Legislation Limbo
Tax Bill's Uncertain Future

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The end of 2021 was confusing when it came to federal tax legislation. House Democrats passed President Joe Biden's Build Back Better Act (BBBA) on Nov. 19, 2021, but the Senate was unable to pass the legislation. Speaker of the House Nancy Pelosi and Senate Majority Leader Chuck Schumer kept saying a tax bill would be enacted by Christmas.

The house of cards collapsed Dec. 19 when Senator Joe Manchin said he would not vote for the "mammoth" 2,000-plus page BBBA, essentially killing it. Biden then issued a statement officially ending all negotiations of the BBBA.

Congressional leaders remain optimistic that a tax bill can pass in early 2022, but the BBBA's precarious tax status has many real estate investors and real estate business people wondering whether their tax fears will come to pass, and when. Questions over the near-term future of taxes add to the economic uncertainty already present because of inflation and the new COVID-19 variants.

Takeaway

President Biden's Build Back Better Act has proven controversial, and whether it (or a smaller version of the tax bill) will pass remains uncertain.

BBBA's Open Issues

Apart from Manchin's refusal to support the BBBA and the question of whether he is willing to negotiate a smaller-scale BBBA (see sidebar), several issues would need to be addressed before any tax legislation could be considered.

One of the biggest is the proposed expansion of the child tax credit. Second, any changes to BBBA will need to conform to the Senate's budget reconciliation rules. Third, the limit or cap on the deduction for state and local property taxes (commonly called the SALT deduction cap), will need to be determined.

Timing of legislation is an issue. On the one hand, politicians want to score a legislative victory before the mid-term elections, even if that means a reduced or scaled-back bill. On the other hand, voting for a large tax-and-spend legislative package becomes problematic as the November elections approach. All of this suggests a tax bill sooner rather than later, if at all.

Key Dates and Timelines

Several key dates could force legislative action. The State of the Union address is scheduled for March 1. Government funding expired Feb. 18, under the current agreement.

The most probable deadline, though, is the end of March (the end of the first quarter of 2022), by which time any tax legislation would need to be passed. If a tax bill is not enacted by then, the odds are virtually zero that BBBA will be passed.

How Big Will Tax Legislation Be?

Manchin has indicated that inflation and the rising federal debt are key drivers for him in considering any tax legislation.

Inflation seems to be broad-based and continuing, so news about inflation is not likely to improve in the first part of 2022. Federal Reserve Chairman Jerome Powell has indicated interest rates hikes are expected in 2022, much earlier than previously predicted.

These influences suggest that any tax bill will need to be much smaller than the one proposed by Biden and the Democratic congressional leaders, or they will need to raise taxes to pay for the BBBA package.

How Will Tax Provisions Change?

Despite the commotion surrounding enactment of the BBBA, its tax provisions seem less controversial than its social spending aspects. Perhaps, then, Manchin's framework for tax rates (see sidebar) might have broad congressional support.

The SALT deduction cap issue will need to be resolved in any bill. Sharp lines are drawn, with congressional members from New York and California solidified against any SALT deduction cap. The problem with the cap, however, is that it benefits the wealthiest people.

The Senate Finance Committee version of the BBBA was released on Dec. 11, 2021. It offered changes and technical fixes, but the Senate parliamentarian has yet to approve this bill. At a minimum, further changes are required.

Importance of the SALT Deduction Cap

Any tax legislation in 2022 will almost certainly have to confront the limitation on the SALT deduction cap.

The Biden administration has consistently used $400,000 as the income cutoff. This means the SALT deduction cap would apply to those with income above $400,000.

The $400,000 is effectively a marker for who is wealthy and who is not. The problem is that amount means something different to taxpayers in smaller, rural states than it does to someone in New York City or San Francisco. Much remains unresolved on this issue. Any tax legislation will have to address this fundamental disagreement.

What Did Manchin Say Exactly?

Manchin's statement was carefully written. He said he was opposed to "this" piece of legislation, being the BBBA. His statement suggests he would consider a small version of the BBBA. Manchin has been less vocal about the tax provisions in the BBBA. He and Schumer agreed in writing on July 28, 2021, to tax rate increases for corporate, individual, and capital gains rates as follows:

- corporate tax rate, 25 percent;
- corporate minimum tax, 15 percent;
- top tax rate on ordinary income, 39.6 percent; and
- capital gains tax rate, 28 percent.

In addition, they agreed to end carried interests.

Despite Manchin's indication of support for these tax increases, there's little doubt that major changes would have to be made to the BBBA before he would support it. Will he be willing to support a smaller-scale version of the BBBA? Obviously, those curious about the direction of tax legislation in 2022 will want to keep a sharp eye and ear on Manchin.

What About Complicated Tax Provisions?

This is a big, global world, and a number of tax issues—such as corporate book income minimum tax provisions or global intangible low-taxed income (GILTI) modifications—are important from an international perspective. However, they can be perplexing.

Some ardently believe corporations should pay a minimum tax, but implementing a corporate minimum tax is not easy. Some want the minimum tax for corporations based on accounting income as opposed to taxable income, believing such a provision would be more difficult to avoid or would be more conceptually sound.

To negotiate a worldwide corporate minimum tax, countries that support the idea would need to adjust their individual tax rules to conform to an international framework. The proposals in the BBBA (the GILTI modifications) seek to align U.S. tax rules with the international framework.

Whether any of these tax provisions end up on a tax bill remains uncertain. Some are proposing a corporate tax increase as an alternative.

The Issue with Tax Extenders

A number of tax provisions expired in 2021, and others will expire in 2022 or even 2023. These include temporary provisions that were set to expire by virtue of earlier tax legislation. For example, the 100 percent bonus depreciation is set to phase down in 2023.

It's possible that Congress could enact a tax extenders bill. A tax extenders legislative package could include certain items from the BBBA, such as changes to the child-care tax credit.

Estate and Gift Tax Changes

Democrats proposed significant and ambitious changes to estate and gift tax rules in early 2021, but the Senate version of the BBBA did not include the proposals.

Each Democratic proposal would have been transformative in one way or another. The main proposals were realization at death, curtailing valuation discounts, transforming the tax treatment of grantor trusts, accelerating the expiration of the doubled estate and gift tax exemption, and the short-lived billionaire's tax. Any of these would have materially changed estate planning. Is there a risk that any of these proposals will reappear in 2022? The odds look slim, but "never" is not a word that should be used when predicting legislative activity and politics.

First, the proposed estate and gift tax changes would generate tax revenue, and they could be resurrected to plug a revenue hole in a 2022 bill. Second, the Treasury or the Internal Revenue Service (IRS) could use administrative methods to accomplish some of the Democrats' goals, such as changing the grantor trust rules by regulation or administrative rule. The use of valuation discounts could be dealt with in regulations, but the last time a regulatory attempt was made to stop valuation discount, more than 10,000 opposing comments were filed with the IRS, and the proposals were dropped.

Some major changes will most likely occur without any legislation. For example, the bonus estate and gift tax exemption amounts are set to expire Jan. 1, 2026. This change is already in the law books. The 2022 exemption amounts for estate, gift, and generation-skipping purposes was increased to $12.06 million (from $11.7 million in 2021). In 2026, these exemption amounts will be reduced to $5 million, adjusted for cost of living to somewhere around $6 million with the result that in 2026 estate and gift taxes are already scheduled for an increase.

Advice to Consider in Light of Volatile Tax Law

As 2022 begins, the tax law is politically unstable. Tax law is and has been unstable because of prevailing political uncertainties. The pandemic further complicates the environment.

There could be a political shift to the left, in which case some of the Democratic proposals could reappear, or not. COVID-19 and its variants and inflation are major uncertainties, driving up asset values. These influences have the not-so-subtle effect of increasing the contingent liability for estate taxes on death.

Although the proposed dramatic changes in the tax law were scuttled, any of them could reappear. The political forces that want tax law changes are still present—perhaps stronger, perhaps weaker. Predicting what will happen in future elections is unsound.

In light of these things, the ultimate message is simple: plan now.

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