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President Biden's Proposed American Families Plan

President Biden released a fact sheet on his just proposed changes to the tax system early on April 28, 2021.

Warning! This is just a proposal by President Biden. As such it is short on details. This is not law and some or all of it will not become law. The following is for information purposes only and should not be acted upon until final law is passed.

We would expect final legislation, if any, to occur in the fourth quarter of this year. The political landscape is unique in 2021, with the expiration of the emergency debt ceiling suspension expiring at the end of July, 2021 and the razor thin Democratic control in the Senate which will in effect give every Senator effective veto power as they try to pass legislation through the budget reconciliation process.

The 15-page fact sheet outlines a tax and spend bill which details more than just tax proposals. Most of the document is dedicated to spending initiatives for education, childcare, nutrition, and family leave. Our summary of this fact sheet we will only focus on the tax proposals.

Key Tax Proposals

- **The top marginal federal tax rate would go up to 39.6% from 37% for individuals:** The proposal would restore the top marginal individual income tax rate to 39.6%.

- **The special capital gain rates will go away for "households making over $1 million":** The proposal would eliminate the lower rate on long term capital gains and dividends for certain taxpayers subjecting this income to ordinary income tax rates (proposed top rate of 39.6%).

- **Broaden the net investment income tax of 3.8% to apply the taxes consistently to "those making over $400,000."** The proposal would subject those making over $400,000 to the 3.8 percent additional Medicare tax. It appears this is meant to insure that income in excess of $400,000 would be either subjected to Medicare taxes or the net investment income tax. Currently if a person is actively involved in an S corporation, any flow-through income the person receives from the S corporation is not subject to either Medicare taxes or the net investment income tax.

- **Significant reduction in step-up of basis on inherited assets.** Potentially far more significant is the apparent taxation of excess appreciation in assets held when a person dies. The President's plan will close this loophole, ending the practice of "stepping-up" the basis for gains in excess of $1 million ($2.5 million per couple when combined with existing real estate exemptions) and making sure the gains are taxed if the property is not donated to charity.
    - While not fully clear, it is possible that those gains in excess of $1,000,000 will be taxed under a mark-to-market system upon death. Although the statement never explicitly says that. If the gain is immediately subjected to tax it seems the basis would be stepped up, yet it seems contradictory to the reference of

ending the practice of "stepping up" basis. On the other hand, the proposal could simply be to limit basis step-up at death but without eliminating the estate tax in exchange for the loss of basis step-up

   - Obviously, details will be very important for this provision, including how this will apply to assets passed to a surviving spouse.
   - The fact sheet also notes that some form of protection for family-owned businesses will be part of the proposed bill. However, there are no details as to what the protections will be.

- **Elimination of capital gains treatment on carried interests:** An issue that was heavily discussed during the process of passing the Tax Cuts and Jobs Act ("TCJA"), this proposal would tax *carried interests* as ordinary income and presumably eliminate the water down treatment under TCJA.

- **Elimination of like-kind exchange deferral for real estate gains more than $500,000.** The Tax Cuts and Jobs Act eliminated like-kind exchange treatment for any assets aside from real estate held for income producing or business purposes. The new proposal would limit deferral of gains greater than $500,000.

- **Tax Cuts and Jobs Act limitation on the deduction of excess business losses for individuals made permanent**. The proposal would also permanently extend the current limitation in place that restricts large, excess business losses.

- **Reporting of cash inflows/flows for accounts by financial institutions**: As part of a focus on increasing tax enforcement activities against higher income taxpayers, the law would add a provision that "would require financial institutions to report information on account flows so that earnings from investments and business activity are subject to reporting more like wages already are." Presumably that information would be used to identify audit candidates, and would likely require explanation of things such as the sources of funds coming into accounts in excess of reported income.

- **Make permanent or extend several individual tax credits added in the American Rescue Plan Act.** The proposal looks to make permanent or significantly extend a number of new individual tax credits that were added on a temporary basis in the American Rescue Plan Act of 2021. These provisions include:
    - Extend expanded ACA premiums tax credits in the American Rescue Plan
    - Extend the Child Tax Credit increases in the American Rescue Plan through 2025 and make the Child Tax Credit permanently fully refundable.
    - Permanently increase tax credits to support families with child care needs (the credit for child care).
    - Make the Earned Income Tax Credit Expansion for childless workers permanent.

According to the Tax Foundation General Equilibrium Model, the tax provisions in the American Families Plan would reduce the economy's size by 0.4 percent in the long run, primarily by increasing marginal tax rates on labor and investment in the pass-through business sector. The capital stock would fall by 0.7 percent, wages by 0.4 percent, and employment by about 64,000 full-time equivalent jobs. GNP, which measures American incomes, would fall by 0.6 percent.