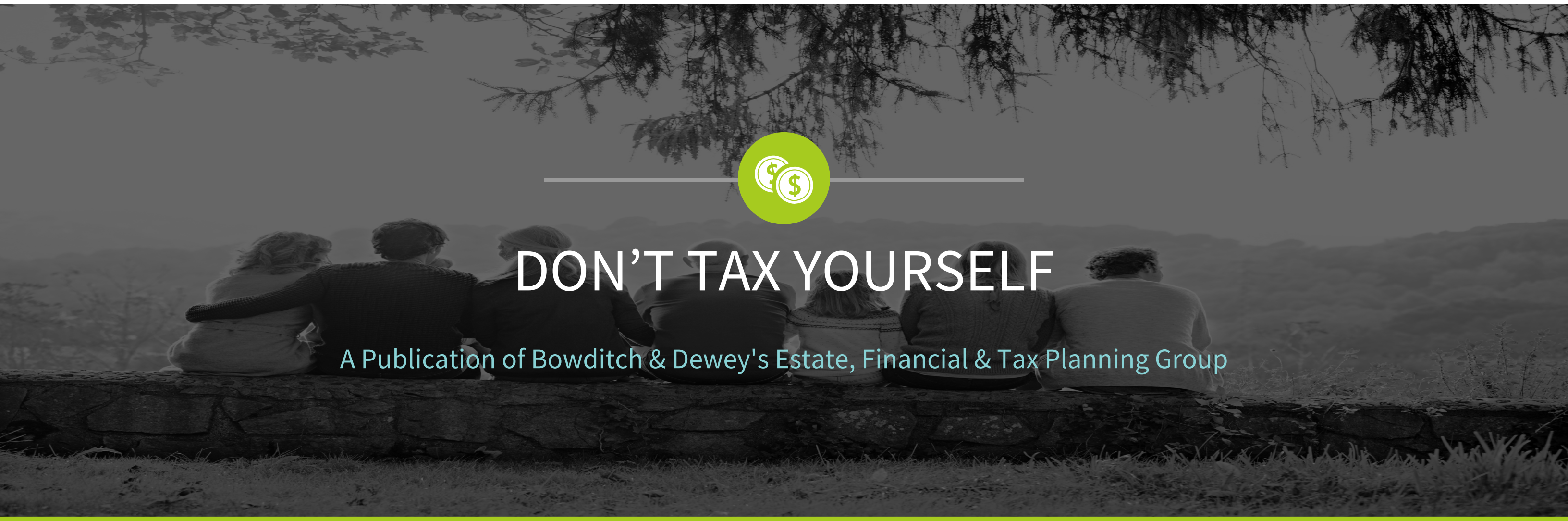

Impact of House Ways and Means Tax Proposal on Domestic Businesses

BY BOWDITCH & DEWEY • SEPTEMBER 22, 2021

On September 13, 2021, the Congressional House Ways and Means Committee introduced 880 plus pages of legislative tax proposals to help fund the House's proposed $3.5 trillion stimulus package. Below are tax proposals relevant to domestic U.S. businesses in the Bill, labeled JCX-43-21. In subsequent blogs, we will address tax proposals relevant to trusts and estates and businesses with international operations.

The House Ways and Means Committee has proposed the following changes that impact domestic businesses:

- Corporations with income over $5 million would be taxed at a 26.5% rate rather than the current 21% corporate tax rate.
- Individuals would be taxed at 39.6% on income if their adjusted gross income ("AGI") exceeds $450,000 (for married filing jointly) or $400,000 (for unmarried individuals), rather than the current top 37% rate.
- Capital gains would be taxed at a 25% rate rather than the current 20% capital gains tax rate.
- Individuals with net investment income (whether they participate in a trade or business that generates such income or not) would be subject to a 3.8% surtax on such income if their AGI exceeds $500,000 (in the case of married joint filers) or $400,000 for unmarried individuals.
- Taxpayers who receive partnership interests in exchange for services generally would be allowed long-term capital gain treatment on the sale or exchange of such partnership interests *only if* the partner holds on to such interests for at least five years. Taxpayers with AGI lower than $400,000 and partners in real estate partnerships would retain long-term capital gain treatment on a sale or exchange after three years from the date of grant.
- Taxpayers with worthless interests in partnerships would be able to claim only a capital loss (rather than an ordinary loss) under section 165 of the Code. Currently, a taxpayer with a worthless partnership interest (who has no share of liabilities of the partnership) can claim an ordinary loss under the Code.
- Taxpayers with AGI equal to or greater than $400,0000 and all trust and estate taxpayers would receive only a 50%

exclusion from capital gains on the sale of qualified small business stock under section 1202 of the Code. Currently, taxpayers receive a 100% exclusion from capital gains tax if they hold such qualified small business stock for at least five years.

- Taxpayers with AGI of $400,000 or more (or $500,000 or more in the case of joint filers) would no longer receive the Qualified Business Income Deduction. The Qualified Business Income Deduction is a 20% deduction against income for U.S. active trade or businesses (structured in partnership or S corporation form). For service businesses, the deduction is further limited to a percentage of wages paid to employees.

- S corporations that incorporated prior to May 13, 1996 would be eligible to reorganize as partnerships without incurring tax. May 13, 1996 was the date of publication of the current law "check-the box" regulations. The eligible S corporation would have to liquidate and transfer its assets and liabilities to a domestic partnership during the two-year period beginning on December 31, 2021.

- IRS employees would no longer need to seek approval from a supervisor before assessing taxpayer penalties. The proposal would repeal a statutory requirement under Code section 6751(b) that any assessment of penalties by an IRS employee must be approved by his or her supervisor. The amendment would be effective for notices issued and penalties assessed after December 31, 2000.

- Public corporations would no longer be able to deduct compensation payments over $1,000,000 made to their ten most highly compensated officers, including the principal executive and principal financial officer. This proposal was currently scheduled to take effect in the taxable year beginning after December 31, 2026.

- The employer credit for wages (12.5% of wages) paid during family and medical leave would expire in the taxable year beginning after 2023. The Taxpayer Certainty and Disaster Relief Act of 2020 scheduled the expiration of this credit for the taxable year beginning after 2025. In place of the tax credit, the House has proposed a twelve-week universal paid family and medical leave.

- The Work Opportunity Credit would be increased to 50% for the first $10,000 in wages through December 31, 2023 for all WOTC targeted groups except for summer youth employees. The credit would apply to the employee's first and second years of employment. The WOTC groups include families receiving TANF or supplemental security income, qualified veterans, qualified ex-felons, certain community residents from empowerment zones, certain vocational rehabilitation referrals, and certain other individuals receiving federal benefits. The current credit is limited to $2,400 per recipient (and $1,200 for certain summer youth employees).

The House has not yet voted on the above proposed legislation. The incremental changes proposed take away many of the structural changes made in the Tax Cuts and Jobs Act of 2017 and would create a fair amount of instability for businesses that had relied on the 2017 tax legislative changes to structure their operations.

Please talk with your tax advisor if you have questions about any of the above proposals.

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