From Pacific Life's Advanced Designs Unit

Potential Tax Law Changes Based on President Biden's Tax Plan

December 2020 (Updated as of November 5, 2021)

Topic: President Biden's Potential Tax Law Changes, Legislative Text Released by the House Ways and Means Committee on September 13, 2021, and Legislative Text Released by the House Rules Committee on October 28, 2021 and November 3, 2021.

The following chart is a summary of highlights of Biden's previous proposed tax law changes[i], the legislative text released by the House Ways and Means Committee Chairman Richard Neal on September 13, 2021,[ii] the framework of the Build Back Better (BBB) Act released by the House Rules Committee on October 28, 2021 and November 3, 2021,[ii] and current tax laws under the Tax Cuts and Jobs Act (TCJA):

Current Tax Laws[iii] Tax Cuts and Jobs Act (TCJA)	**Potential Tax Law Changes[i, ii]**
Top Rate on Ordinary Income • Rates begin at 10% and climb to 37%. The top rate is 37%. • The current 37% top rate applies for single taxpayers with income in excess of $529,000 and married taxpayers with income in excess of $620,000.	***Top Rate on Ordinary Income*** ***Current Proposal - The Build Back Better Framework dated 11/3/21:*** • The current proposal is consistent with the prior proposal dated 10/28/21 below. ***Prior Proposal - The Build Back Better Framework dated 10/28/21:*** • The BBB Framework does not raise the current top 37% income tax rate (with the exception of multi-millionaires subject to the proposed surcharge below). • Impose a 5% surcharge on individuals with modified adjusted gross income (MAGI) exceeding $10M ($5M if married filing separately and $200,000 for trusts and estates) placing them at a top rate of 42%. • Impose an additional 3% surcharge on individuals with MAGI exceeding $25M ($12.5M if married filing separately and

	$500,000 for trusts and estates) placing them at a top rate of 45%. ***Prior Proposals by the Ways and Means Committee on 9/13/21:*** • Raising only the top marginal rate from 37% to 39.6%. • The top rate of 39.6% would apply for individual taxpayers with income in excess of $400,000 ($425,000 for heads of households, $450,000 for married filing jointly and $12,500 for trusts and estates starting in 2022). • Impose a 3% surcharge tax on individuals with modified adjusted gross income (MAGI) exceeding $5M ($2.5M if married filing separately and $100,000 for trusts and estates).
Top Rate on Long-Term Capital Gains and Qualified Dividends • The top rate is 20% (23.8% when including the 3.8% Net Investment Income Tax (NIIT)).	***Top Rate on Long-Term Capital Gains and Qualified Dividends*** ***Current Proposal - The Build Back Better Framework dated 11/3/21:*** • The current proposal is consistent with the prior proposal dated 10/28/21 below. ***Prior Proposal - The Build Back Better Framework dated 10/28/21:*** • The BBB Framework does not raise the current 20% top rate on investment income (with the exception of multi-millionaires subject to the proposed surtax). The 3% and 5% surcharges would be added to the top rate resulting in effective rates of 25% and 28% for individuals with MAGI exceeding $10M and $25M respectively, plus the existing 3.8% Net Investment Income Tax. ***Prior Proposals by the Ways and Means Committee on 9/13/21:*** • Increase the top rate from 20% to 25% (28.8% when including the 3.8% Net Investment Income Tax). • Effective for taxable years ending after the date of introduction of the bill (i.e. taxable years ending after September 13, 2021). This would have a retroactive effective date. • 3% surcharge tax on individuals with modified adjustment gross income (MAGI) exceeding $5M ($2.5M if married filing separately and

	$100,000 for trusts and estates) appears to include capital gains.
Itemized Deductions • Taxpayers are entitled to deduct the greater of 1) the standard deduction, or 2) the sum of the itemized deductions (things like mortgage interest, medical expenses, state and local income and property taxes, and charitable contributions). The TCJA nearly doubled the standard deduction (from $6,350 to $12,400 for single taxpayers, $12,700 to $24,800 for married couples), while limiting or eliminating certain itemized deductions.	***Itemized Deductions*** ***Current Proposal - The Build Back Better Framework dated 11/3/21:*** • Raise the cap on the state and local (SALT) deduction from $10,000 to $72,500 and extend this cap through 2031. • The higher SALT cap amount would apply to the 2021 tax year. ***Prior Proposal - The Build Back Better Framework dated 10/28/21:*** • Nothing proposed. • While there was no mention of state and local tax (SALT) deductions, House Ways and Means Chairman Neal indicated that something is going to be done on SALT, even though it was left out of the BBB framework.
Pass-through Businesses • Net Investment Income Tax imposes a 3.8% tax on "net investment income" of individuals, estate, or trusts that have modified income (MAGI) above defined statutory thresholds. Net investment income generally includes interest, dividends, capital gains, rental and royalty income, nonqualified annuities, and income from businesses that are passive activities to the taxpayer.	***Current Proposal - The Build Back Better Framework dated 11/3/21:*** • The current proposal is consistent with the prior proposal dated 10/28/21 below. ***Prior Proposal - The Build Back Better Framework dated 10/28/21:*** • Impose a 3.8% Net Investment Income Tax (a.k.a. "NIIT" and "Medicare surtax") to all income (passive or non-passive) from pass-through businesses when income exceeds $400,000 ($500,000 if married filing jointly). This would expand the scope of the NIIT and close the loophole for wealthy business owners. • THE NIIT would not be assessed on income on which FICA is already imposed.
Elimination of the 20% Qualified Business Income (QBI) Deduction • Pass-through businesses that operate as an S-Corporation, partnership or sole proprietorship may claim a 20% deduction on qualified income earned in the business.[iv] This reduces the effective top rate on this type of income from 37% to 29.65%.	***Elimination of the 20% Qualified Business Income (QBI) Deduction*** ***Current Proposal - The Build Back Better Framework dated 11/3/21:*** • The current proposal is consistent with the prior proposal dated 10/28/21 below. ***Prior Proposal - The Build Back Better Framework dated 10/28/21:*** • The BBB Framework did not include direct

	changes to the current 199A rules. ***Prior Proposals by the Ways and Means Committee on 9/13/21:*** • Deduction limited to $500,000 for joint returns, ($250,000 for married filing separately and $400,000 for individuals) regardless of whether a business is considered a Specified Service, Trade or Business (SSTB). Current 199A rules would not change other than to impose dollar caps on the deduction.
Corporate Tax • Corporate tax rate of 21%. • No corporate alternative minimum tax (AMT).	***Corporate Tax*** ***Current Proposal - The Build Back Better Framework dated 11/3/21:*** • The current proposal is consistent with the prior proposal dated 10/28/21 below. ***Prior Proposal - The Build Back Better Framework dated 10/28/21:*** • 15% minimum tax on corporations with average annual book earnings that exceeds $1B for any three consecutive years. • 1% Surcharge on Corporate Stock Buybacks ***Prior Proposals by the Ways and Means Committee on 9/13/21:*** • Increase the corporate tax rate from 21% to 26.5% for businesses with income in excess of $5M (18% for businesses with income below $400,000 and 21% for businesses with income up to/not exceeding $5M). For businesses with income in excess of $10M, the amount of tax will be increased by the lessor of 3% of any excess or $287,000.
Retirement Accounts	***Cap on Retirement Savings*** ***Current Proposal - The Build Back Better Framework dated 11/3/21:*** • The updated BBB Framework re-introduces eliminating backdoor ROTHs, income limits for ROTH conversions, and the new required minimum distribution (RMD) requirement for high-income taxpayers with large retirement account balances in excess of $10M (See prior proposal by the Ways and Means Committee dated 9/13/21 below). • The difference in this current proposal is that the RMD requirement extends the effective

	date from 2022 to 2029. The updated framework also extends the effective date of the proposed limit on contributions to 2029. ***Prior Proposal - The Build Back Better Framework dated 10/28/21:*** • Nothing proposed. • The BBB Framework did not include prohibiting contributions or new required minimum distributions from retirement accounts exceeding $10M. The proposal did not mention eliminating backdoor ROTH IRAs either. ***Prior Proposals by the Ways and Means Committee on 9/13/21:*** • Prohibits contributions for taxpayers with retirement accounts exceeding $10M (vested balances) for individuals with income above $400,000 and joint filers with income above $450,000 beginning 2022. There would be required minimum distributions (RMDs) of 50% of the amount by which the aggregate retirement account balance exceeds $10M. If an individual's aggregate balance exceeds $20M, any excess must be 100% distributed. This applies regardless of the age of the taxpayer. • Eliminating Backdoor Roth IRAs – prohibits after-tax contributions beginning in 2022. • Income Limit for Roth Conversions - prohibit high income taxpayers ($400,000 single/ $450,000 married) from doing Roth conversions beginning in 2032.
Estate Tax • Temporarily doubling of the federal estate and gift tax exemption from $5 million (annually indexed for inflation) to $10 million (annually indexed for inflation) through the end of 2025 with a top tax rate of 40% • In 2026, the federal estate, gift and generation skipping transfer (GST) tax exemption amounts are scheduled to revert to $5,000,000 per person (indexed for inflation for tax years after 2011	***Current Proposal- The Build Back Better Framework dated 11/3/21:*** • The current proposal is consistent with the prior proposal dated 10/28/21 below. • There are no direct changes to the current estate and gift tax regime and no reference to valuation discounts, elimination of step up in basis, or grantor trusts. ***Prior Proposal- The Build Back Better Framework dated 10/28/21:*** • Nothing proposed. • The BBB Framework did not include direct changes to the current estate and gift tax regime and made no reference to valuation

discounts, elimination of step up in basis, or grantor trusts.

Prior Proposals by the Ways and Means Committee on 9/13/21:

Estate Tax

- Terminate temporarily increased estate tax exemption and revert exemption to $5M per individual (indexed for inflation). Effective beginning 2022.

Grantor Trusts Included in Taxable Estate

- Includes assets of a grantor trust in the decedent's/grantor's taxable estate when the decedent is the deemed owner of the trust
- Treat sales between grantor trusts and grantors as equivalent to sales between an owner and a third party
- Effective for trusts created on or after date of enactment or to contributions on or after the date of enactment to existing trusts

Valuation Discount

- Transfers of non-business assets held within an entity denied a valuation discount (i.e. in general, discounts eliminated for entities other than their assets used in an active business).

To Contact Pacific Life's Advanced Designs Unit: 800.800.7681 x3690 or Advanced.Designs@pacificlife.com

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[i] "Details and Analysis of President-elect Joe Biden's Tax Plan" Garrett Watson et al, available at https://taxfoundation.org/joe-biden-tax-plan-2020/#Key (October 22, 2020). See also Fact Sheet: The American Families Plan | The White House

[ii] Fact Sheet: The American Families Plan | The White House; See also https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/NEAL_032_xml.pdf; See also https://rules.house.gov/sites/democrats.rules.house.gov/files/BILLS-117HR5376RH-RCP117-17.pdf; See also https://rules.house.gov/sites/democrats.rules.house.gov/files/BILLS-117HR5376RH-RCP117-18.pdf

[iii] See https://www.irs.gov/tax-reform; See also https://www.irs.gov/newsroom/the-highlights-of-tax-reform-for-businesses

[iv] Not all pass-through businesses are eligible for the 199A 20% deduction. Once a business passes over an income threshold ($164,900 for individuals, $329,800 if married in 2021), then businesses that are considered a specified service trade or business (SSTB) start to get phased out of the 20% deduction. Businesses that are Non-SSTB do not have this limitation, however, once they pass an income threshold ($164,900 for individuals, $329,800 if married in 2021), they have their own test that must be passed in order to the get the deduction. See IRC Section 199A.

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