WINSTON & STRAWN LLP

BLOG

House Ways and Means Committee Tax Proposal

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On September 13, 2021, the House Ways and Means Committee unveiled a government-funding proposal involving a series of tax hikes and reforms. Key elements of the proposal include increasing the top marginal individual income tax rate to 39.6% and the capital gains rate to 25%, instituting a graduated corporate income tax rate with a top rate of 26.5%, and making certain changes to taxation of international transactions.

INDIVIDUALS

- **Top Marginal Individual Income Tax Rate**. Increased to 39.6%.
  - This rate applies to married individuals filing jointly with taxable income over $450,000; heads of households with taxable income over $425,000; unmarried individuals with taxable income over $400,000; married individuals filing separate returns with taxable income over $225,000; and estates and trusts with taxable income over $12,500. This change would apply to taxable years beginning after December 31, 2021.
- **Capital Gains Rate**. Increased to 25%. In combination with the existing 3.8% Medicare tax and the 3% surcharge described below, this yields an effective capital gains rate of 31.8% for taxpayers with income in excess of $5,000,000 or $2,500,000 for a married individual filing separately.
  - The current 20% rate continues to apply for the portion of the taxable year on or prior to September 13, 2021. Gains recognized later in the year that arise from transactions with respect to which a written binding contract was entered into before September 13, 2021 are treated as occurring prior to September 13, 2021.
- **Net Investment Income**. Expands the net investment income tax to cover net investment income derived in the ordinary course of a trade or business for taxpayers with taxable income in excess of $400,000 (single filer) or $500,000 (joint filer), as well as for trusts and estates. This change would apply to taxable years beginning after December 31, 2021.
- **Surcharge**. Imposes a tax equal to 3% of a taxpayer’s modified adjusted gross income in excess of $5,000,000 or $2,500,000 for a married individual filing separately. This surcharge would be applicable to taxable years

beginning after December 31, 2021.

- **Grantor Trust Transactions**. Treats sales between grantors and grantor trusts as equivalent to sales between third parties. This change would apply only to trusts created, and sales made, after the date of enactment of the Act.

CORPORATIONS

- **Corporate Tax Rate**. Replaces the flat corporate income tax with a graduated rate structure:
    - 18% on the first $400,000 of income; 21% on income up to $5 million, and 26.5% on income thereafter. The benefit of the graduated rate phases out for corporations making more than $10,000,000. This change would apply to taxable years beginning after December 31, 2021.
- **GILTI and FDII**. Reduces the Section 250 deduction with respect to both FDII (to 21.875%) and GILTI (to 37.5%), which are the deduction limits currently set to apply for taxable years after 2025. In combination with the proposed 26.5% corporate rate, this yields an effective 16.5625% GILTI rate and a 20.7% FDII rate. If the Section 250 deduction with respect to GILTI or FDII exceeds taxable income, the excess is allowed as a deduction, which will increase the net operating loss for the taxable year. A transition rule is provided for taxable years that include but do not end on December 31, 2021. In addition, the QBAI exemption is reduced from 10% to 5%. Also amends Section 951A to provide for country-by-country application of the GILTI regime.
- **BEAT**. The BEAT rate is amended to 10% in taxable years beginning after December 31, 2021, and before January 1, 2024; to 12.5% in taxable years beginning after December 31, 2023, and before January 1, 2026; and to 15% in any taxable year beginning after December 31, 2025. The base erosion minimum tax amount is to be determined taking into account tax credits.
    - Modifies the rules in Section 59A(c) for determining modified taxable income, including computing such amount without regard to base erosion tax benefits; without adjusting the basis of inventory property due to base erosion payments; by determining net operating losses without regard to any deduction which is a base erosion tax benefit; and according to other adjustments under rules similar to the rules applicable to the alternative minimum tax.
    - Amends the definition of base erosion payments to include amounts paid to a foreign related party that are required to be capitalized in inventory under Section 263A, as well as amounts paid to a foreign related party for inventory that exceed the costs of the property to the foreign related party. A safe harbor is available to deem base erosion payments attributable to indirect costs of foreign related parties as 20% of the amount paid to the related party.
    - Provides an exception for payments subject to U.S. tax, and for payments to foreign parties if the taxpayer establishes that such amount was subject to an effective rate of foreign tax not less than the applicable BEAT rate. The provision is effective for taxable years beginning after December 31, 2021.

OTHER BUSINESS TAX PROVISIONS

- **Portfolio Interest**. Modifies the definition of “10-percent shareholder,” whose interest is exempt from portfolio interest. In the case of an obligation issued by a corporation, any person who owns 10% or more of the total vote or value of the stock of such corporation is not eligible for the portfolio interest exemption. This amendment applies to obligations issued after the date of enactment of the Act.
- **Carried Interest**. Extends from three to five years the holding period required for gain attributable to an applicable partnership interest to qualify for long-term capital gain treatment; adds rules for measuring the holding period, including in the context of tiered partnerships; modifies the rules applicable to sale or exchange transactions; and extends regulatory authority to address carry waivers and arrangements that avoid the purposes of Section 1061. Gain attributable to a partnership interest includes amounts that are treated as capital

gain or subject to tax at the capital gain rate, including real estate used in a trade or business. This provision applies to taxable years beginning after December 31, 2021.

- **1202 Stock**. Amends section 1202(a) to provide that the special 75% and 100% exclusion rates for gains realized from certain qualified small business stock will not apply to taxpayers with adjusted gross income equal or exceeding $400,000. The baseline 50% exclusion remains available for all taxpayers. The amendments made by this section apply to sales and exchanges after September 13, 2021, subject to a binding contract exception.
- **S Corporation to Partnership Conversions**. Permits certain S corporations organized prior to May 13, 1996 to reorganize as domestic partnerships without triggering tax in the two-year period beginning on December 31, 2021.
- **Constructive Sales**. Includes digital assets in the constructive sale and anti-abuse rules previously applicable to other financial assets, preventing taxpayers from locking in investment gains without realizing taxable gain. This change applies to constructive sales occurring after the date of enactment of the Act.
- **199A**. Amends section 199A to provide for maximum allowable deductions of $400,000 (single filer), $500,000 (joint filer), as well as $10,000 for trusts and estates. This change applies to taxable years beginning after December 31, 2021.

APPROPRIATION

- **IRS**. Appropriates $78.9 billion for necessary expenses for the IRS for strengthening tax-enforcement activities and increasing voluntary compliance, and modernizing information technology to effectively support enforcement activities. The use of these funds is not intended to increase taxes on any taxpayer with taxable income below $400,000.
- **Treasury**. Appropriates $410 million for necessary expenses for the Treasury Inspector General for Tax Administration to provide oversight of the IRS.
- **Tax Court**. Appropriates $157 million for the Tax Court.

These proposals are subject to change or amendment, and modifications may be forthcoming. Winston & Strawn will continue to monitor developments.

For further information, please contact the authors or your Winston relationship attorney.

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