May 2021

Details and Analysis of Tax Proposals in President Biden's American Families Plan

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The Biden administration's proposed American Families Plan (AFP) would partially pay for about $1.8 trillion in new federal spending on education and family programs with about $661 billion in additional taxes on higher-income individuals and pass-through businesses like partnerships, sole proprietorships, and S corporations.

The tax system would become more progressive than under current law through higher marginal tax rates on high earners and expanded refundable tax credits for lower-income taxpayers. The funding choices in the American Families Plan come at the cost of reduced economic output, fewer jobs, and lower wages.

According to the Tax Foundation General Equilibrium Model, the American Families Plan's tax changes would lead to a 0.4 percent reduction in long-run Gross Domestic Product (GDP). Gross National Product (GNP) would fall by 0.6 percent, employment would decrease by about 64,000 full-time equivalent jobs, and wages would drop 0.4 percent. Our analysis does not account for the economic or revenue effects of the spending portions of the American Families Plan. It is valuable to consider the impact of the American Families Plan tax proposals to see the trade-offs of a particular way of financing the plan's proposed spending.

The proposed American Families Plan would include the following major tax changes:

Raise the top marginal income tax rate from 37 percent to 39.6 percent, which would apply to income over $452,700 for single and head of household filers and $509,300 for joint filers.

Tax long-term capital gains and qualified dividends as ordinary income for taxpayers with taxable income above $1 million, resulting in a top marginal rate of 43.4 percent when including the new top marginal rate of 39.6 percent and the 3.8 percent Net Investment Income Tax (NIIT).

Tax unrealized gains at death for unrealized gains above $1 million ($2 million for joint filers, plus current law capital gains exclusion of $250,000/$500,000 for primary residences).

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Apply the 3.8 percent NIIT to active pass-through business income above $400,000. Limit 1031 Like-Kind Exchanges above $500,000 in deferred capital gains, end the preferred treatment of carried interest, and make permanent the 2017 tax law's limitation on excess losses that applies to non-corporate income.

Extend the enhanced Child Tax Credit (CTC) in the American Rescue Plan Act (ARPA) through 2025, which provides $3,600 for children under age 6 and $3,000 for children ages 6 to 17 and phases out at a 5 percent rate beginning at $112,500 for head of household filers and $150,000 for joint filers. The credit amounts would not fall below what would be allowed in each year under current law.

Make permanent the American Rescue Plan Act changes that made the CTC fully refundable and expanded the Earned Income Tax Credit (EITC) and Child and Dependent Care Tax Credit (CDCTC).

Make permanent the expanded health insurance Premium Tax Credits provided in American Rescue Plan Act.

The American Families Plan would also increase Internal Revenue Service (IRS) funding by $80 billion over a decade to increase tax collections, which we did not model.

According to the Tax Foundation General Equilibrium Model, the tax provisions in the American Families Plan would reduce the economy's size by 0.4 percent in the long run, primarily by increasing marginal tax rates on labor and investment in the pass-through business sector. The capital stock would fall by 0.7 percent, wages by 0.4 percent, and employment by about 64,000 full-time equivalent jobs. GNP, which measures American incomes, would fall by 0.6 percent.

TABLE 1.

Economic Effect of the Tax Provisions in the Proposed American Families Plan

Gross Domestic Product (GDP)	-0.4%
Gross National Product (GNP)	-0.6%
Capital Stock	-0.7%
Wage Rate	-0.4%
Full-time Equivalent Jobs	-64,000

Source: Tax Foundation General Equilibrium Model, May 2021.

Table 2 shows the long-run economic effects for each of the tax proposals in the American Families Plan.

TABLE 2.

Economic Effect of the American Families Plan by Tax Provision

Provision	Long-Run Change in GDP	Long-Run Change in GNP	Long-Run Change in Full-Time Equivalent Jobs	Long-Run Change in Wages	Long-Run Change in Capital Stock
Tax Unrealized Capital Gains over $1 Million at Death and Impose a 39.6 Percent Tax Rate on Capital Gains Realized for Income Earned over $1 Million	-0.1%	-0.3%	-27,000	-0.1%	-0.3%
Impose Net Investment Income Tax on Active Pass-through Income Over $400,000	-0.1%	-0.1%	-12,000	-0.1%	-0.2%
Make the Excess Business Loss Limitation Permanent	-0.1%	-0.1%	-16,000	-0.1%	-0.2%
Limit 1031 Exchanges to $500K in Gain	Less than -0.05%	Less than -0.05%	-1,500	Less than -0.05%	Less than -0.05%
Tax Carried Interest as Ordinary Income	Less than -0.05%	Less than -0.05%	-1,000	Less than -0.05%	Less than -0.05%
Expanded Tax Credits (EITC, CTC, CDCTC, Premium Tax Credits)	Less than -0.05%	Less than -0.05%	-6,500	Less than -0.05%	Less than -0.05%
Total	**-0.4%**	**-0.6%**	**-64,000**	**-0.4%**	**-0.7%**

Source: Tax Foundation General Equilibrium Model, May 2021. Items may not sum due to rounding.

Increasing the tax rate on capital gains from 23.8 percent to 43.4 percent, taxing capital gains at death, and applying the 3.8 percent NIIT to active pass-through income reduce long-run GDP by 0.2 percent, accounting for about half of the total economic impact of the American Families Plan tax proposals. Long-run GDP falls by an additional 0.1 percent because of making permanent the excess business loss limitation, and the remaining provisions reduce long-run GDP by another 0.1 percent.

The American Families Plan's proposed increase to the top individual income tax rate from 37 percent to 39.6 percent does not reduce long-run growth, as the top individual income tax rate is already scheduled to increase under current law in 2026. This is because of the temporary nature of the tax reduction under the Tax Cuts and Jobs Act (TCJA) from 2018 to 2025.

The tax increases in the American Families Plan would also reduce American incomes (GNP) by 0.6 percent. Raising taxes on domestic savers reduces the amount of domestic saving, which means that foreign savers would finance a greater share of investment opportunities in the U.S. Over the long run, that leads to a reduction in American income as the investment returns flow to foreign savers instead of American savers. It would also manifest in a shifted balance of trade, increasing the trade deficit, all else held equal.

As to revenue effects, the tax increases in the American Families Plan would raise about $661 billion in federal revenue from 2022 to 2031 on a conventional basis. However, the increased revenue is offset by about $998 billion in expanded tax credits. Overall, the tax changes in the American Families Plan would reduce federal revenue by about $337 billion on a conventional basis, before accounting for any new revenue arising from the American Families Plan's proposed tax enforcement measures.

TABLE 3.

Conventional and Dynamic Revenue Effect of the American Families Plan (Billions of Dollars)

Proposal	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2022 - 2031
Raise Top Individual Income Tax Bracket to 39.6 Percent	27.1	28.6	29.3	30.9	0.0	0.0	0.0	0.0	0.0	0.0	115.9
Tax Unrealized Capital Gains at Death Over $1 Million and Impose a 39.6 Percent Tax Rate on Capital Gains on Income Earned over $1 Million	-3.6	5.7	16.2	18.9	19.5	23.6	27.2	30.8	34.7	39.8	212.8
Impose Net Investment Income Tax on Active Passthrough Income	14.5	15.3	15.9	16.8	17.1	18.9	19.8	20.6	21.5	22.8	183.2
Make the Active Pass-through Loss Limitation Permanent	0.0	0.0	0.0	0.0	20.2	21.0	21.8	22.7	23.6	24.5	133.8
Limit 1031 Exchanges to $500K in Gain	0.6	0.7	0.7	0.7	0.7	0.8	0.8	0.8	0.8	0.9	7.5
Tax Carried Interest as Ordinary Income	0.6	0.7	0.7	0.7	0.7	0.8	0.8	0.8	0.8	0.8	7.4
Total Revenue Raisers	**39.3**	**51.0**	**62.8**	**68.1**	**58.1**	**65.0**	**70.4**	**75.7**	**81.5**	**88.8**	**660.6**
Permanent Full Refundability of Child Tax Credit (CTC) and Extend Expanded CTC Through 2025	-101.6	-101.1	-100.2	-98.8	-3.0	-2.8	-2.7	-2.6	-2.4	-2.3	-417.5
Permanent Expansion of Earned Income Tax Credit (EITC)	-12.0	-12.0	-12.1	-12.1	-15.0	-15.1	-15.2	-15.3	-15.4	-15.4	-139.7
Permanent Expansion of Child and Dependent Care Tax Credit (CDCTC)	-8.0	-8.3	-8.6	-9.0	-9.4	-9.8	-10.3	-10.7	-11.1	-11.5	-96.7
Permanent Expansion of Premium Tax Credits	-22.0	-30.3	-31.6	-33.0	-34.4	-35.7	-37.1	-38.5	-39.9	-41.4	-343.8
Total Tax Credits	**-143.6**	**-151.7**	**-152.5**	**-152.9**	**-61.8**	**-63.5**	**-65.3**	**-67.0**	**-68.8**	**-70.7**	**-997.7**
Total Conventional Revenue	**-104.3**	**-100.7**	**-89.7**	**-84.8**	**-3.7**	**1.5**	**5.1**	**8.7**	**12.7**	**18.1**	**-337.1**
Total Dynamic Revenue	**-119.8**	**-118.6**	**-109.2**	**-105.7**	**-9.2**	**-5.7**	**-3.4**	**-1.0**	**1.5**	**4.6**	**-466.5**

Source: Tax Foundation General Equilibrium Model, May 2021. Items may not sum due to rounding.

On a dynamic basis—that is, after accounting for reduced economic output resulting from the American Families Plan tax changes—federal revenue would drop about $467 billion between 2022 and 2031, again without considering revenue from greater tax enforcement. This is primarily because the smaller economy produces lower income and payroll tax revenue over the budget window.

As to the distributional effect, the American Families Plan would increase the progressivity of the tax code by raising marginal income tax rates faced by higher earners while expanding several refundable tax credits for low- and middle-income earners.

The American Families Plan would increase the after-tax income of the bottom quintile by about 17 percent in 2022 on a conventional basis, which is largely driven by the American Families Plan's extension of the expanded CTC through the end of 2025. The top 1 percent of earners would experience a 1.9 percent drop in after-tax income in 2022.

TABLE 4.

Distributional Effect of the American Families Plan (Percent-Change in After Tax Income)

Income Group	Conventional, 2022	Conventional, 2031	Dynamic, long-run
0% to 20%	17.0%	7.3%	7.0%
20% to 40%	5.5%	2.2%	1.9%
40% to 60%	2.0%	0.4%	0.1%
60% to 80%	1.0%	0.1%	-0.1%
80% to 90%	0.4%	Less than -0.05%	-0.2%
90% to 95%	0.1%	Less than -0.05%	-0.3%
95% to 99%	-0.1%	-0.2%	-0.5%
99% to 100%	-1.9%	-2.8%	-3.1%
Total	1.2%	0.1%	-0.2%

Source: Tax Foundation General Equilibrium Model, May 2021.

After the expanded CTC expires in 2026, lower- and middle-income taxpayers would see a smaller increase in after-tax incomes, still reflecting the fully refundable, but smaller, CTC, and the permanent changes to the EITC, CDCTC, and expanded premium tax credits. The bottom quintile would experience a 7.3 percent increase in after-tax income by 2031 on a conventional basis, while the top 1 percent would see a 2.8 percent drop in after-tax income.

On a long-term dynamic basis, the smaller economy reduces after-tax incomes relative to the conventional analysis, but on net, after-tax incomes are still higher for the bottom three quintiles. Taxpayers above the 60th income percentile would see their after-tax incomes drop, ranging from -0.1 percent for those in the 60th to 80th income percentiles to a -3.1 percent reduction for the top 1 percent.

Finally, we use the Tax Foundation General Equilibrium Tax Model to estimate the impact of tax policies. The model produces conventional and dynamic revenue and distributional estimates of tax policy. Conventional estimates hold the size of the economy constant and attempt to estimate potential behavioral effects of tax policy. Dynamic revenue estimates consider both behavioral and macroeconomic effects of tax policy on revenue.

The model also produces estimates of how policies impact measures of economic performance such as GDP, GNP, wages, employment, the capital stock, investment, consumption, saving, and the trade deficit.

In our revenue estimate, we assume that the baseline long-run capital gains realization elasticity is -0.79. We reduce this elasticity by 20 percent when simulating the impact of taxing a portion of unrealized capital gains at death (-0.63). Individuals are initially more responsive to the change of capital gains tax rate, with a higher transitory elasticity for the first two years (-0.96). Our estimate for taxing unrealized capital gains at death includes an adjustment for paying tax owed on illiquid assets over 15 years.