

## NIIT Expansion Under Proposed Build Back Better Act Includes Subtle Tax Increase on Sales of Private Businesses

Alert

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In general, tax experts were pleased that the Build Back Better Act, passed recently by the U.S. House of Representatives, did not include many of the tax increases previously proposed by the Biden Administration. Excluded, for example, were significant increases in the tax rate on capital gains and the corporate income tax rate, as well as a possible repeal of the special deduction for "qualified business income."

A careful review of the act in its current form reveals, however, that sellers of any private business, and many S corporation shareholders, would face a new 3.8% tax, effective January 1, 2022. This tax increase occurs because of an expansion of the scope of the 3.8% net investment income tax (NIIT) under the act. Under existing law, the NIIT does not apply to (1) income allocated to an S corporation shareholder (if the shareholder materially participates in the business of the S corporation, which is usually the case), (2) gain from the sale of S corporation stock or an interest in a partnership or limited liability company (if the selling owner materially participates in the business being sold) or (3) gain from the sale of the assets of a partnership, limited liability company or S corporation (if such gain is allocated to an owner who materially participates in the business being sold).

Under the act, the expanded NIIT would apply to all income earned by an individual, unless such income is either taxable wages or subject to the self-employment tax. (Note: The expanded NIIT would apply to individuals filing a joint return and having adjusted gross income over \$500,000, or single individuals having adjusted gross income over \$400,000.) None of the items listed in the preceding paragraph is subject to the self-employment tax, so under the act, these items would now be subject to the tax increase.

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In sum, the expanded NIIT would impose a new 3.8% tax on (1) most income allocated to an S corporation shareholder and (2) gain from the sale of the interests in, or the assets of, any private business taxed as an S corporation or a partnership (all effective January 1, 2022) provided the owners exceed the adjusted gross income thresholds in the prior paragraph.

It is not yet clear whether the U.S. Senate will pass the act before the end of the this year, but if this were to occur, it would place a premium on closing pending business sales on or before December 31. If the act passes in its current form, gain from the sale of a private business would be subject to a new 3.8% tax, effective January 1, 2022.

### **CONTACT**

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