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Tax Impact of Proposed Build Back Better Act on Taxable VEBAs

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If you oversee taxable assets (or are curious), continue reading. Otherwise, enjoy your weekend.

As we're approaching the end of the year, we wanted to point out potential tax rate changes for taxable VEBA Trusts in 2022. Under the version of the Build Back Better Act (BBB) passed by the house, the Trust tax rates which apply to taxable VEBA Trusts could rise materially. While the 5% and additional 3% surcharges on adjusted gross income for individuals do not kick in until $10m and $25m respectively, those numbers are reduced to $200k and $500k for taxable Trusts. This would increase the income and capital gains tax rate by 8 percentage points.

Additionally, VEBAs are currently exempt from Net Investment Income Tax (NIIT) — 3.8%. Furthermore, there is a push to widen the base for the 3.8% NIIT from which Trusts are currently exempt. While the details in the proposal are still a bit murky, it's clear the Act intends to expand the application of the NIIT.

The combined impact could cause capital gains, income, and dividends to see tax rates rise by 11.8 percentage points if the Act moves along in its current state.

If you anticipate any liquidity needs or rebalancing activity in the near future, it may make sense to accelerate the trading into 2021. Furthermore, if the current Trust tax increases within the Act are removed, paying a tax "today" by realizing gains in 2021 merely accelerates a tax that would have otherwise been paid in the future at the same tax rate. The dollar cost of realizing those gains can be measured by calculating the present value of the tax over the investment horizon discounted using after-tax Treasury rates. This cost can be compared to your assessment of the legislation in its current form ultimately becoming law.

We'd be happy to discuss in further detail on this topic and/or other taxable assets if you'd like.

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