

# INCOME TAXES - CHANGES COMING SEPTEMBER 2021



***“The point to remember is that what the government gives it must first take away.”***

*John S. Coleman*

With the year-end rapidly approaching, Washington D.C. has been frantically trying to craft a \$3.5 trillion spending bill which includes tax hikes. President Biden and the Democratic leadership have issued their framework for the proposed tax changes. Before we look at this framework in more detail let’s refresh ourselves on who pays the taxes and to what extent.

The following information is taken from Federal Individual Income Tax returns received by the IRS. The data presented is from the 2018 tax returns that were filed in 2019, which is the latest year the data is available. Throughout this commentary, taxpayers are categorized based on their adjusted gross income (AGI).

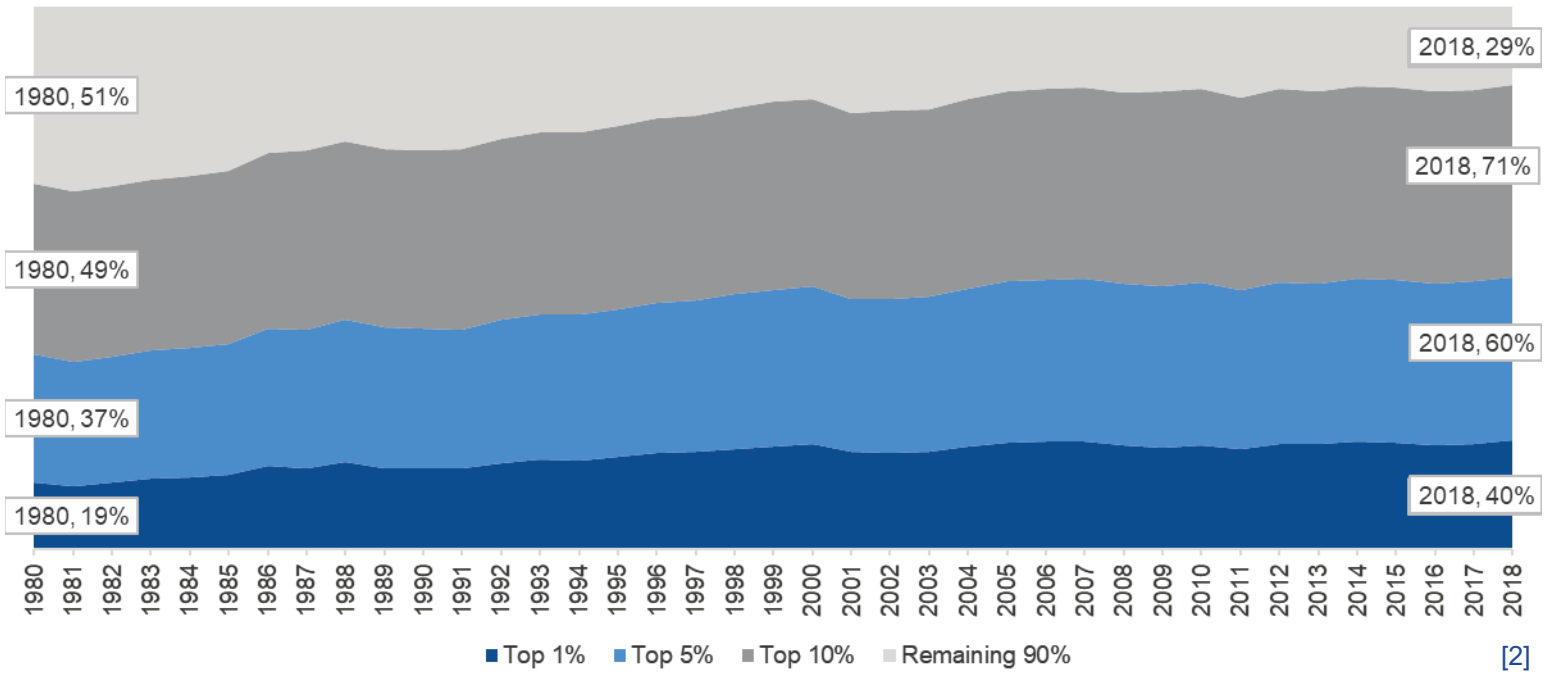
| Category Based<br>on Federal AGI | AGI brackets          | Number of<br>Tax Returns | (In Millions \$)     | Percent of                               | (In Millions \$)             | Percent of                                |             |            |
|----------------------------------|-----------------------|--------------------------|----------------------|--|------------------------------|---|-------------|------------|
|                                  |                       |                          | Total<br>Federal AGI | Total Federal AGI<br>Category Cumulative | Federal Income<br>Taxes Paid | Federal Taxes Paid<br>Category Cumulative |             |            |
| Top 1%                           | \$540,009 and up      | 1,443,179                | \$ 2,420,025         | 21%                                      | 21%                          | \$ 615,716                                | 40%         | 40%        |
| Top 2% - 5%                      | \$217,913 - \$540,009 | 5,772,714                | 1,797,971            | 16%                                      | 36%                          | 310,651                                   | 21%         | 60%        |
| Top 6% - 10%                     | \$151,935 - \$217,913 | 7,215,894                | 1,293,121            | 11%                                      | 48%                          | 169,976                                   | 11%         | 71%        |
| Top 11% - 25%                    | \$ 87,044 - \$151,935 | 21,647,680               | 2,458,004            | 21%                                      | 69%                          | 239,698                                   | 16%         | 87%        |
| Top 26% - 50%                    | \$ 43,614 - \$ 87,044 | 36,079,466               | 2,252,693            | 19%                                      | 88%                          | 155,000                                   | 10%         | 97%        |
| Bottom 50%                       | under \$ 43,614       | 72,158,933               | 1,342,069            | 12%                                      | 100%                         | 45,137                                    | 3%          | 100%       |
|                                  |                       |                          | <b>144,317,866</b>   | <b>\$ 11,563,883</b>                     | <b>100%</b>                  | <b>\$ 1,536,178</b>                       | <b>100%</b> | <b>[1]</b> |

The chart shows that the top 1% of taxpayers (AGI above \$540,009) earned 21% of the income (as measured by Federal Adjusted Gross Income) and paid 40% of the total federal income taxes. Add in the next 4% and we see that the top 5% of taxpayers earned 36% of the income and paid 60% of the taxes. Combine that with the next 5% and we see that the top 10% of taxpayers earned 48% of the income and paid 71% of the taxes. Again, top 10% of taxpayers earned 48% of the income and paid 71% of the taxes.

The chart on the next page shows the percentage of the total federal income taxes paid by differing taxpayer income categories back to 1980. The chart helps visualize the shift in income tax payments towards the higher earning taxpayers. In 1980 the top 1% paid 19% of the total federal income taxes while in 2018 they paid 40%. The top 5% paid 37% in 1980 vs. 60% in 2018. And the top 10% earning taxpayers paid 49% of the federal income taxes in 1980 while paying 71% of the 2018 taxes.

The top 10% of  
taxpayers earned  
48% of the income  
and **PAID 71%**  
**OF THE TAXES**

**Percent of Total Federal Income Taxes Paid by Each Income Category: 1980-2018**



[2]

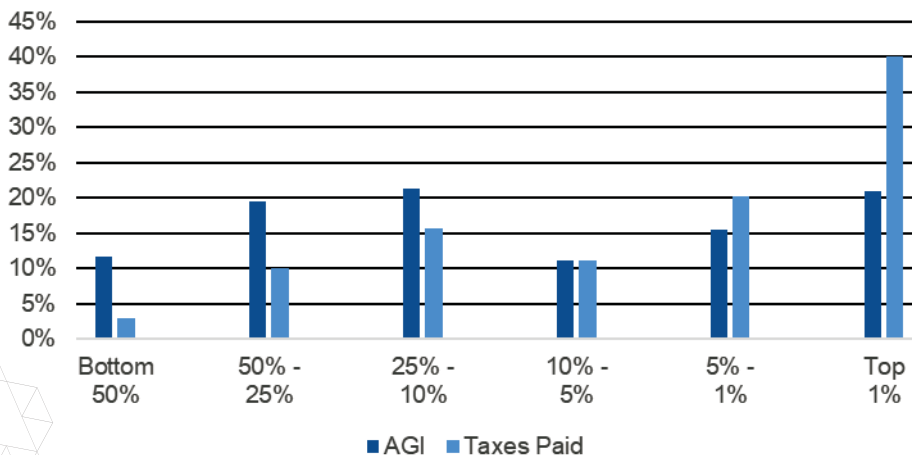
Below, we see that only the top 10% of taxpayers pay more than 10% of their federal adjusted gross income in federal income taxes while the remaining 90% of all tax filers pay 10% or less of their adjusted gross income in federal income taxes.

| Category Based on Federal AGI | AGI brackets          | Number of Tax Returns | (In Millions \$)<br>Total Federal AGI | (In Millions \$)<br>Federal Income Taxes Paid | Federal Taxes Paid as a % of Federal AGI |
|-------------------------------|-----------------------|-----------------------|---------------------------------------|---|--|
| Top 1%                        | \$540,009 and up      | 1,443,179             | \$2,420,025                           | \$615,716                                     | 25%                                      |
| Top 2% - 5%                   | \$217,913 - \$540,009 | 5,772,714             | 1,797,971                             | 310,651                                       | 17%                                      |
| Top 6% - 10%                  | \$151,935 - \$217,913 | 7,215,894             | 1,293,121                             | 169,976                                       | 13%                                      |
| Top 11% - 25%                 | \$ 87,044 - \$151,935 | 21,647,680            | 2,458,004                             | 239,698                                       | 10%                                      |
| Top 26% - 50%                 | \$ 43,614 - \$ 87,044 | 36,079,466            | 2,252,693                             | 155,000                                       | 7%                                       |
| Bottom 50%                    | under \$ 43,614       | 72,158,933            | 1,342,069                             | 45,137  | 3%                                       |
|                               |                       | <b>144,317,866</b>    | <b>\$11,563,883</b>                   | <b>\$1,536,178</b>                            | <b>13%</b>                               |

[3]

And finally, we see that the bottom 90% of taxpayers pay a substantially lower percentage of the total taxes than they earn of the total income, while the top 5% pay a substantially higher percentage of the total taxes compared to their percentage of the total income.

**Share of Federal AGI vs Share of Income Taxes Paid By Income Category: 2018**

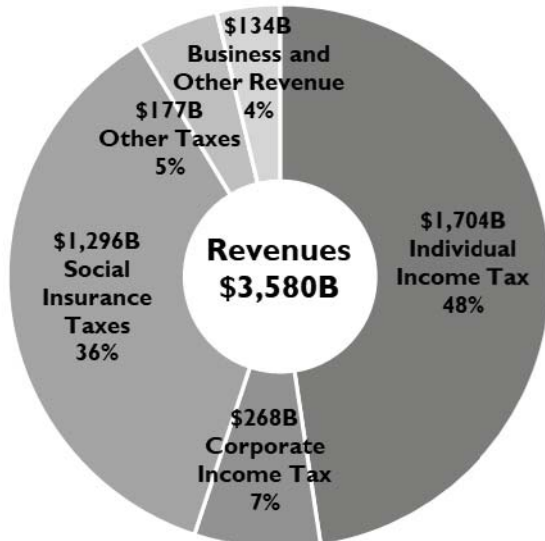


[4]

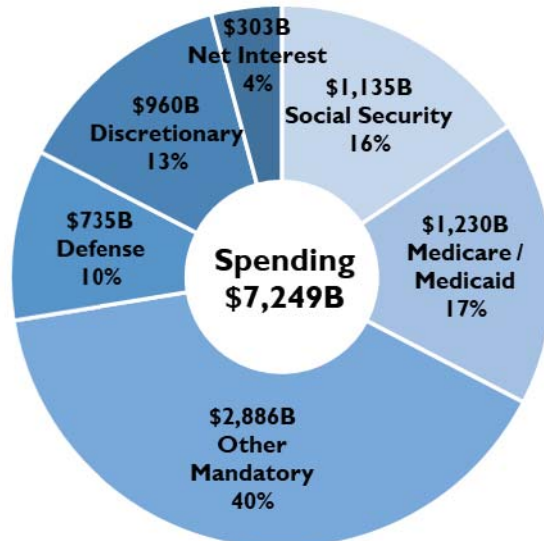
It is also important to point out that since 1980 the average tax rate actually paid has come down for all taxpayers. Who has benefited “the most” will be part of the debate.

- In 1980 the average tax rate (federal income taxes paid as a percent of federal adjusted gross income) was 26.85% for the top 5% and 6.10% for the bottom 50% of tax return filers.
- In 2018 the average tax rate was 21.96% for the top 5% and 3.36% for the bottom 50% of tax return filers.
- The decrease in average tax rate (raw %) from 1980 to 2018 is 4.89% for the top 5% and 2.74% for the bottom 50% of tax return filers.
- Another way of saying the same thing is that the decrease in the average tax rate (as a % of the 1980 rate) is 18% (4.89 / 26.85) for the top 5% and 55% (3.36 / 6.10) for the bottom 50% of tax return filers.

Any discussion of spending and taxes should be accompanied by a consideration of the Federal budget and our national debt. The following pie-charts show the sources of the U.S. revenue and the categories of the U.S. expenditures for the 2021 fiscal year. Individual income taxes make up 48% of the total Federal revenue. Looking at the expenditures we see that 73% of the total spending is made up of Social Security, Medicare, Medicaid and other mandatory programs, 4% is net interest on the national debt leaving only 23% “in play”. Of that 23%, defense spending accounts for 10% and other discretionary expenses make up the remaining 13%.



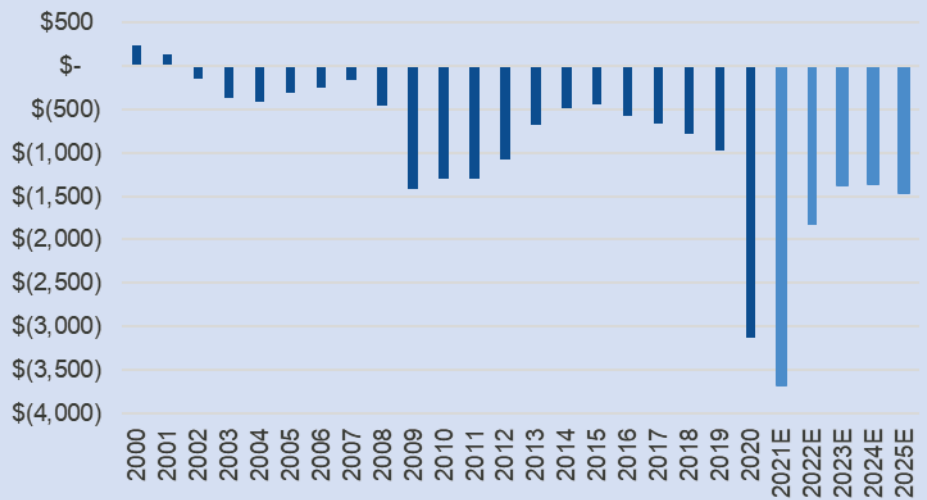
[5]



[6]

The next two charts show the annual deficits and the gross national debt in dollars. We are planning to spend \$9.3 trillion more than we collect over the next 5 years which is adding to our existing debt of \$27 trillion. To put that into perspective, all of the billionaires in the U.S. (724 per Forbes 2021 billionaires listing) are worth a collective \$4.4 trillion. That means if we confiscated ALL of the wealth of every billionaire in the U.S. it would cover less than half of the next five years proposed deficits!

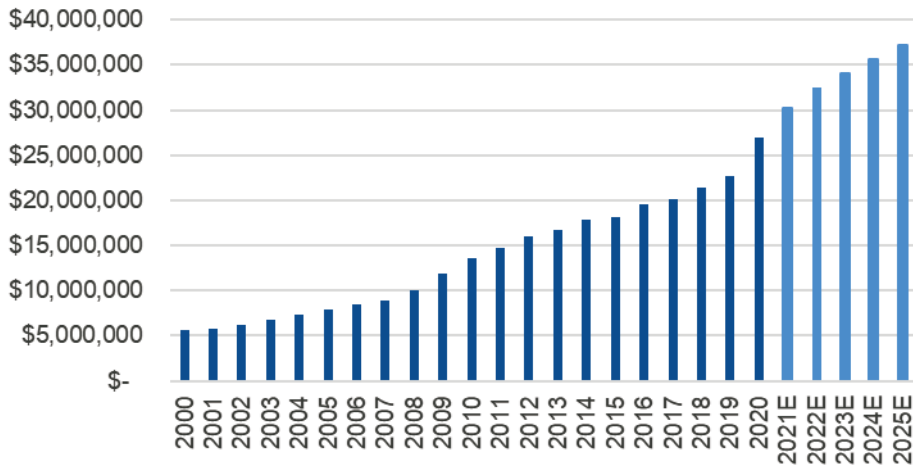
U.S. Federal (Deficit) Surplus \$ in Billions 2000-2025E



[7]

The wealth of ALL U.S. Billionaires would cover LESS THAN HALF of the proposed deficits over the next five years.

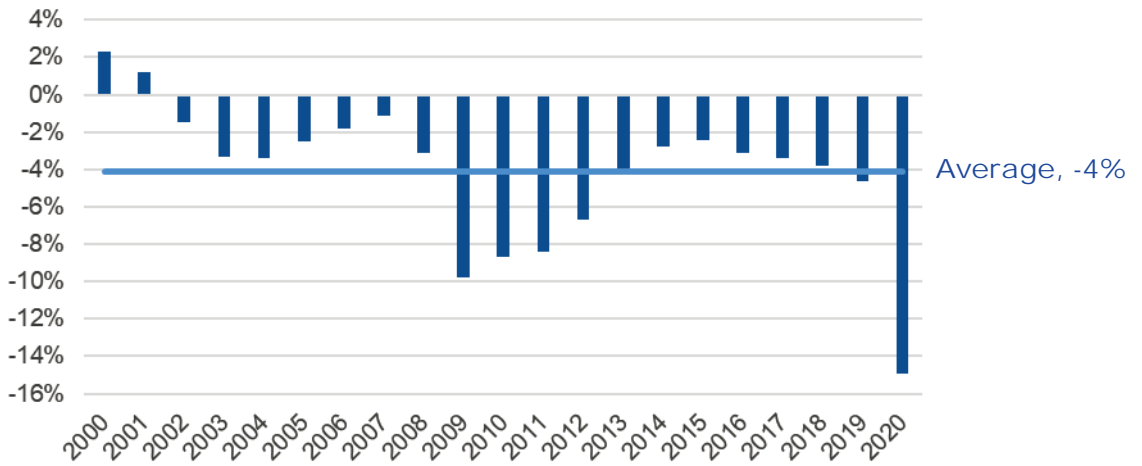
**U.S. Gross Public Debt \$ in Billions 2000-2025E**



[8]

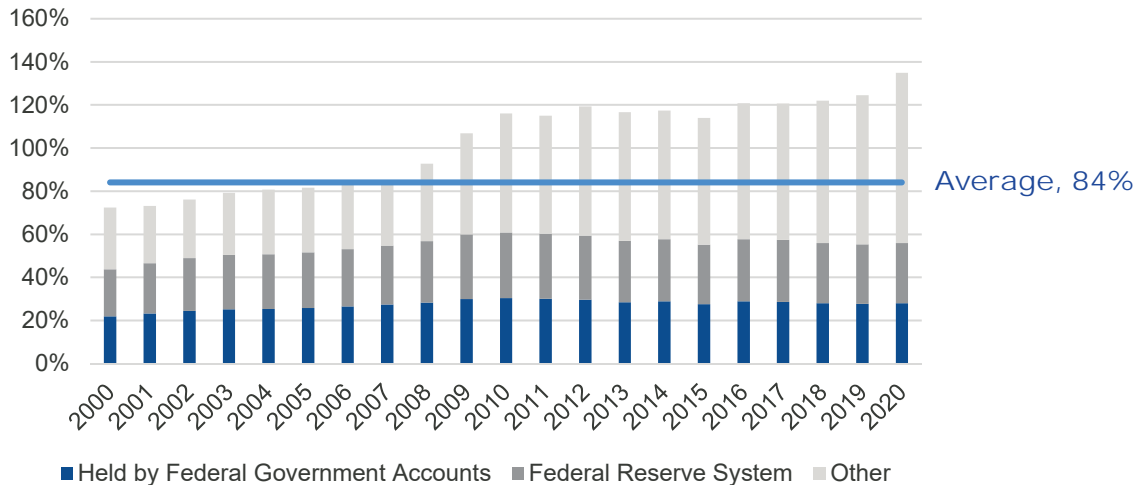
The same data is shown as a percentage of the U.S. GDP to give perspective to the data in comparison to the size of the U.S. economy (as measured by the GDP).

**U.S. Federal Deficit (Surplus) as % of GDP 2000-2020**



[9]

**U.S. Debt as % of GDP 2000-2020**



[10]

And that transitions us to the current talk of the proposed tax changes. It is important to note that at the current time there is bill that has passed the House Ways & Means Committee, but has not been voted on by either the House or the Senate. We expect this bill to be the framework for whatever is agreed upon in the final tax bill to be presented to the President for signing.

Items in the framework affecting individual income tax filers are as follows (effective for 2022 unless stated):

- Increases the top tax rate from 37% to 39.6%
- Reduces the income level to reach the new top rate from \$523,600 to \$450,000
- Increases the top capital gain rate from 20% to 25%
- Reduces the income level to reach the new capital gain rate from \$501,600 to \$450,000
- New capital gain rate would go into effect for transactions entered into on or after September 14, 2021 unless subject to a binding agreement dated September 13, 2021 or prior
- Creates a new 3% surtax on income over \$5 million (bringing the top tax rate to 42.6%)
- Subjects Sub Chapter S income to the 3.8% Net Investment Income Tax (NIIT) for filers with income above \$500,000
- Caps the deduction for Qualified Business Income (QBI) at \$500,000 – this affects business owners who report their business income on their personal tax returns
- Extends the current Child Tax Credit to 2025 which is set to expire at end of 2021
- Eliminates the “back-door” Roth strategy for those earning over \$208,000
- Institutes new Required Minimum Distributions (RMD) for those earning over \$450,000 and owning retirement assets totaling over \$10 million
- Not in the current bill is the elimination of the \$10,000 limit for deducting state & local taxes as an itemized deduction (leaving that change to be determined in the final Bill)

Items in the framework affecting corporate tax filers are as follows:

- Increases the corporate tax rate from a flat 21% to a tiered tax rate structure of 18% on income under \$400,000 to a maximum tax rate of 26.5% for income over \$5 million

Items in the framework affecting Estate and Gift taxes are as follows:

- Reduces the estate & gift tax lifetime exclusion from \$11.7 million to \$6 million.
- Changes the benefits of “Grantor Trusts” as a transfer strategy. This affects the use of Intentionally Defective Grantor Trusts (IDGT) and Spousal Lifetime Access Trusts (SLAT) as planning tools. Proposed changes to be effective on the date that the final bill is signed by the President. Trusts in existence as of the effective date would be grandfathered under existing law.
- Eliminates the use of valuation discounts for family partnerships and entities transferring non-business assets held by that entity.

Tax changes have some hurdles to overcome before any bills are passed and the final legislation is signed by the President. At this time, the tax proposals are going to be part of the massive reconciliation bill (needing only simple majority in the Senate) which includes the \$3.5 trillion spending plan being debated.

While most people only think of taxes once a year, we think about them all year long. We will be closely following the tax bill's progress all along the way. Wealth transfer strategies are an important part of our planning process. Taxes on differing investment options are an integral part of an overall investment strategy. We have no control over what comes out of Washington, but we can help clients understand the impact that taxes have on their financial and investment strategies.

If you know of someone who could benefit from our services, please pass our name along. We would enjoy the opportunity to share our experiences with others.

Prior newsletters are archived on our website at [www.jvlwealth.com](http://www.jvlwealth.com)

By: Jerry VanderLugt CPA, CFP®, CVA

## REFERENCES

- [1] Information obtained from Internal Revenue Service, accessed at [www.taxfoundation.org](http://www.taxfoundation.org)
- [2] Information obtained from Internal Revenue Service, accessed at [www.taxfoundation.org](http://www.taxfoundation.org)
- [3] Information obtained from Internal Revenue Service, accessed at [www.taxfoundation.org](http://www.taxfoundation.org)
- [4] Information obtained from Internal Revenue Service, accessed at [www.taxfoundation.org](http://www.taxfoundation.org)
- [5] Information obtained from Office of Management and Budget, accessed at <https://www.govinfo.gov/app/collection/budget/2021>
- [6] Information obtained from Office of Management and Budget, accessed at <https://www.govinfo.gov/app/collection/budget/2021>
- [7] Information obtained from Office of Management and Budget, accessed at <https://www.whitehouse.gov/omb/historical-tables/>
- [8] Information obtained from Office of Management and Budget, accessed at <https://www.whitehouse.gov/omb/historical-tables/>
- [9] Information obtained from Office of Management and Budget, accessed at <https://www.whitehouse.gov/omb/historical-tables/>
- [10] Information obtained from Office of Management and Budget, accessed at <https://www.whitehouse.gov/omb/historical-tables/>



1535 44th St SW, Suite 400  
Wyoming, MI 49509  
616.261.2800  
[www.jvlwealth.com](http://www.jvlwealth.com)