

The BBBA would prohibit 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. This change would generally take effect for tax years beginning after December 31, 2021, but there is a two-year transition period for IRAs already holding these investments.

Investing in Owner's Business. To prevent self-dealing, under current prohibited transaction rules, IRA owners cannot invest IRA assets in a corporation, partnership, trust, or estate in which the owner has a 50-percent or greater interest. However, IRA owners can invest IRA assets in a business in which they own, for example, one-third of the business while also acting as the CEO. The proposal would adjust the 50-percent threshold to 10 percent for investments that are not tradable on an established securities market, regardless of whether the IRA owner is an

officer. The BBBA would also prevent investing in an entity in which the IRA owner is an officer. Further, the proposal would modify the rule to be an IRA requirement (i.e., in order to be an IRA, it must meet this requirement). These changes would generally take effect for tax years beginning after December 31, 2021, but there is a two-year transition period for IRAs already holding these investments.

The BBBA would clarify that, for purposes of applying the prohibited transaction rules with respect to an IRA, the IRA owner (including an individual who inherits an IRA as beneficiary after the IRA owner's death) is always a disqualified person. This clarification would apply to transactions occurring after December 31, 2021.

Reporting and Enforcement

The proposed BBBA would add 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 IRS and the plan participant whose balance is being reported. This would be effective for tax years beginning after December 31, 2021.

In addition, the proposal would extend the statute of limitations for IRA noncompliance related to valuation-related misreporting and prohibited transactions from three years to six years. This provision would apply to taxes to which the current three-year period ends after December 31, 2021.

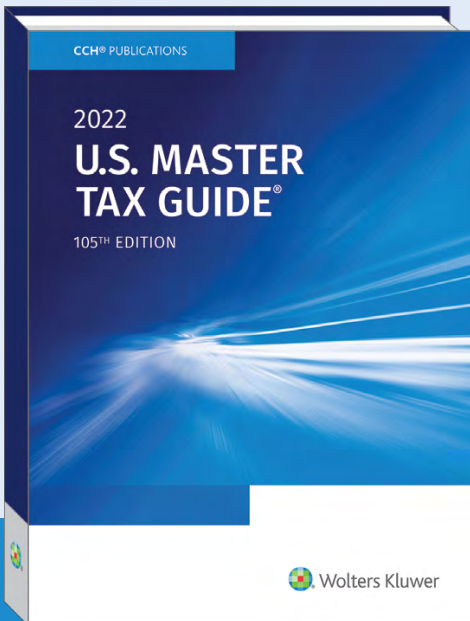
COMPLIANCE AND IRS ENFORCEMENT

A significant strategy in coming up with ways to pay for a large legislative package is by improving IRS service to close the so-called “tax gap.” The tax gap is the difference between what should be collected by the IRS and what is actually collected by the IRS. In many cases, the lack of resources by the IRS to enforce the nation's tax laws can be leveraged by taxpayers to lower their tax bills, and it is believed that a small investment in IRS resources can lead to an outsized increase in revenue.

The proposed legislation looks to close the tax gap by allocating an increased amount to the IRS to improve enforcement.

The BBA also would improve IRS enforcement by modifying the rules applicable to third-party settlement organizations. It would impose a limit on the contribution of conservation property, and more to the point, clarify the accuracy-related penalty that can be levied for violations of this limitation. Finally, the proposal would allow the IRS more freedom in assessing certain penalties by eliminating the requirement that a supervisor must approve an agent's determination to assess a penalty.

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