<u>Summary of Individual Tax Increases Impacting Family-Owned Businesses</u>

The Build Back Better Act includes many proposals to increase taxes on individuals and estates. Many of these provisions will increase tax burdens on family-owned businesses at a time when there is no liquidity and many are working to recover from the pandemic. The consequence in many cases will be a forced sale of the business and new hurdles to the transition of businesses to the next generation during the lifetime of its owners.

Below is a summary of a few of the provisions that should <u>not be included</u> as part of the reconciliation bill.

1. **<u>Grantor Trusts</u>**. Effective as of the date of enactment, the bill would require grantor trusts to be included in the grantor decedent's taxable estate. While the bill would apply to trusts created after the date of enactment, it also appears to apply retroactively in certain cases with respect to contributions to a trust after the date of enactment.

   Forms of grantor trusts have been utilized for decades as an important tool to allow the orderly transition of family businesses to the next generation and to provide liquidity through life insurance upon the death of a family member. The proposal would force the sale of illiquid family businesses by subjecting the value of the business held by a grantor trust to estate taxes, and include proceeds from life insurance held in a trust in the decedent's estate.

   The provision would limit an individual's ability to provide support for a surviving spouse through Spousal Lifetime Access Trusts. Individuals should be able to fully use their estate and gift tax exemption and also provide maximum support for his or her spouse. The changes proposed would hinder the ability of one spouse to support the surviving spouse and any dependents.

2. **<u>Valuation Discounts</u>**. The bill would amend the gross estate valuation rules to provide that when a taxpayer transfers nonbusiness assets, those assets should not be afforded a valuation discount for transfer tax purposes. The change would apply to transfers after the date of enactment.

   The proposed elimination of valuation discounts would apply both to gifts during life and at death of non-publicly traded stocks, limited partnership interests, limited liability company interests and other interests unless the interests are in operating businesses.

   This ignores the basic valuation rule of an asset – "what a hypothetical willing buyer will pay a hypothetical willing seller with neither being under a compulsion to buy or sell" – and could artificially increase the value of assets causing additional estate or gift tax to be paid unnecessarily.

   While the proposal would carve out operating businesses, it is not clear that the exception would apply to most family businesses, which are commonly owned through limited liability companies, partnerships and S corporations.

3. **Unified Credit**. The bill would terminate the temporary increase in the unified credit against estate and gift taxes, reverting the credit from the current $11,700,000 per person to its 2010 level of $5 million per individual, indexed for inflation. The provision would apply to estates of decedents dying and gifts made after Dec. 31, 2021.

   The reduction in the unified credit will result in an increased estate tax on many family-owned businesses. Lowering the limit will force the sale of family businesses that are illiquid, resulting in losses to local economies, job losses and cuts in civic and philanthropic contributions to the community often made by multi-generational family businesses.

4. **IRA Limitations**. The bill would limit contributions once combined defined contribution plan and IRA account balances exceed $10 million. Generally, the bill would require distributions of excess amounts – 50% of the excess in the case of an IRA and 100% in the case of a Roth IRA with a balance over $20 million.

   The bill also would prohibit certain non-publicly traded investments from being held in retirement accounts.

   The provision would require distributions to occur as early as 2022, although the Treasury Department is authorized to extend the distribution period. Distributions from non-Roth accounts are immediately taxable at ordinary rates. For most taxpayers under age 59½, the distribution of Roth account income would also be immediately taxable at ordinary rates

   These provisions substantially affect owners of family-owned businesses who have saved through retirement plans for decades. The impact of the restrictions reaches far beyond any abuses cited in the news as justification for these provisions and will significantly harm the retirement savings of more than the ultra-wealthy.

5. **199A 20% Deduction on Qualified Business Income**. The bill would restore the top individual income tax rate to 39.6% and create a new limitation for the section 199A deduction, with a $500,000 cap for joint filers or surviving spouses, $250,000 for married filing separately, $10,000 for trusts or estates and $400,000 for all other taxpayers. Current law phaseouts of the deduction above the threshold amount continue to apply.

   The 199A deduction was intended to create parity between corporate tax rates and pass-through tax rates. Taking together the proposal to increase individual rate, a surcharge for certain high-income individuals, the expansion of the 3.8 net investment tax to active income, and the cap on the 199A deduction, pass-through entities would bear an unfair burden of the proposed tax increases, even taking into account the proposed increase in the corporate tax rate. This could result in an individual tax rate in excess of 46%, compared to an effective rate under current law of 29.6%, taking into account a 20% 199A deduction.

The 199A deduction should be retained in its current form to provide greater parity between the individual tax rates for pass-through business owners and the corporate tax rate. Most family-owned businesses are operated in pass-through entities, either through partnerships, limited liability companies or S corporations. The proposal to limit the 199A deduction would only hinder the operation and potential from growth of pass-through enterprises and disproportionately burdens family-owned businesses.