Insight

The American Rescue Plan's Major Tax Policy Changes

GORDON GRAY | FEBRUARY 12, 2021

Executive Summary

- The House of Representatives is considering a $1.9 trillion fiscal package under the reconciliation process, including several substantial provisions under the jurisdiction of the Ways and Means Committee.
- Among the costliest provisions in the package are tax provisions, most conspicuously a third round of direct payments of $1,400 per taxpayer.
- The plan contains substantial expansions to federal transfer programs under the guise of "temporary" COVID-19 policy, notwithstanding that these policies have been progressive priorities for years.

Introduction

The House of Representatives is currently considering a fiscal package under reconciliation procedures, as the budget resolution instructed 12 House committees and 11 Senate committees to report legislation amounting to nearly $1.9 trillion in new tax and spending programs. Under reconciliation rules, legislation can be considered and enacted with a simple majority vote. Of all the House committees, the Ways and Means Committee received the largest reconciliation instruction, directing it to report legislation increasing the deficit by nearly $941 billion over the next 10 years. The legislative package under consideration by the Ways and Means Committee contains nine separate subtitles, including a subtitle G that is largely devoted to individual tax relief proposals. The most conspicuous and costly of these proposals is a third round of Economic Impact Payments of $1,400 to eligible households. Among other tax policies, the Committee's tax subtitle also includes expansions of the Child Tax Credit (CTC), the Earned Income Tax Credit (EITC), dependent care tax policies, extension of the employee retention credit, and an international business tax increase.

Direct Payments

The American Rescue Plan provides a third round of direct payments to individuals and families. For individuals, the plan provides a $1,400 payment, phasing out between $75,000 and $100,000 in income. The payment is thus phased out entirely for an individual making 100,000. Married couples would receive $2,800, subject to phaseout between $150,000 and $200,000. Thus, for married couples making $200,000, the payment would be phased out. The provision also provides an additional $1,400 per dependent, though also subject to phaseout. Eligibility and benefit levels would be based on 2019 or 2020 income-tax filings. Individuals will not be required to repay any overpayment when filing their 2021 taxes next year.

According to analysis of a similar proposal performed by the Tax Foundation, over 94 percent of U.S. households should receive the full rebate, though the Ways and Means proposal incrementally reduces eligibility faster at higher income thresholds. The Joint Committee on Taxation (JCT) estimated that this provision would cost $422 billion, more than twice the the $164 billion cost of the $600 rebates in the Consolidated Appropriations Act passed in December.

Child Tax Credit Expansion

The American Rescue Plan contains a substantial expansion and modification of the CTC. Under current law, taxpayers may claim a $2,000 credit per child under the age of 17. The credit phases out for single parents earning over $200,000 and $400,000 for married couples. Taxpayers for whom the credit exceeds their income can claim up to $1,400 per child as a refundable credit. The American Rescue Plan would increase, for one year, the CTC to $3,000. The plan would create a second phaseout, whereby the increased CTC would be reduced by $50 for every additional $1,000 over $75,000 for single parents and $150,000 for joint filers. The credit would continue to be reduced to the current-law $2,000 at which point the current-law phaseout regime would apply. The American Rescue Plan would also make the credit fully refundable, such that individuals may received the full value of the credit in excess of any income.

The American Rescue Plan would also make the credit advanceable on a monthly basis for eligible families. Under this provision, eligible families would receive 1/12 the value of their credit each month. Like the overall credit expansion, the advancebility regime expires at the end of 2021. Under this provision, monthly payments would begin in July, and necessarily cease in December. Advanceable credits face administrative challenges and have been attempted in the past (specifically an advanceable EITC, which was repealed during the Obama Administration), though that does not preclude a successful administration of this proposal. The plan would also extend this policy to territories. Combined, the JCT estimated that these expansions and modifications to the CTC would cost $109.5 billion over the next decade. As these credit expansions have been a progressive priority prior to COVID-19, however, one can envision these policies becoming part of the regular ritual of permanently extending “temporary” policies.

Earned Income Tax Credit

The EITC provides a refundable tax credit to low-income, working Americans. It provides a credit equal to certain percentages of earned income. The credit percentages and applicable income vary by household size. Childless adults receive a smaller percentage of a lower, smaller band of income than do claimants with children. For example, the maximum credit for a childless adult in 2021 is $543, while the maximum credit for an eligible claimant with one child is $3,618.

The American Rescue Plan would, for one year, increase the credit percentage from 7.65 percent to 15.3 percent and increase the applicable income band. The credit expansions would combine to increase the maximum credit for a childless claimant in 2021 to $1,502. The plan would also, among other modifications, extend the credit to U.S. territories. Combined, the American Rescue Plan’s EITC expansion would cost $26.2 billion over the next decade.

Dependent Care Provisions

Under current law, taxpayers may claim the Child and Dependent Care Tax Credit (CDCTC), which provides a non-refundable credit of 35 percent of certain qualifying childcare expenses up to $3,000 for households with one child, and $6,000 for households with two or more children. The credit phases out for incomes above $15,000 to a maximum percentage of 20 percent. The American Rescue Plan would make the credit fully refundable and the credit percentage would be increased to 50 percent. The plan would substantially increase the eligible expenses to $8,000 for households with one child and $16,000 for households with two or more children, while the income phaseout would be increased to $150,000. This policy would also be extended to U.S. territories. The plan would also increase the amount by which taxpayers may exclude from their income the value of employer-provided dependent care from $5,000 to $10,500. Combined, JCT estimates these expansions would cost $8.1 billion over the next decade.

Enhanced Retention Credit

The CARES Act created a new tax credit to incentivize firms to retain their workforce. The end of year Consolidated Appropriations Act further expanded the credit, which provides employers with a tax credit equal to 70 percent of an employee's wages, up to $10,000 per employee per quarter (as opposed to per year). The American Rescue Plan would extend this policy by two calendar quarters until January 2022. The plan also applies the credit to employers' Medicare payroll taxes, as opposed to Social Security payroll taxes. The JCT estimated these provisions would cost $8.8 billion.

Repeal of Worldwide Interest Allocation

In somewhat of an aberration, the American Rescue Plan includes a significant tax increase on U.S. multinationals, at least on paper. The American Rescue Plan would repeal a 2004 tax policy that only went into effect this year. The 2004 provision allows multinational firms to elect to apportion certain expenses on a worldwide basis, and thus, arguably, improve how multinationals calculate foreign tax credits. The tax policy argument is less salient in this context because but for the last month, these rules have never been implemented; Congress has serially delayed them. The plain rationale for including this change in this bill is to raise revenue, particularly in the years beyond the budget window, to comply with the Senate's Byrd rule. The JCT estimated this proposal would raise $22.3 billion over the next decade.

Conclusion

The American Rescue Plan contains five major tax related changes at a cost of $548 billion. The plan also contains a relatively obscure tax increase, likely to comply with Senate rules governing the budget reconciliation process. While direct payments are plainly popular, and have been incorporated in past fiscal relief measures, they are poorly targeted on the needy. Moreover, the plan contains substantial expansions to federal transfer programs under the guise of "temporary" COVID-19 policy, notwithstanding that these policies have been progressive priorities for years.