Advancing The Democratic Tax Agenda In 2021

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On Nov. 7, several major news organizations declared Joe Biden as the nation's president-elect. While states have not officially certified their results, Democrats will assume control of the White House, with the balance of power on Capitol Hill yet to be determined.

While U.S. House of Representatives Democrats have retained their majority by a narrower margin, whether they control of the U.S. Senate will depend on the results of two Jan. 5, 2021, Georgia special elections. Incumbent Republican Sen. Kelly Loeffler will face off against Democrat Raphael Warnock and incumbent Republican Sen. David Perdue will face off against Democrat Jon Ossoff.

Democrats would need to pick up both Georgia seats to take control of the Senate beginning Jan. 20. Republicans are currently favored to control the Senate by a narrow margin.

Regardless, a slim Democratic majority or a divided government due to a Republican-controlled Senate will be an impediment to enacting the Democrats' sweeping tax and economic policy vision. Here are the top three takeaways on how tax policy under a Biden administration will be forced to evolve based on current expectations of the political makeup of Congress.

1. The Biden tax agenda will shrink significantly, with the campaign vision taking a backseat.

Biden campaigned on a promise to address income inequality and ensure that corporations, especially those that offshore jobs, pay their fair share. On the individual side, Biden would accomplish this goal by raising rates on high-income earners, reverting the top rate to 39.6% from 37%, capping the value of itemized deductions at 28% and reinstating the Pease limitation on itemized deductions for those with taxable income above $400,000.

Biden would tax long-term capital gains and qualified dividends at ordinary income rates on income above $1 million, and eliminate the step-up in basis for capital gains. He would also phase out the Internal Revenue Code Section 199A qualified business income 20% tax deduction, enacted by the Tax Cuts and Jobs Act for individuals earning over $400,000.[1]

The Biden tax increases would largely finance an ambitious agenda for lower- and middle-income Americans. The tax incentives include (1) assistance for caregivers, (2) housing assistance, and (3) retirement benefits, as well as various spending initiatives.

On the corporate side, Biden proposed rolling back certain benefits enacted by the TCJA, including increasing the corporate rate from 21% to 28% and doubling the tax rate for global intangible low-tax income earned by foreign subsidiaries of U.S. firms from 10.5% to 21%. Biden's plan also included a 15% minimum book-profits tax for companies with at least $100 million in book profits.

The ongoing financial crisis already left an uphill path for the Biden tax increases. Many moderate Democrats are wary of the impact of tax hikes on a fragile economy. Now, without a clear majority, Biden's individual and corporate tax increases are unlikely to pass the Senate. Biden's generous working-class spending programs will also be deferred without revenue to pay for these benefits.

However, this does not mean that Democrats will abandon their agenda. With the House under Democratic control, the party will continue to use the lower chamber to pass messaging bills leading up to the 2022 midterms.

Democrats will continue to demand that corporations pay their fair share and advocate for policies that raise the standard of living for working-class Americans. This will be part of a strategy either to (1) persuade Senate Republicans to support some of these proposals or (2) convince voters to preserve their House majority and flip control of or increase their margins in the Senate as well.

Democrats will have to compromise and fine-tune their agenda, especially given the results of the election. Progressive and moderate Democrats offer starkly different economic visions, with Democratic leadership cautioning against moving too far to the left.

Prior to the election, Biden was under tremendous pressure from influential progressives, including former presidential candidates Sens. Bernie Sanders, D-Vt., and Elizabeth Warren, D-Mass., to embrace even steeper tax increases for wealthy individuals and corporations. Both liberal senators proposed wealth taxes and other measures to address income inequality. Given the results of the election, Biden will be in a better position to resist pressure from the left to move in this direction.

2. Expect legislative activity and compromise — a divided government can still accomplish a lot.

A divided government does not have to embrace legislative gridlock — Senate Majority Leader Mitch McConnell, R-Ky., crafted three major bipartisan economic deals with then-Vice President Joe Biden during the Obama administration to aid recovery from the recession.

Should both parties choose to set aside partisan divisions, they could replicate this model on major legislative priorities including: (1) a COVID-19 economic recovery package; (2) a long-term tax and economic relief package, which includes a "Made in America" agenda; (3) a retirement security and employee benefits package; and (4) an infrastructure investment package.

A COVID-19 Package

Leading up to the election, Congress failed to reach agreement on COVID-19 stimulus legislation. If Congress is still unable to reach a compromise during the lame duck session, Biden's first challenge as president will be passing a relief package.

So far, Biden's plans have aligned with proposals by House Democrats in the $3 trillion Health and Economic Recovery Omnibus Emergency Solutions, or HEROES, Act and in the $2.2 trillion revised HEROES Act.

With jobs reports that continue to improve, Majority Leader Mitch McConnell, R-Ky., believes that a relief package must be smaller and targeted.

Prior to the election, while President Donald Trump signaled that he was open to a larger package, Senate Republicans remained opposed. With Senate Republicans now replacing the administration in negotiations, both parties will have to compromise significantly in order to move something forward.

Republicans will continue to demand liability protection for businesses, while Democrats will prioritize individual relief, including an enhanced child tax credit, child and dependent care deduction, and earned income tax credit. However, there are areas where both parties agree, including:

- Tax credits for hiring and retaining employees, including an expansion of the employee retention tax credit;
- Tax credits for businesses to offset the costs of adapting to COVID-19, such as the cleaning and workplace reconfiguration credit proposed in the Health, Economic Assistance, Liability Protection and Schools Act;
- Various liquidity proposals for businesses, including a second draw of the Paycheck Protection Program;
- Another round of economic impact payments; and
- Enhanced unemployment benefits.

Republicans will likely cede to some Democratic priorities on the individual side and, in return, Democrats will have to agree to more generous liability protections and business tax proposals, including preserving the net operating loss provision from the Coronavirus Aid, Relief and Economic Security Act.

Enactment of a stimulus package is in the interest of both parties — state legislatures, regardless of party affiliation, are facing major budget shortfalls and will need funding to continue various spending programs. Additionally, as small businesses prepare for winter, they will need additional funding to weather the ongoing public health crisis.

Larger businesses, especially in the retail industry, have also had little aid from the CARES Act since U.S. Department of the Treasury facilities were largely ineffectual due to various covenants and restrictions. A stimulus package could help both businesses and individuals by staving off bankruptcies and closures, ensuring continued strong jobs numbers, and keeping unemployment on a downward curve.

Long-Term Tax and Economic Relief Package

Compromise on a long-term tax and economic relief package is also a possibility. The TCJA was the GOP's signature legislative achievement during the Trump administration and Republicans are eager to preserve the law. However, several business provisions sunset starting in 2022, and the individual provisions expire after 2025.

Specifically, on the business side, by 2022, the interest expense limitation changes from earnings before interest, taxes, depreciation and amortization, or EBITDA, to earnings before interest and taxes. In 2023, 100% expensing will be phased down annually in 20% increments. In addition, the TCJA provision permitting expensing of research and development expenses will change.

If past is precedent, a bipartisan compromise is possible — in 2010, the Obama administration negotiated a bipartisan agreement with congressional Republicans to extend Bush-era tax cuts to all Americans for two years, including wealthier families, in exchange for continued relief for middle-class families, additional payroll tax relief for workers and enhanced unemployment benefits.

Similarly, Republicans might be willing to strike a deal on various individual refundable tax benefits and green energy incentives proposed by the Biden campaign in exchange for preserving and expanding some of the corporate provisions in the TCJA.

While Democrats have shown little interest in preserving the change to EBITDA for the interest expense limitation, several Democrats are in favor of an enhanced business expense deduction. Similarly, there is bipartisan support for certain individual refundable tax credits, especially the child tax credit.

A tax and economic relief package might also be an opportunity to enact a made-in-America agenda.

The Biden campaign put forward a slew of policies designed to limit companies moving operations abroad, including a 10% offshoring-penalty surtax on services and sales to U.S. customers from a U.S. company's foreign subsidiary; a clawback provision to force companies to return public investments and deny all deductions and expensing write-offs for companies that move jobs overseas, if those jobs could have been offered to Americans; and strengthening rules against corporate inversions.

The tax increases in the made-in-America package are complemented by incentives to reward good corporate actors that reshore jobs to the U.S. and spur economic development. The manufacturing communities tax credit is a key part of this initiative — it would provide a 10% credit for revitalizing, renovating or retooling existing or recently closed-down facilities.

It would also be available for projects that expand U.S. facilities to grow domestic employment or for companies that increase manufacturing wages above the pre-COVID-19 baseline of $100,000.

Congressional Republicans have introduced several tax bills to accomplish similar objectives. Sen. Lindsey Graham of South Carolina has proposed incentivizing domestic production of personal protective equipment. Sen. John Cornyn, R- Texas, proposed an investment tax credit to spur U.S. research and manufacturing of advanced microchips.

The bipartisan interest in a made-in-America initiative is in part spurred by fears that the nation's supply chains are too heavily reliant on foreign countries, which set back the national pandemic response. Without personal protective equipment, ventilators and other critical equipment manufacturing located domestically, the U.S. was reliant on China and other countries for supplies.

Democrats and Republicans both view bolstering American manufacturing and jobs as a priority, even if they have not reached an agreement on the final details. Republicans have already criticized the Biden manufacturing communities tax credit on the grounds that it will not be sufficient to incentivize domestic manufacturing. Furthermore, Republicans have noted that pairing this policy with increases to the corporate tax rate reduces the efficacy of the credit.

Democrats could partially address Republican concerns by agreeing to maintain the current corporate tax rate and modify some of the disincentives included in the made-in-America proposal. Tax writers could reach a compromise on a tax credit for domestic job creators, businesses that revitalize or retool manufacturing and those that reshore jobs.

Democrats might also push to expand the credit to incentivize corporations that hit certain environmental or social benchmarks, as a way of furthering the integration of environmental, social and corporate governance factors into corporate performance metrics.

Of course, paying for a deal or at least partially offsetting some of the incentives could be the biggest hurdle to overcome.

Retirement Security and Employee Benefits Package

The Biden campaign has proposed replacing the current deduction for retirement savings contributions with a 26% refundable tax credit for each dollar contributed.[2] With a divided government, this type of large-scale reform is unlikely. However, there is broad bipartisan support for a package that bolsters incentives and loosens restrictions, making it easier for Americans to access plans.

The retirement savings crisis has been exacerbated by COVID-19 and many Americans have dipped into retirement savings as a bridge to allow them to weather the financial impact of the pandemic. This puts pressure on Congress to quickly take steps to improve retirement security.

Last month, House Ways and Means Chairman Richard Neal, D-Mass., and Ranking Member Kevin Brady, R-Texas, demonstrated how a bipartisan collaboration on retirement savings legislation might work by jointly introducing the Securing a Strong Retirement Act of 2020. The SSRA will likely serve as a blueprint for any retirement savings legislation considered in 2021.

A retirement package will prioritize auto-enroll 401(k), incentives for small businesses to offer retirement plans, increases to the saver's credit, portability of benefits and increases to the age threshold for minimum distributions to address workers increasingly outliving their retirement assets.

It will also likely address the impact that student debt has on retirement savings by allowing individuals to pay down a student loan instead of contributing to a 401(k) plan and still receive an employer match in their retirement plan.

More broadly, Democrats might also seek to address gaps in access to employee benefits and the safety net for gig economy workers. Once again, the pandemic has highlighted the volatility of platform-based income and the need for these workers to have access to safety nets.

Furthermore, though the CARES Act provided unemployment benefits for gig workers, many could not immediately access these benefits due to a lack of tax information reporting. Without the requisite paperwork, it was difficult for many state unemployment agencies to verify prepandemic income for these workers.

Both Democrats and Republicans recognize the need to address the classification of gig economy workers, access to benefits and tax information reporting. While both parties have taken vastly different approaches, a compromise might be possible.

If legislation in this space does not move forward, regulatory action is likely. A Biden administration could reverse course from the U.S. Department of Labor and National Labor Relations Board under the Trump administration and provide gig workers with greater protections.

Infrastructure

Lawmakers recently reauthorized the Fixing America's Surface Transportation Act for one year through Sept. 30, 2021. The next extension could be part of a more comprehensive infrastructure package.

House Democrats outlined their vision for infrastructure reform earlier this year through the Moving Forward Act, a $1.5 trillion package that funds both traditional infrastructure priorities — surface transportation, rail and transit systems, and ports — as well as proposals that invest in schools, affordable housing, broadband access, green energy and child care.

The bill also includes a section that addresses infrastructure financing, such as reinstating Build America Bonds and advance refunding bonds, and expanding the issuance of private activity bonds. Democrats did not include revenue provisions, arguably one of the biggest hurdles to overcome to pass infrastructure legislation.

Republicans generally take a more narrow view of infrastructure, seeing it as limited to transportation-related proposals. However, there is incentive to compromise on a package that could include a broader set of priorities. The pandemic has highlighted that broadband access and child care are an essential part of the infrastructure needed for the economy to function.

An infrastructure package could not only help strengthen these systems, but also help drive investment and job creation, putting pressure on Congress to reach an agreement. An infrastructure package would also be a major achievement for the Biden administration and he will likely prioritize it as such.

3. Democrats will use regulation to fulfill their promise to have corporations pay their fair share.

Regulatory Revisions

Democrats will use regulatory tools at their disposal to further their agenda. Since the passage of the TCJA in 2017, Democrats have been critical of the law as primarily benefiting large corporations and encouraging offshoring. They could revisit regulatory guidance released by the Treasury on various TCJA provisions, including global intangible low-taxed income, or GILTI, and opportunity zones.

For example, Democrats have expressed concerns with the final GILTI regulations released earlier this year. Specifically, the regulations allow U.S. shareholders of a controlled foreign corporation to exclude certain income from its GILTI calculation if the corporation's effective foreign rate on its gross tested income exceeds 18.9%.

U.S. shareholders must elect to exclude high-taxed income — high-tax kickout election — and U.S. corporate shareholders can repatriate excluded income tax-free.

The final regulations expanded on previous regulatory guidance by dropping a requirement that in order to qualify for the high-tax exclusion, income must be foreign-base company income or foreign insurance income. Democrats, including Senate Finance Committee Ranking Member Ron Wyden of Oregon and Ohio Sen. Sherrod Brown, have introduced legislation to prevent the Treasury from carving out high-tax income from GILTI calculations.

Under a Biden administration, the Treasury could reverse its position and take a more narrow view of what qualifies for the GILTI high-tax exclusion.

Another area where Democrats might seek to tighten guidance is opportunity zones. While Democrats cannot change zone designation, they can introduce metrics to measure the impact of investment and pursue additional guidance that increases transparency.

Democrats might also use the Treasury to weaken the state and local tax deduction cap imposed by the TCJA. Previous guidance limited the ability of states to bypass the SALT cap. Following the passage of the TCJA, several states enacted legislation that would allow municipalities, counties or school districts to establish charitable funds to finance public projects. Taxpayers who contributed to the funds were eligible to receive a credit — no more than a certain percentage of the donation—to reduce their property tax. Under a Biden administration, the Treasury may decide to allow these workarounds.

Changes to the IRS and Enforcement

In addition to pursuing changes in regulatory guidance, a Biden administration will likely pursue structural changes to the Internal Revenue Service. While current Commissioner Charles Rettig is likely to remain at his post, a Biden administration would likely bolster funding for a resource-starved IRS, helping the agency update outdated technology systems and rebuild lost institutional knowledge. Additional funding would also allow the IRS to pursue more enforcement actions, including audits, which would help narrow the tax gap and bring in more revenue.

A Biden administration might also bring the Democrats' diversity and inclusion agenda to the Treasury, studying how enforcement is carried out across different races and income brackets. Depending on its findings, it might institute policies to correct any racial inequities built into the enforcement system.

Conclusion

Democrats have been waiting for a chance to reverse many of the changes the Trump administration made to tax policy through the TCJA and subsequent regulatory action. Even with a divided government, Democrats will enthusiastically pursue all avenues to slowly advance their agenda. While change may not be sweeping and swift, incremental developments will still have a major impact on tax policy in 2021 and beyond.

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[1] 115 P.L. 97.

[2] The Biden campaign did not specify a percentage; this is a revenue-neutral estimate by the Tax Policy Center.