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In September, the House of Representatives proposed several tax increases to pay for President Biden's Build Back Better plan. Over the past eight weeks, however, the politics have changed, resulting in fewer broad tax increases and a wealth surtax on a smaller set of taxpayers.

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A SHIFT IN HOW DEMOCRATS WILL TAX THE WEALTHY

Back in September, the House of Representatives proposed tax increases on income, capital gains, dividends, small businesses (that would kick in at roughly $400k), and corporations, as well as estate tax reform (exemption lowered from $11M to $6.5M) and grantor trust reform. Over the past eight weeks, however, the politics have changed. The president's approval rating has fallen and Republicans did well in this month's elections. In response, moderate Democrats opposed the tax rate increases and estate tax changes, and have come up with an alternative way to raise money: taxing a smaller set of wealthy taxpayers with a surtax on their total income.

Latest Version Focuses on Wealth Surtax

The latest version of the reconciliation bill, which is expected to be voted on in the House in November, no longer taxes income, capital gains, dividends, or estates directly. Instead, a single taxpayer with $5M of total income or married couple with $10M of income will face a surtax of 5%. If the taxpayers' income exceeds $12.5M (single) or $25M (married), the surtax increases to 8%. This surtax is applied on all income above the threshold with no deductions. As a result, capital gains above the threshold would face the additional 5% or 8% levy. The surtax would also apply to the estate or trust of a taxpayer with modified adjusted gross income above $200,000 and $500,000. Small businesses paying the individual income tax would still be subject to the originally proposed 3.8% Medicare tax although the small business deduction would not be eliminated.

IRAs Remain a Target

Individual Retirement Accounts of the wealthy remain a target. Congress did remove a provision forcing IRA holders to liquidate private (illiquid) securities. However, the proposal caps IRA contributions once the assets in an individual's retirement plans reach $10 million and requires minimum distributions for those IRAs. The new proposal also includes workplace 401(k) Roth plans in calculating the total holdings. However, these provisions do not go into effect until 2029.

November House Reconciliation Bill

Individual Tax / State & Local Tax Deduction (SALT)	No change in individual income tax rates with an increase in the SALT deduction up to $80k with no income limits
Wealth Surtax	A new 5% surtax on modified AGI over $5M ($10M married) and additional 3% surtax on MAGI over $12.5M ($25M married). For married households with more than $25M income, the income tax rate will be 45% and capital gains tax rate will be 31.8%
Estate & Trusts	Estate and grantor trust tax changes were removed. However, the new 5% surtax applies on estate of taxpayer with MAGI above $200,000; 3% surtax above $500,000
Small Business Tax	A new 3.8% surtax on small business income over $400,000 to pay for Medicare
Capital Gains & Dividend Taxes	No direct increase in the capital gains or dividend tax rate
IRAs	Limit IRA contributions when balances reach $10M in assets; require minimum distributions; effective date changed to 2029

It is widely expected these proposed tax changes will pass the House sometime in November, but that is just the first step. The Senate will then also need to consider the legislation and further changes can be made. However, we believe at this point that the structure of the House bill is likely to remain intact. **We will be watching these developments closely as activity picks up heading into the holidays.**

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