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HIGHLIGHTS FROM THE AMERICAN FAMILIES TAX PROPOSAL

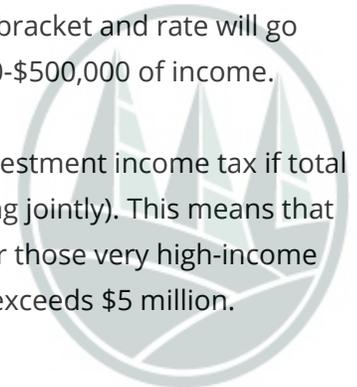
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On September 13th the House of Representatives Ways and Means Committee released the new American Families Tax Proposal. This proposal contains many provisions that could affect both businesses and individuals. While the bill is still far from final, we want to highlight a few of the proposed changes that are likely to impact the greatest number of our clients. For some reading this overview, it may serve as just an FYI. For others it may serve as a call to action or at least a call to review your current situation.

HOW WILL THE PROPOSED CHANGES AFFECT YOU?

Let's start with income tax. The top income tax rate will increase from 37% to 39.6% for taxpayers with income exceeding 400,000 (single) or \$450,000 (married filing jointly). This proposed change, which would go into effect in 2022, not only increases the top tax rate, but also reduces the income threshold for the top tax bracket from \$628,300 (married filing jointly) to \$450,000 (married filing jointly). The current 37% bracket and rate will go away. This proposed change would be most impactful for households with \$400,000-\$500,000 of income.

Also starting in 2022, distributions from an S-Corp will be subject to the 3.8% net investment income tax if total modified adjusted gross income exceeds \$400,000 (single) or \$500,000 (married filing jointly). This means that the top tax bracket for small business owners could be 43.4% (39.6%+3.8%). And, for those very high-income earners, regardless of S-Corp affiliation, a 3% surtax will be assessed when income exceeds \$5 million.





In addition to increasing income tax rates, the bill also proposes an increase to the top capital gains rate from 20% to 25%. Unlike the income tax change that wouldn't occur until 2022, the capital gains rate increase would be effective as of September 13th of this year. The 0% and 15% rates for realized capital gains will still be applicable. The 25% rate kicks in when income exceeds \$400,000 (single) and \$450,000 (married filing jointly).

Turning from tax rates to tax efficient vehicles, the bill contains provisions for funding Roth IRAs, especially for high earners. Roth conversions will be eliminated in 2032 for taxpayers in the top bracket. This gives high earners 10 more years to convert their pre-tax IRAs to Roths. In addition, the bill also puts an end to after-tax Roth conversions, also known as backdoor Roth conversions, after 2021. If this bill passes, 2021 will be the last year for all taxpayers – regardless of income levels – to convert after-tax IRA dollars to a Roth IRA (backdoor conversion).

The American Families Tax Proposal also touches on estate tax. It proposes to cut the estate and gift tax exemption in half starting in 2022. Currently, you can pass \$11.7 million at your death estate tax free. Married couples can pass \$23.4 million. Under the new legislation, individuals will be capped at \$5.85 million and married couples at \$11.7 million. Portability, which is the ability for a married couple to share their total exemption amount, will remain in place. Although the exemption amounts under the proposal still seem large, it is a 50% reduction to current law and will impact high net worth individuals with large estates. For those who may be impacted by this potential change, we recommend checking in with your estate planning attorney to see if any changes to your estate plan are warranted.

***“Good fortune is what happens when opportunity meets with planning.”
– Thomas Edison***

WHAT ARE THE NEXT STEPS?

It will likely be weeks and months before we know if this bill, or some version of it, will pass through Congress and become law. With that said, many people who study this closely think the odds are greater than 50% that some version of this bill will get passed before the end of the year. So, what to do while we wait?

If it is likely that you will be in the top income tax bracket next year, it may make sense to accelerate income slated for 2022 into 2021, if possible. The top rate this year is 37%. If the bill passes in its current form, the top rate next year will be 39.6%, plus any applicable surtax. As for the capital gains rate, if the September 13th date holds, there is not much to be done to avoid the extra 5% tax for high income earners. However, realized capital gains do count as income in the year they are generated and accelerating some of this income into 2021 may be a good strategy depending on your anticipated income next year. The proposed changes to the estate tax laws have the potential to impact your current estate plan. A conversation with an estate planning attorney can help you identify any changes that may be beneficial for you.

We are not CPAs, tax accountants or attorneys and do not give legal or tax advice. We are fortunate to work with excellent tax and legal professionals and are happy to provide a recommendation if needed. We encourage all our clients to reach out to us with your questions and concerns. We are happy to be your first call to help you determine if you need to seek out additional expertise.

We will keep you updated as we learn more.

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