ROPES & GRAY

Capital Insights

Perspectives on the New Administration

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American Family Plan—Summary of Certain Key Tax Components

*****These legal developments are still in progress. We will update this Alert as the Plan makes its way through the legislative process.*****

On Wednesday April 28, 2021, President Joseph R. Biden announced the American Families Plan, designed to expand access to education, child care, and health care, among other initiatives. The White House released a fact sheet outlining the plan, and Biden detailed the plan in an address to Congress.[1] The American Families Plan would be funded by increasing tax enforcement on corporations and high-income taxpayers, enforcement of which would be supported by newly enhanced information reporting from financial institutions. The initiatives would also be funded by raising taxes on high-income taxpayers, including (i) increasing the top income tax rate to 39.6% from 37%, (ii) increasing the capital gains rate to 39.6% from 20% for those earning $1 million or more, (iii) eliminating a step-up in basis for gains in excess of $1 million, (iv) eliminating the carried interest loophole, (v) eliminating the special real estate tax break on gains greater than $500,000, (vi) extending the limitation that restricts excess business losses, (vii) and ensuring those making over $400,000 pay the same consistent 3.8% Medicare tax. These proposals are summarized in this Alert.

President Biden has also recently proposed investing $80 billion in the Internal Revenue Service (IRS) for enforcement funding and giving IRS the authority to regulate paid tax preparers.[2] The plan did not address expansion of the state and local tax (SALT) deduction, which is currently capped at $10,000. The American Families Plan follows the $2.3 trillion American Jobs Plan and Made in America Tax Plan released at the end of March and is the second part of President Biden's Build Back Better agenda. (*See* Ropes & Gray April 6, 2021 Alert.)

American Families Plan—Highlight of Key Tax-Related Components

1. The tax plan would revitalize and focus enforcement efforts on higher earners and high net worth individuals (in addition to the enforcement effort described in the Made in America Tax Plan). As part of the current proposal, additional resources will be devoted to increasing enforcement against those earning over $400,000 per year and introducing mandatory reporting by financial institutions of account flows for investment and business activities.

2. The tax plan would raise the top marginal income tax rate to 39.6% from 37%.

    - TCJA History: The 2017 Tax Cuts and Jobs Act (TCJA) reduced the top federal income tax rate from 39.6% to 37%. The plan seeks to restore such tax rate to 39.6%.

    - This new top marginal income tax rate would apply to the wealthiest 1% of Americans (described as those making over $400,000).

3. The tax plan would raise capital gains and dividends tax to 39.6% from 20% for households earning $1 million or more.
    - Currently, the top tax rate for long-term capital gains (*i.e.*, gains on the sale of capital assets that have been held for more than one year) and corporate dividends is 20%.
    - The plan would increase this rate to 39.6%, the proposed top marginal income tax rate, for households making over $1 million (the top 0.3% of Americans).
4. The tax plan would end the practice of stepping up a transferee's tax basis in property received from a decedent for gains greater than $1 million.
    - The plan would protect family-owned businesses and farms, so that these types of businesses would not be taxed if being passed to heirs who would continue to run the business.
    - The plan would contain an exception for property donated to charity.
5. The tax plan would permanently close the carried interest loophole, often used by investment managers to earn income at lower capital gains rates instead of the higher ordinary income rates.
    - The plan has not addressed the mechanics of this change, but has stated that, by closing the loophole, hedge fund partners would pay ordinary income tax rates on their incomes.
6. The tax plan would eliminate deferral of taxable gain for like-kind exchanges with gains greater than $500,000.
    - TCJA History: Historically, taxable income could be deferred for gains from like-kind exchanges (of any value) and prior to the TCJA, this special treatment applied to many kinds of property. The TCJA limited the special treatment of like-kind exchanges to real property only.
    - The proposal would limit the like-kind exchange for gains greater than $500,000, under section 1031 of the Internal Revenue Code of 1986 (the Code).
7. The tax plan would extend restrictions on excess business losses.
    - TCJA History: The TCJA limited excess business losses for non-corporate taxpayers under Code section 461(l). The limitation applies at the individual level for business losses in excess of $250,000 of the taxpayer's income attributable to that trade or business ($500,000 for joint returns). This provision was set to expire in 2025.
    - Cares Act History: Extended through 2026 and retroactively repealed the limitation for 2018–2020.

- The proposal will permanently extend the 461(l) excess business loss limitation.

8. The tax plan would ensure those making over $400,000 consistently pay Medicare taxes (at consistent rates) regardless of the source of income.

9. As part of the broader American Families Plan, the administration proposes several tax cuts for families with children and American workers, including: extending the Child Tax Credit, the Earned Income Tax Credit, and the Child and Dependent Care Tax Credit. In addition, the plan would extend the health insurance tax credits previously introduced in the American Rescue Plan.

1. *See also* White House Press Briefing, *Background Press Call by Senior Administration Officials on the American Families Plan* (Apr. 28, 2021), https://www.whitehouse.gov/briefing-room/press-briefings/2021/04/28/background-press-call-by-senior-administration-officials-on-the-american-families-plan/.

2. U.S. Department of Treasury, *Investing in the IRS and Improving Tax Compliance* (Apr. 28, 2021), https://home.treasury.gov/news/press-releases/jy0150.