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Post-2020 tax policy possibilities

A Biden presidency and Democratic Senate could bring change to the course of tax policy

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Overview

The 2020 presidential election season has been anything but typical with the unprecedented circumstances of the coronavirus pandemic and a focus on racial injustice. Mainstay election issues of the economy and health care are viewed through the lens of crisis: reopening the economy is at odds with curbing the spread of the virus, and that tension has created economic uncertainty that the nation is not likely to completely get beyond for some time. How tax and economic policy will be addressed if Democrats are in control in 2021 is gaining attention.

The dawn of the pandemic capped a primary season that saw Democratic candidates draw from a wide menu of tax policy ideas, from unrealized Obama-era proposals to newer plans like wealth taxes. Presumptive Democratic nominee Joe Biden had a relatively modest tax platform and has gotten ahead while hanging back. Most of his economic proposals were presented as revenue sources for climate, health and education plans last year. While he has not released a single campaign tax plan, what has been put forward largely harkens back to the Obama-era, pre-Tax Cuts and Jobs Act (TCJA) playbook: tax increase proposals from a time when deficits from the previous recession were the subject of fierce partisan battles.

Making wealthy individuals and corporations “pay their fair share” has long been a touchstone for Democrats. Mindfulness of where the economy is in early 2021, however, may temper calls for tax increases in the near term. Leaders like Senate Finance Committee ranking member Ron Wyden (D-OR) have said if they have new power in the presidency and/or Senate majority in 2021, they will first act to repair economic damage before increasing taxes for the sake of fairness.

Similarly, if the economy is ailing, raising taxes for deficit reduction may take a back seat given that deficit concerns have largely been pushed aside in responding to the crisis. Likewise, if President Trump wins reelection and Republicans still control the Senate, any focus on tax is likely to be refining and/or making permanent TCJA provisions, not addressing deficits.

A Biden victory could bring control of the Senate along with it. An early focus on tax would likely be on stimulating the economy, perhaps through investments in manufacturing, supply chains, infrastructure and clean energy, as well as via R&D for technologies like electric vehicles, 5G and artificial intelligence. Democrats could also seek to bolster public safety net programs − Biden recently announced a plan on childcare and similar needs – and address outstanding health care priorities, as well as enact any coronavirus response measures not agreed to in 2020. These plans could be proposed along with tax increases, likely rolling back parts of the TCJA and ending the lower capital gains rate, though some may be deemed stimulus and not paid for.

A Senate Democratic majority probably would be narrow, and Democrats would likely need to turn to the budget reconciliation process that allows certain legislation to pass with 51 votes, rather than the 60-vote filibuster threshold, for a major economic bill that doesn’t have broad bipartisan support. (That is, unless a new Senate Democratic majority seeks to change Senate rules regarding the filibuster.) Even with that procedural advantage, getting to 51 votes could be difficult given splits in ideology among moderate and progressive Democrats that will play a large role as the party tries to move on legislation.

Washington Council Ernst & Young
https://www.ey.com/en_us/tax/washington-council-ernst-young

Highlights of Biden tax increase proposals and plans they would pay for

Business tax proposals

		Climate/ Infra-structure	Health care	Education	Made in USA, R&D	Child, elder care	Housing
Corporate rate	28%	■					
Other business changes	End subsidies for fossil fuels	■					
	Repeal CARES Act* excess business losses provision			■			
	No ad deduction for Rx companies		■				
	Financial fee on certain liabilities of firms with more than $50 billion in assets						■
Intl' tax	21% GILTI rate (possible per-country minimum tax)	■			■		
	Tighter anti-inversion rules	■			■		
	Sanctions for facilitating "illegal corporate tax avoidance," "harmful tax competition"	■			■		
	Reduce incentives for "tax havens, evasion and outsourcing"	■			■		
Surtax	15% minimum tax on book income >$100m	■					
Real estate	End use of like-kind exchanges, use of real estate losses to reduce tax liability					■	
Individual tax proposals							
Top income tax rate	39.6%; 199A deduction phased out for incomes above $400,000		■				
Capital gains	Repeal lower tax rate for capital gains for households earning >$1m		■				
Itemized deductions	Capped for "wealthiest" at 28%			■			
Estate tax	End estate tax stepped-up basis			■			
Social Security	Increase payroll tax withholding for annual incomes more than $400k						

Business tax

The 28% corporate rate proposed by Biden was targeted by the Obama administration when it discussed doing tax reform in 2015 and 2016, though it was never formally proposed in an Obama Administration budget. Some more progressive Democrats, including several who ran in the Democratic presidential primaries, have proposed raising the corporate rate all the way back to 35%. However, it seems as if the political ceiling is 28%. Along with raising the corporate rate, Biden has called for a "minimum corporate tax" of 15% applying to book income for companies with net income greater than $100 million.

In the international context, Biden has joined many other Congressional Democrats in calling for changes to the global intangible low-taxed income (GILTI) rules, believing it does not have enough teeth to prevent US companies from taking undo advantage of other international tax changes included in the TCJA that partially eliminated US tax on foreign-source earnings.

Biden has proposed combining the 28% corporate tax rate with a 21% tax rate on GILTI, so he seems to concede that GILTI should be taxed at a rate lower than the corporate tax rate, but other Democrats have proposed taxing GILTI at the full US corporate tax rate. Importantly, Biden would go a step further, joining some other Democrats in proposing to apply GILTI on a jurisdictional basis, rather than an aggregate basis as it currently applies. Democrats supporting such a move will find good company with the Organisation for Economic Co-operation and Development's efforts to develop model minimum tax legislation under Pillar 2 of the Base Erosion and Profit Shifting 2.0 project that also appears likely to include a per jurisdiction approach. All these ideas seemed to be aligned with Democrats' stated desire to remove incentives for companies to shift US jobs and physical operations overseas.

As part of a housing plan, Biden proposed a financial fee on certain liabilities of firms with more than $50 billion in assets. No further details were provided, but it appears the proposal would be modeled after the Financial Crisis Responsibility Fee proposed by President Obama.

* Coronavirus Aid, Relief, and Economic Security Act

Regarding real estate investment, Biden proposed to pay for childcare improvements by ending the use of like-kind exchanges and use of real estate losses to reduce tax liability. Addressing 1031 exchanges is among the alternatives to a wealth tax put forward by other Democrats, and Biden appears poised to go the base-broadening, loophole-closing route.

Individual

Individual tax proposals were some of the first put forward when the campaign kicked off in April 2019. "Let's get rid of capital gains loopholes for multimillionaires," Biden said, adding that capital gains treatment was behind an Obama-era quote from Warren Buffett that he should not pay a lower tax rate than his secretary. The lower rate for dividends would also be repealed, according to campaign officials.

Biden has stated that tax increases won't affect families earning less than $400,000 annually. He has also reportedly proposed phasing out above that dollar limit the Section 199A qualified business income deduction available to individuals, including many owners of sole proprietorships, partnerships and S corporations.

Not all of Biden's proposals are tax increases. He has also, in some of the same plans that call for tax provisions as revenue offsets, proposed to extend, revive or create tax incentives.

Tax incentive proposals
Climate/infrastructure
Tax incentives for carbon capture, use, storage
Restore the full electric vehicle tax credit
Tax credits for residential energy efficiency
Expand tax deductions for energy retrofits, smart metering systems, emissions-reduction in buildings
Reinstate the solar Investment Tax Credit
Make permanent New Markets Tax Credit
Establish a Manufacturing Communities Tax Credit
Housing
First Down Payment Tax Credit up to $15,000
Renter's credit to reduce rent and utilities to 30% of income
Expand Low-Income Housing Tax Credit
Childcare, elder care
$8,000 tax credit for childcare
$5,000 tax credit for informal caregivers (aimed at elder care)
Tax credits for businesses to build childcare facilities onsite
Expand Earned Income Tax Credit to those older than 65

Revenue

The revenue impact of the Biden campaign's proposals have only been scored by nongovernmental think tanks, which have tallied them at or near $4 trillion in tax increases: $3.8t by both the American Enterprise Institute (AEI) and Tax Foundation, and $4t by the Tax Policy Center (TPC).

Source footnotes on last page

Revenue from Biden tax increase proposals	10-year revenue
Business	
Increase statutory corporate tax rate to 28% (CBO: every percentage point increase = ~$100b)	$700b[1]
Financial fee on certain liabilities of firms with more than $50 billion in assets	$100b[1]
15% minimum tax on book income	$400b[2]
21% GILTI rate	$340b[2]
End fossil fuel tax incentives	$40b[2]
End real estate tax benefits (like-kind exchanges, exemption for rental loss, rental depreciation)	$500b[7]
Individual	
Tax capital gains and dividends as ordinary income for taxpayers with income >$1m	$800b[2]
Cap itemized deductions for "wealthiest" at 28%	$310b[2]
Increase top individual tax rate to 39.6%	$191b[3]
End estate tax stepped-up basis	$105b[1]
Other proposals	
Carbon tax @$25/t$CO_2$e (tons of carbon dioxide equivalent)	$1.1t[1]
Financial transactions tax: • 0.5% for stocks, 0.1% for bonds and 0.005% for derivatives • 0.1% on the sale of stocks, bonds or derivatives	 $2.4t[4] $800b[5]
Estate tax increase • 2009 estate tax of 45% on estates greater than $3.5m, rising to 77% >$1b • $3.5m exemption, 55% rate, rising to 75% on estates >$1b	 $2.2t[4] $500b[5]
Wealth tax • Above $32m joint income, starting at 1% up to 8% >$10b • 2% wealth tax on net worth above $50m, 6% above $1b	 $4.35t[4] $3.75t[5]
Mark-to-market plan requiring capital gains to be taxed annually at ordinary income levels	$1.5t–$2t[6]

TPC analysis. The nonpartisan Tax Policy Center said about half of that revenue gain would come from higher taxes on high-income households and about half would come from higher taxes on businesses, especially corporations. In the TPC's breakdown, Biden's proposal to increase the corporate tax rate to 28% accounts for about one-third of the additional revenue over 10 years, while applying Social Security taxes to earnings above $400,000 accounts for about 25%. Increased taxes on capital gains and dividends accounts for another 11%, and repealing the TCJA's tax cuts for taxpayers with incomes above $400,000 raises a similar amount (11%). Biden would spend more than $270b of that revenue on tax credits and income exclusions for family caregiving, retirement saving, student loan forgiveness, energy efficiency, renewable energy and expanding the electric vehicle fleet.

Distributionally, TPC said Biden's plan would raise taxes on households with income of more than $837,000 (i.e., the top 1%) by an average of about $299,000, or 17.0% of after-tax income. By contrast, TPC said taxpayers in the middle-income quintile would see an average tax increase of $260.

AEI. The conservative-leaning American Enterprise Institute's analysis of Biden's tax proposals found that altogether, his policies would raise about $3.8t over 10 years, slightly lower than the TPC analysis. AEI estimated that Biden's most significant tax increases would fall on the top 1% of earners and "overall … make the US tax code more progressive."

Like TPC, AEI found that the highest-income filers would produce most of the new revenue, projecting that 72% of new tax revenue in 2021 would come from the top 1% of tax filers, whose after-tax income would fall by 17.8%, with an average tax increase of $118,674. AEI said nearly all the income and payroll tax increases in Biden's proposals target the top 1%; tax increases for the bottom 99% are largely due to business tax hikes.

The conservative Tax Foundation said the Biden tax plan would reduce GDP by 1.51% over the long term. The group said the plan would shrink the capital stock by 3.23% and reduce the overall wage rate by 0.98%, leading to 585,000 fewer full-time equivalent jobs. The group found that on a dynamic basis, the plan would raise about 15% less revenue than on a conventional basis over the next decade. Dynamic revenue gains would total approximately $3.2 trillion between 2021 and 2030 because the relatively smaller economy would shrink the tax base for payroll, individual income and business income taxes.

On macroeconomic effects, AEI forecasts that Biden's tax policies would reduce the level of US gross domestic product (GDP) relative to the baseline by 0.06% from 2021 to 2030 by reducing labor supply and capital stock. AEI estimated that higher effective tax rates on high-income households and corporations would cause a short-run reduction in GDP, followed by a medium-run increase due to the reduction in debt.

Other Democratic proposals

The Biden plan has thus far left out some of the more progressive tax revenue proposals that emerged during the primary campaign season, including a wealth tax. But many members of Congress will also have ideas beyond, and to the left, of what he has proposed.

A financial transactions tax has had support in Congress and was picked up by other candidates. Sen. Brian Schatz (D-HI) and Rep. Peter DeFazio (D-OR) sponsored the Wall Street Tax Act of 2019 (S. 647, H.R. 1516) to impose a 0.1% a tax on securities transactions. Sen. Bernie Sanders' (I-VT) bill (S. 1587), cosponsored by Sen. Kirsten Gillibrand (D-NY) would impose a financial transactions tax of 0.5% for stocks, 0.1% for bonds and 0.005% for derivatives.

Senator Wyden, who would likely become chairman of the tax-writing Finance Committee should Democrats take control of the Senate, has proposed a plan to impose a mark-to-market approach requiring capital gains to be taxed annually at ordinary income levels.

"Anti-deferral [mark-to-market] accounting rules" would only apply to individuals with more than $1m in annual income or $10m in assets. Applicable taxpayers would be required to pay annual taxes on unrealized gains and take a deduction for unrealized losses on liquid assets, such as stock, while for illiquid assets mark-to-market would not apply but a look-back charge would be imposed on gains realized upon the sale of these assets.

Biden hasn't proposed estate tax changes beyond eliminating stepped-up basis, but Biden-Sanders "unity" principles released in July said they should be "raised back to the historical norm." Democrats have at times urged a return to the 2009 regime: $3.5m exemption and 45% rate. Interest remains in repealing the $10,000 state and local tax deduction cap.

The economy in 2021

At the beginning of 2021, it is likely that the focus will be on reviving the economy while still tending to the demands of the coronavirus. It is possible more virus-related relief will be needed, or that Democrats, if in control, would try to enact some of the measures that President Trump and Senate Republicans have not agreed to in coronavirus measures. There are several tax items in the House-passed Health and Economic Recovery Omnibus Emergency Solutions Act that are not likely to be agreed to by Republicans this year, and so could be ripe for action if Democrats control Washington in 2021:

- Making the child tax credit fully refundable, increasing the amount to $3,000 per child ($3,600 for a child under age 6), and making 17-year-olds qualifying children
- Making the child and dependent care tax credit fully refundable and increasing the maximum credit rate to 50%
- Increasing the exclusion for dependent care assistance from $5,000 to $10,500

There will also be a focus on the recovery and job creation. Biden has said that if elected, he would provide "further immediate relief" to families, small businesses and communities dealing with the coronavirus pandemic.

In terms of stimulus, Biden has thus far outlined plans to invest a combined $700b in procurement and R&D designed to boost US manufacturers and stimulate the economy, as well as $2t in clean energy and infrastructure investment. In both cases, Biden has emphasized the job-creation benefits of the plans and the campaign has signaled they would be partially paid for by reversing tax cuts for corporations and impose "common-sense tax reforms that finally make sure the wealthiest Americans pay their fair share." Probably the best model for a united government coming into power amid a crisis was President Obama working largely with the Democratic Congress on financial rescue and recovery in 2009. The new president had campaign tax proposals, but those largely were jettisoned initially to focus on recovery.

If racial economic equality is an early priority, Biden has proposed opportunity zone changes in a context that focuses on creating jobs for low-income residents and otherwise providing a direct financial impact to households, as well as additional review of and reporting by opportunity zone recipients.

He also proposed making permanent the New Markets Tax Credit.

At some point, however, tax increases will likely be proposed for what is already a massive revenue hole from the coronavirus. The Congressional Budget Office (CBO) on April 24 said the FY2020 budget deficit is projected to be $3.7t. The deficit was $864b just for June. Also inevitable: a discussion over the future of Social Security, with the troubling outlook for the program over at least the past two decades now even worse with an aging population and the payroll and other economic effects of the pandemic, which some say accelerates the insolvency date by about a year. Biden proposes to impose Social Security payroll taxes on incomes greater than $400,000 per year, in addition to the first $137,000 in annual income, with no additional tax on income in the doughnut hole in between.

Principles behind Democratic tax policy

The "fair share" principle goes back to the Obama administration and has continued in the wake of the TCJA, which Democrats say tilted benefits toward corporations and wealthy individuals. While Democrats are seen as having won the 2018 congressional elections largely on the issue of health care, they were also highly critical of the TCJA. Now-Speaker Pelosi criticized the tax bill for adding to the deficit, saying lawmakers should "make the middle class tax cuts permanent" but "bring balance" to the tax system and reduce debt "by having a revenue package that does just that, that puts the middle class first." She also suggested the 21% corporate income tax rate is too low. Democrats are likely to stick to these principles.

While Democrats back making permanent most TCJA provisions for individuals that expire after 2025, it is less clear how they will approach business changes/phase-outs sooner:

- The 30% limitation on the deduction of interest expense is calculated without depreciation and amortization after 2021 (i.e., earnings before interest and taxes vs. earnings before interest, taxes, depreciation and amortization)
- Bonus depreciation phased down 20% yearly after 2022
- Amortization of R&D expense beginning in 2022
- Reduction in the Section 250 deduction for purposes of GILTI and foreign-derived intangible income rules

Process

If Democrats have a slim Senate majority, which is likely to be the case if they win control of the chamber, the procedural focus will likely be on the budget reconciliation process, which has often been used in unified government situations in which the controlling party lacks 60 Senate votes. Reconciliation has frequently been used by Congress to make changes to the tax code and modify mandatory spending programs.

Reconciliation bills can pass the Senate with 51 votes, though there are strict rules accompanying the use of the process, including that reconciliation bills cannot contribute to the budget deficit for the period outside the budget window. Use of the budget reconciliation requires two steps:

- Both the House and Senate must pass the same concurrent budget resolution that contains reconciliation instructions to committees to change spending and/or revenue numbers. The reconciliation instructions don't prescribe specific policies to achieve the number targets.
- Bills that adhere to the resolution must then be passed and signed into law.

Reconciliation is generally easier to do when raising taxes than cutting taxes since reconciliation originally was designed as a deficit reduction measure, and there is no worry about 10-year sunsets or fitting the contents of the bill within a revenue constraint. Of course, reconciliation becomes essentially irrelevant should Democrats pursue and achieve repeal of the 60-vote Senate filibuster to their agenda. Not all Democrats support this move, however, and Biden's explicit backing would be surprising given his decades in the Senate. Allies like Senator Chris Coons (D-DE) back the move, but moderate Senator Joe Manchin (D-WV) has dismissed the idea. It did get a boost from former President Obama July 30.

Lessons from 2017

While fiscal stimulus seems a top contender as an early agenda item, a first bill under Democratic control may not involve tax policy. The same was true in 2017; as the Republican majorities took office that January, they planned to use budget reconciliation to repeal the Affordable Care Act and secure a win for the new president, quickly passing a budget resolution for FY 2017 – several months into that fiscal year – with reconciliation instructions to that effect. But that effort ended in failure in July as then-Sen. John McCain (R-AZ) joined two other Republicans in narrowly defeating the bill on the floor. So in August, Majority Leader Mitch McConnell (R-KY) quickly pivoted to tax reform, and Republicans drafted a second budget resolution (this one for FY 2018) with new instructions that also produced the TCJA. The GOP leadership was able to ease the path to passage by omitting a plan by House Ways and Means Committee Chairman Kevin Brady (R-TX) for a border adjustment tax.

Then, after an intraparty debate over the size of the deficit that the tax reform bill would permit, Sen. Pat Toomey (R-PA) sealed a key agreement with then-Budget Committee Chairman Bob Corker (R-TN), a moderate, to allow the new budget resolution to increase the deficit by $1.5t, promising that increased revenue spurred by economic growth would make up any projected shortfall. Those and other maneuvers ultimately helped lock in winning votes in the House and Senate, and President Trump signed the bill on December 22 – perhaps a land-speed record for a tax reform law. Democrats would likely have to navigate through similar disagreements between moderates and liberals to get a reconciliation bill quickly.

Should the 60-vote Senate filibuster remain intact, thereby requiring the reconciliation process to advance major agenda items, a similar construct could unfold in 2021: since Congress has not approved a FY 2021 budget resolution, that process could be revisited by Democrats early next year, creating an initial reconciliation opportunity followed by a second reconciliation opening in calendar year 2021 with adoption of a FY 2022 budget resolution.

Timing

Whatever the shape of a first economic bill, it will likely take several months to pass. With Republicans in control in 2001, it took until Memorial Day to get the first Bush tax cut bill (Economic Growth and Tax Relief Reconciliation Act (EGTRRA)) done. Under GOP control again in 2017, detailed tax reform proposals came out November and then there was a legislative sprint until the end of the year. The last previous change to the statutory corporate income tax rate (an increase) was in the Omnibus Budget Reconciliation Act of 1993, which wasn't enacted until August of that year.

Also of interest is the matter of the effective date, especially as it relates to potential increases in the corporate rate. The 1993 corporate rate change, the last before the TCJA, took effect retroactively to January 1, 1993, although it was only a one-point increase. The 2001 Bush tax cuts (EGTRRA) were retroactive to the beginning of the year. The TCJA was immediate but not retroactive, and that was a rate cut. The current thinking is that a significant tax bill would take well into 2021 to complete, with an effective date of the beginning of 2022.

Conclusion

While exact plans of Democrats, should they control Congress and the presidency in 2021, will continue to develop in the months ahead and will likely depend in part on the state of the economy at that time. A near-term economic bill could be expected with follow-on legislative efforts addressing additional Democratic priorities. The early priority is likely to be COVID-19 recovery and other stimulus. Infrastructure investments will be a priority, as will proposals related to climate change. Some "low-hanging fruit" tax provisions could be tapped as an early revenue source and the first shot at improving tax fairness.

Action could follow later on long-held priorities that are made more urgent by the virus and its effect on the economy, like shoring up the social safety net, health care and education. Tax proposals are likely to eventually be tapped for revenue, in the fashion Biden has taken during the campaign: eschewing a wealth tax or other new concepts in favor of base broadening, loophole closing and turning the tax rate dials. Based on Biden's comments during the campaign, tax increases that could be turned to for early revenue include repealing the preferential tax treatment capital gains for higher-income individuals, ending estate tax stepped-up basis and, perhaps, long-time Democratic targets like carried interest. These could be the first steps toward the rebalancing of the tax system to which Democrats aspire, with a corporate tax rate increase and other more systemic changes perhaps facing a slightly longer runway for enactment.

Looking back … tax bill timing

1990

Omnibus Reconciliation Act of 1993 – Enacted August 10, 1993, corporate rate increase retroactive to beginning of 1993

2000

Economic Growth and Tax Relief Reconciliation Act of 2001 – Enacted June 7, 2001, with tax rate reductions retroactive to years beginning after December 31, 2000

2010

Tax Cuts and Jobs Act – Enacted December 22, 2017, with tax rate reductions effective for years beginning after December 31, 2017

2020

Sources

[1] CBO, "Options for Reducing the Deficit, 2019 to 2028," 12/13/18

[2] *Bloomberg*, "Biden to Target Tax-Avoiding Companies … ," citing Biden campaign officials, 12/4/19

[3] JCX-53-19 (Joint Committee on Taxation score of House State and Local Tax bill)

[4] Sanders campaign

[5] Warren campaign

[6] Senate Finance Committee ranking member Ron Wyden (D-OR), September 2019 white paper

[7] Tax Policy Center analysis of Biden plan

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