APRIL 6, 2021

Biden Administration Unveils Tax Plan to Boost Investments in Infrastructure

Authors: Peter Glicklich, Zachary C. Kling, Gregg M. Benson and Heath Martin

President Biden and his administration recently released the American Jobs Plan, which provides additional detail on policies that were discussed throughout President Biden's campaign and the early days of his administration. Through the American Jobs Plan, which was released on March 31, 2021, the administration proposes making significant investments in U.S. infrastructure projects, which could total $2.3 trillion in spending over eight years. As part of the American Jobs Plan, the administration proposes to cover some of this spending by raising taxes on corporations and rolling back or modifying some of the tax law changes under the *Tax Cuts and Jobs Act of 2017*.

President Biden's tax proposals in the American Jobs Plan, if enacted, are expected to affect most taxpayers, but are primarily targeted at U.S. corporations, U.S. multinational enterprises that earn income abroad and individuals with high income. Below, we provide a brief overview of the Biden administration's tax proposals and some observations on how these changes may affect investments and business activities in the United States.

Corporate, International and Business Tax Changes

Key International Proposals

- Changing the global intangible low-taxed income (GILTI) regime, including by increasing the effective tax rate on GILTI to 21%, calculating GILTI on a country-by-country basis and eliminating the exemption of a 10% return on qualified business asset investment (QBAI).
- Imposing a 10% surtax on U.S. corporations that "offshore manufacturing and service jobs to foreign nations in order to sell goods or provide services back to the American market."
- Eliminating the foreign derived intangible income (FDII) deduction available to U.S. corporations with respect to sales made to foreign buyers of goods and services that are tied to intangible assets (e.g., patents and trademarks) held in the United States.
- Repealing the base erosion and anti-abuse tax (BEAT) and implementing an "under-taxed payments rule" to bring the U.S. tax code more in line with Pillar Two of the OECD/G20 BEPS Project.

Other Proposals Affecting Businesses

- Increasing the corporate income tax rate from 21% to 28%.
- Imposing a 15% alternative minimum tax on book income of corporations with at least $100 million of book income. The current proposal contemplates allowing net operating loss and foreign tax credits to be applied when calculating the minimum tax due.
- Imposing a "financial risk fee" on certain liabilities held by certain financial institutions with more than $50 billion of assets. The Biden administration has not published the rate, but prior proposals from the Obama administration for similar fees ranged from 7 to 15 basis points.

These changes will lead to higher effective tax rates on U.S. corporations and thus may lower overall returns for investors in U.S. corporations. In addition, these changes may cause U.S.-based multinationals to reconsider their international business structures, which could result in efforts to remove non-U.S. business activities from the U.S. tax net through inversions into more tax-friendly jurisdictions or base erosion transactions. Moreover, Treasury Secretary Janet Yellen has recently called for global coordination on the development of an international minimum tax rate that would apply to multinational corporations in order to avoid businesses being incentivized to shift profits to whichever jurisdiction offers the lowest tax rate. The Biden administration implicitly acknowledges this danger by saying that it intends to discourage changes in residency by implementing "strong anti-inversion regulations and penalties" and by providing numerous "carrots" to encourage investment in the United States.

Proposed Incentives to Encourage Investment in the United States

The Biden administration has proposed the creation, expansion or reinstatement of various deductions and credits designed to encourage investment in U.S.-based manufacturing and in renewable or "clean" energy technologies (while proposing to eliminate certain tax preferences for fossil fuels). These include the following:

- Introducing a 10% credit for investment in the United States that creates U.S.-based manufacturing jobs. Qualified expenses for this credit would include investments made to restore closed facilities and the costs of bringing production back from overseas. This credit would be payable in advance to eligible taxpayers.
- Expanding and making permanent the new markets tax credit and reinstating the energy investment tax credit and the electric vehicle tax credit.
- Providing tax credits for businesses to upgrade equipment and processes, invest in factory construction and expansion, and deploy low-carbon technologies in order to develop a low-carbon manufacturing sector.
- Expanding deductions for energy technology upgrades, smart metering systems and other emissions-reducing investments in commercial buildings.
- Increasing incentives for the development and implementation of carbon capture, use and storage technology.

Takeaway

Despite the increase in the "headline" corporate tax rate, the new minimum tax on book income and the changes to U.S.-international taxation, we expect the United States to remain a favourable environment for foreign investors. Specifically, the incentives proposed by the Biden administration should increase the desirability of investments into U.S. infrastructure projects, companies with a U.S. manufacturing presence and U.S.-based companies active in the renewable and clean energy technology sectors. The effect of the proposals may, however, turn into a balancing act that could play in different ways depending on developments in the U.S. and world economy.

Individual Income, Payroll and Estate Tax Changes

The Biden administration has already changed existing tax law by expanding the child tax credit in the *American Rescue Plan Act of 2021*. Additional Biden administration proposals, such as the expansion or reinstatement of certain individual tax credits, may continue this policy of benefiting middle- and lower-income taxpayers, but most of the proposed changes are targeted at increasing the effective tax rate of high-income taxpayers.

Key Individual Income and Payroll Proposals

- Reverting the top individual tax rate to 39.6% (from the current 37%).
- Imposing the 12.4% Social Security payroll tax on wages above $400,000 per year.

- Taxing capital gains and qualified dividends at the top marginal ordinary income tax rate when the taxpayer's income is above $1 million.
- Phasing out the qualified business income deduction for filers with taxable incomes above $400,000.
- Limiting the availability of itemized deductions for individuals earning more than $400,000 per year.
- Reinstating the first-time homebuyers' tax credit and expanding both the earned income tax credit and the child and dependent care tax credit.

Key Estate Tax Proposals

- Eliminating the "step-up" in tax basis of an individual's assets upon death.
- Decreasing the estate tax exemption back to $3.5 million ($7 million for married couples) and increasing the rate of the federal estate tax to 45%.

Further to the administration's policy proposals regarding estate tax, a group of senators led by Chris Van Hollen (D-MD) has introduced the *Sensible Taxation and Equity Promotion (STEP) Act*. The STEP Act proposes to do the following:

- Tax built-in gain upon the transfer of appreciated assets by gift (including transfers to trusts commonly used in estate planning) during the transferor's lifetime with only a $100,000 lifetime exemption.
- Tax all non-grantor trusts on all of their appreciated assets every 21 years and impose additional reporting requirements on trusts with assets of more than $1 million or with gross income of more than $20,000.
- Tax at death the built-in gain on the decedent's appreciated assets with a $1 million exemption. Gains on a personal residence of up to $500,000 for married couples and appreciation on assets held in retirement accounts would be exempt. The income tax paid by the estate on such gains would be deductible for estate tax purposes.

Conclusion

The American Jobs Plan is an ambitious and noteworthy first step for President Biden, who campaigned on the ideas of transformative infrastructure investments and accompanying changes to the tax code to pay for them. It remains uncertain, however, whether the Biden administration will be able to garner the support necessary to achieve its full legislative agenda, given the slim majority held by Democrats in the Senate and the low likelihood of any Republican support.

President Biden is looking to deliver a win on his campaign promise of fixing the United States' crumbling infrastructure and will certainly be pushing for legislation. In light of the proposed price tag, it seems certain that some amount of tax reform is on the horizon if he wants to deliver on that promise.

Key Contacts: Peter Glicklich, Michael N. Kandev and R. Ian Crosbie