MEEDER INVESTMENT MANAGEMENT

Proposed Tax Changes in the American Families Plan: Potential Impact on Your Future

The U.S. House Democrats in September 2021 released a draft of the American Families Plan that contains many changes to the current tax code. Looking into these changes we can gain insight and see their potential impact on our financial situations now and in the future. Below we have highlighted a few key aspects of these changes for you.

1 New tax brackets

The new initiatives will help reduce the net cost of various spending initiatives by raising taxes on those whose income is above $400,000 or $450,000 in joint income. So, the top marginal income tax rate would rise from 37% to 39.6%.

2 Capital gains rates

In addition to increasing the top ordinary tax rate, the bill will also increase the top capital gains bracket. Initially it was proposed to make the capital gains tax equal to the top ordinary tax rate we discussed earlier of 39.6%, but the bill proposes an increase in the top capital gains rate to a maximum of 25%. However, the bill would realign the capital gains brackets with the ordinary income tax brackets making them start at the same dollar amounts. This means that the new top cap gains bracket would start at just $400,000 for single filers and $450,000 for joint filers.

The big question looming is when the effective date of any change is scheduled. The Biden budget called for making changes on the top rate retroactive to April this year. However, this bill, as most experts expected, proposes making the change effective after introduction.

3 Other increased tax rates

This bill is a real killer for high-income owner/employees of S-Corporations. Under the current law, S-Corp profits are not subject to either employment taxes or the net investment tax. The bill would change that for high earners. Specifically, single filers with modified adjusted gross income (MAGI) more than $400,000 and joint filers with income more than $500,000 would see S-Corp profits subject to the 3.8% surtax. That is in addition to the top ordinary rate discussed earlier, so the true rate goes up from 37% to 43.4%.

The next section of the bill limits the maximum 199A deduction (the 20% pass-through deduction) to no more than $500,000 for joint filers and $400,000 for single filers. This is a cap on the deduction—not a phaseout based on the amount of an individual's income. President Biden's plan called for the deduction to be phased out for those with income above $400,000.

In a provision that will apply to very few high-income taxpayers, a new 3% surtax would be applied to taxpayers with MAGI over thresholds are as follows:

- $500,000 for those filing joint, single, HoH, widows
- $2,500,000 for those filing married or an individual filing a separate return

Since those are MAGI limits that are below-the-line deductions (like large charitable contributions) it will not do anything to reduce the surtax. Further, the same surtax that applies to the exclusive club of multi-million-dollar earners also hits trusts at just $100,000 of income.

Now consider that most non-spouse beneficiaries, including trusts, must empty IRAs, 401Ks, etc. within 10 years. It is not nearly as hard to have $100,000 of income (held in trust) when you are looking at (forced) large retirement account distributions. This could be another reason why retirement account owners with large accounts being left to discretionary trusts should plan to convert more during life in an effort to minimize greater tax erosion after death—thanks to the lousy trust tax brackets.

4 Impact on Roth accounts

The bill does a few things. First, it eliminates all Roth conversions for high income taxpayers. How high does a person's income have to be to be prohibited from making a Roth conversion? You cannot be a taxpayer in the highest ordinary income tax bracket which is single filers at $400,000 and above, and joint filers at $450,000 and above. The effective date for this change is December 31, 2031, and while just about everything else in this bill that applies to high income net worth taxpayers kicks in on January 1, 2022. Why would this be delayed so long? That is part of the budget and numbers game. Keeping Roth conversions for high earners alive for ten years (even incentivizing more conversions with a "Buy it up now while supplies last" rule) brings in money now! This will reduce the overall net cost of the bill.

It gets worse, if passed, effective January 1, 2022, after-tax amounts in retirement accounts will no longer be eligible for conversion to Roth accounts. That means there is a really good chance the back-door Roth is dead after this year.

If you're like many, you have worked many decades to accumulate assets to prepare for enjoyable golden years. Be sure to consult with qualified tax and financial professionals to help you stay on track to achieving your retirement goals.

If you have questions or would like to discuss how these proposed changes might affect your individual situation, please reach out to the professionals at Meeder Private Wealth by calling **1.866.633.3371**; emailing **privatewealth@meederinvestment.com**; or visiting us at **meederinvestment.com/en/privatewealth**

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