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GMS Flash Alert

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United States - American Families Plan Revealed with Tax Increases for High-Income Individuals

In anticipation of U.S. President Joseph R. Biden's address to a joint session of Congress on April 28, the White House released a fact sheet detailing the individual income tax provisions contained in the "American Families Plan,"[1] the second part of the Administration's economic recovery plan.[2] The American Families Plan ("the Plan") is estimated to have a revenue cost of $1.8 trillion, consisting of $1 trillion in spending on "human infrastructure" – education and training, child care, and other social welfare items – and $800 billion in tax benefits to support lower-income earners. The cost of the Plan would be offset by increases in individual income taxes for high-income taxpayers.

WHY THIS MATTERS

If enacted, the individual income tax proposals included in the Plan would affect assignees' U.S. tax obligations and could raise overall mobility program costs, depending on the provisions of an employer's policy and the income levels of its assignees. However, the actual impact to assignees and programs will depend on the technical details of any legislation negotiated in Congress.

The American Families Plan

According to the fact sheet, the American Families Plan presently includes the following individual income tax proposals:

- Raise the top individual income tax rate from 37 percent back to 39.6 percent[3];
- Raise the tax rate on capital gains and qualified dividends for households with income over $1 million to 39.6 percent;
- Extend the child tax credit expansion enacted in the American Rescue Plan Act through 2025 and make the child tax credit fully refundable on a permanent basis[4];
- Make the temporary changes to the child and dependent care tax credit included in the American Rescue Plan Act of 2021 permanent[5];

- Tax unrealized capital gains at death and eliminate stepped-up basis for gains in excess of $1,000,000 ($2,500,000 per couple when combined with existing real estate exemptions), with exceptions for donations to charity[6];
- Treat carried interest as ordinary income;
- End tax deferral for Internal Revenue Code (I.R.C.) section 1031 like-kind exchanges for gains in excess of $500,000;
- Permanently extend the current limitation in place that restricts large, excess business losses[7];
- Expand the Affordable Care Act (ACA) premium tax credits;
- Make the earned income tax credit (EITC) expansion for childless workers permanent;
- Apply the 3.8-percent Medicare tax "consistently to those making over $400,000," which may be referring to changing the application of Net Investment Income Tax to active owners of passthrough entities, and/or eliminating the exemption from self-employment tax for limited partners.

Increase to Top Individual Income Tax Rate

The 2017 tax law commonly known as the "Tax Cuts and Jobs Act" (TCJA) temporarily lowered the top individual income tax rate from 39.6 percent to 37 percent for tax years 2018 through 2025. Under the Plan, the top individual income tax rate would revert to its pre-TCJA rate of 39.6 percent.

KPMG NOTE

It is not clear whether the tax bracket amounts would be affected by this change.

The Biden Administration has pledged that the individual income tax changes will not increase taxes on taxpayers earning less than $400,000.

Increase to Capital Gain Tax Rates for High-Income Earners

Under current law, long-term capital gains and qualified dividends are taxed at a rate of 0 percent, 15 percent, and 20 percent, with the applicable tax rate based on a taxpayer's taxable income and filing status. The Plan would modify these rates by imposing a tax of 39.6 percent on long-term capital gains and qualified dividends for households making over $1,000,000.

KPMG NOTE

It is unclear based on the details provided in the fact sheet whether the $1,000,000 threshold will vary based on a taxpayer's filing status.

Child Tax Credit

The Internal Revenue Code generally provides taxpayers with a child tax credit of up to $2,000 per qualifying dependent child under the age of 17 with a Social Security Number ("SSN"). This credit is phased out by $50 for each $1,000 by which a taxpayer's modified adjusted gross income ("MAGI") exceeds $200,000 ($400,000 for married couples filing jointly). MAGI for this purpose includes income excluded from adjusted gross income under the foreign earned income exclusion. The credit is generally refundable up to $1,400 per qualifying dependent child if the taxpayer has earned income of up to $2,500 and does not claim the foreign earned income exclusion.

The American Rescue Plan Act of 2021 made temporary modifications to the child tax credit for the 2021 tax year, in that it increased the amount of the child tax credit to $3,000 per qualifying child age 6 and older and $3,600 per qualifying child under the age of 6. It also expanded the definition of "qualifying child" to include a dependent child under the age of 18. For taxpayers with a principal place of abode[8] in the United States for more than one-half of the 2021 tax year, the child tax credit is fully refundable.[9]

In addition, *The American Rescue Plan Act of 2021* created a new phase-out range that applies to the increased credit amount allowed for 2021. The increased credit of $1,000 per qualifying child (or $1,600 per qualifying child under age 6) is phased out by $50 for each $1,000 by which a taxpayer's MAGI exceeds $75,000 ($112,500 for head of household; $150,000 for married couples filing jointly). The remaining $2,000 per qualifying child credit is subject to the same phase-out rules as in prior years – it is reduced by $50 for each $1,000 that the taxpayer's MAGI exceeds $200,000 ($400,000 for married couples filing jointly).

The American Rescue Plan Act of 2021 also added a new section to the Internal Revenue Code[10] that directs the Treasury to establish a temporary program for making advanced periodic payments during 2021 to taxpayers equal to what the Treasury estimates to be 50 percent of the refundable child tax credit amount based on the taxpayer's prior year tax return, considering the passage of time with respect to the ages (and status as qualifying children) of the taxpayer's children.

Under the Plan, the expansion of the child tax credit under *The American Rescue Plan Act of 2021*, including the disbursement of advanced periodic payments, would be extended through the 2025 tax year, rather than expiring after 2021, and the Plan would make the child tax credit permanently fully refundable for taxpayers with a principal place of abode in the United States for more than one-half of the tax year. The Plan does not modify the nonrefundable $500 credit for other dependents.

KPMG NOTE

To be eligible to claim the foreign earned income exclusion, an assignee must generally not have an abode within the United States (unless the assignee is in a combat zone in support of the U.S. Armed Forces). Thus, individuals who qualify for the foreign earned income exclusion for more than one-half of the tax year, even if they do not claim the foreign earned income exclusion, will generally not qualify for the increased refundable portion of the child tax credit.

Child and Dependent Care Credit

Similar to the child tax credit, the Plan proposes to make permanent the temporary child and dependent care tax credit ("CDCTC") expansion enacted in *The American Rescue Plan Act of 2021*.[11] Under the Plan, families making less than $125,000 a year are eligible to claim a credit for 50 percent of their expenses related to qualified child care for children under the age of 13. The amount of qualified expenses eligible for the credit is limited to $8,000 for one child or $16,000 for two or more children. As such, the maximum credit allowed under the Plan is $4,000 ($8,000 for two or more children under age 13). Families with income between $125,000 and $400,000 will receive a partial credit. The credit can be used for expenses ranging from full-time care to after-school care to summer care.

KPMG NOTE

The descriptions in the fact sheet are very "high level" and do not include technical detail or effective dates. More detail on the Biden Administration's proposal can be expected in the Treasury Department's description of tax proposals in the budget (the "Greenbook") which is expected by late May or early June 2021.

The Biden Administration might also announce additional tax proposals as the process moves forward (including in the Treasury Greenbook). For example, several tax changes proposed by the president during the campaign have not been included in today's release but might be included in the Greenbook. Further, Congress can be expected to add, drop, and modify proposals as it considers legislation implementing the plan. Congressional leadership, as one example, has indicated an interest in revisiting the limit on the deduction for state and local taxes.

Furthermore, the narrow margin of Democratic control in the Congress presents legislative challenges and may affect the prospects, process, and details of this proposed legislation.

FOOTNOTES:

1 Prior to President Biden's address, the White House released a fact sheet on these proposals: https://www.whitehouse.gov/briefing-room/statements-releases/2021/04/28/fact-sheet-the-american-families-plan/.

2 See *GMS Flash Alert* 2021-101 (April 1, 2021) for details of the first part of the Administration's recovery plan.

3 The 2017 tax law commonly known as the "Tax Cuts and Jobs Act" temporarily lowered the top individual tax rate to 37 percent for tax years 2018 through 2025.

4 See *GMS Flash Alert* 2021-079 (March 10, 2021) for an overview of the changes the American Rescue Plan Act made to the child tax credit.

5 See *GMS Flash Alert* 2021-079 (March 10, 2021) for an overview of the changes the American Rescue Plan Act made to the child and dependent care tax credit.

6 This proposed provision will be designed with protections so that family-owned businesses and farms will not have to pay taxes when given to heirs who continue to run the business.

7 See *GMS Flash Alert* 2021-079 (March 10, 2021) for an overview of the changes the American Rescue Plan Act made to the limitation on excess business losses for noncorporate taxpayers.

8 As defined in I.R.C. § 32.

9 In the case of a joint return, only one spouse needs to have a principal place of abode in the United States for more than one-half of the 2021 tax year.

10 I.R.C. § 7527A.

11 See *GMS Flash Alert* 2021-079 (March 10, 2021) for an overview of the changes the American Rescue Plan Act made to the child and dependent care tax credit.

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