Proposed Surcharge on High-Income Individuals, Estates and Trusts

The House version of the Build Back Better Act would impose a 5% surcharge on modified adjusted gross income that exceeds $5 million for married individuals filing separately, $200,000 for estates and trusts and $10 million for all other individuals. An **additional** 3% surcharge would be imposed on modified adjusted gross income in excess of $12.5 million for married individuals filing separately, $500,000 for estates and trusts and $25 million for all other individuals. The proposal would be effective for taxable years beginning after December 31, 2021 (i.e., beginning in 2022).

While keeping the proposed surcharges in mind, taxpayers should consider whether they can minimize their tax bills by shifting income or deductions between 2021 and 2022. Ideally, income should be received in the year with the lower marginal tax rate, and deductible expenses should be paid in the year with the higher marginal tax rate. If the marginal tax rate is the same in both years, deferring income from 2021 to 2022 will produce a one-year tax deferral and accelerating deductions from 2022 to 2021 will lower the 2021 income tax liability.

Actions to consider that may result in a reduction or deferral of taxes include:

- Delaying closing capital gain transactions until after year end or structuring 2021 transactions as installment sales so that gain is deferred past 2021 (also see *Long Term Capital Gains*, below).
- Considering whether to trigger capital losses before the end of 2021 to offset 2021 capital gains.
- Delaying interest or dividend payments from closely held corporations to individual business-owner taxpayers.
- Deferring commission income by closing sales in early 2022 instead of late 2021.
- Accelerating deductions for expenses such as mortgage interest and charitable donations (including donations of appreciated property) into 2021 (subject to AGI limitations).
- Evaluating whether non-business bad debts are worthless by the end of 2021 and should be recognized as a short-term capital loss.
- Shifting investments to municipal bonds or investments that do not pay dividends to reduce taxable income in future years.

On the other hand, taxpayers that will be in a higher tax bracket in 2022 or that would be subject to the proposed 2022 surcharges may want to consider potential ways to move taxable income from 2022 into 2021, such that the taxable income is taxed at a lower tax rate. Current year actions to consider that could reduce 2022 taxes include:

- Accelerating capital gains into 2021 or deferring capital losses until 2022.
- Electing out of the installment sale method for 2021 installment sales.
- Deferring deductions such as large charitable contributions to 2022.