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# American Families Plan: Biden's "Called Shot"…or Not

Babe Ruth stood out for his talent and showmanship, even on a Yankees team with eight other future Hall of Famers. Ruth set hitting records and inspired legends—especially his "called shot" in the 1932 World Series against the Chicago Cubs.[1] The score was 4-4 in the fifth inning. In response to heckling from the Cubs players, Ruth stepped up to the plate and pointed to center field with a boldness that defied baseball's unwritten rules of decorum. Even for the Babe, hitting a homer was no sure thing. However, in this case, a legend was born, as Ruth did indeed blast the ball out to the deepest part of the stadium for a home run and the Yankees went on to win the World Series.

Unlike Babe Ruth, candidates running for office are typically vague when indicating what they plan to do. However, during the 2020 election campaign, Joe Biden boldly announced that if he won, he would enact tax policies that resulted in "the rich" paying more. After a hotly contested election, Biden took office in January 2021 and, much like Ruth's called shot, began to issue executive orders and pass legislation to further his stated agenda. In direct opposition to President Trump's tax cuts from the Tax Cuts and Jobs Act of 2017, the Biden Administration released details of the American Families Plan.

Although this legislation still needs to pass Congress, in this issue of *The Good Advisor*, we look at the potential increases to both income and capital gains taxes that this legislation could bring and, more specifically, how these changes might impact charitable giving.

## The American Families Plan

The Biden Administration's American Families Plan (AFP) is a $1.8 trillion spending proposal that features $1 trillion in stimulus spending and $800 billion in tax cuts that benefit lower and middle-income workers and families through permanent and expanded credits and closing or reducing tax loopholes.[2] According to the Administration, the overarching goal is for the bill to be largely deficit-neutral. This means it won't result in any additional federal government spending despite the hefty price tag, since spending will be funded by substantially increasing taxes on households making over $1 million along with households in the highest income tax bracket. Theoretically, the American Families Plan budget will be fully paid for over 15 years by increasing both income and long-term capital gains taxes.

Of course, as this tax plan makes its way through Congress, it is sure to be challenged in both chambers by Republicans strongly defending the Trump tax cuts and more progressive Democrats who believe the plan does not go far enough. However, while we wait to see what the final version may contain, it is important to look at key aspects of the AFP and begin considering how these changes might impact clients and their philanthropic plans.

### Income Tax

In 2017, the Trump administration introduced the Tax Cuts and Jobs Act (TCJA), which significantly reformed the Internal Revenue Code (IRC). From an individual income tax perspective, the TCJA kept the same number of tax brackets but lowered the rates and widened the ranges for tax years 2018–2025.

Under the proposed AFP, the highest tax bracket will return to the pre-TCJA 39.6% from the current

37%. These taxpayers would pay the increased rate:

- Single taxpayers (and head of household) with incomes over $518,400
- Married filing jointly with incomes over $622,050
- Married filing separately with incomes over $311,025

**DONOR IMPACT:**

Taxpayers who are just within the income range of this bracket may feel the impact of the additional 2.6% more during this COVID-affected economy than they would have during an economic boom. This combination (a slightly greater tax burden and an uncertain economy) may cause donors to feel hesitant about continuing with certain planned gifts or making new gifts. Affected donors may appreciate an exploration of charitable giving tools that can provide future income.

## Capital Gains Tax

The TCJA did not change the capital gains tax rate or the net investment income tax (NIIT) rate. It did, though, change the brackets for capital gains, so that the top 20% rate no longer lines up with the top income tax bracket, but instead has its own threshold that falls in the middle of the 35% bracket.

Long-term capital gains rates for 2021 are:

| Tax Rate | Single | Married Filing Jointly | Head of Household | Married Filing Separately |
|---|---|---|---|---|
| 0% | Up to $40,400 | Up to $80,000 | Up to $54,100 | Up to $40,400 |
| 15% | $40,401 - $445,850 | $80,801 - $501,600 | $54,101 - $473,750 | $40,401 - $250,800 |
| 20% | Over $445,850 | Over $501,600 | Over $473,750 | Over $250,800 |

Biden's proposed increase to the capital gains tax is even more significant than the proposed increase to the income tax. If the AFP passes successfully, the top rate for long-term capital gains tax will increase from 20% to 39.6% for those making $1 million or more. According to the White House, this increase will only affect around 500,000 households.

It is important to note that the AFP does not include any change or adjustment to the net investment income tax created in the Health Care and Education Reconciliation Act of 2010.[3] The NIIT is typically associated with items of passive income in three categories:

1. Gross income from interest, dividends, capital gains, non-qualified annuities, royalties, and rents—income that is not derived in the ordinary course of a trade or business
2. Gross income derived from a business that is either a passive activity (within the meaning of IRC §469) or a business that trades in financial instruments or commodities as defined in IRC §475(e)(2)
3. Net gain (to the extent taken into account in computing taxable income) attributable to the disposition of property other than property held in a business that is neither a passive activity nor trades in financial instruments or commodities

When adding the NIIT to the proposed AFP's increased capital gains rate, taxpayers with income over $1 million face a maximum capital gains tax rate of 43.4%.

**DONOR IMPACT:**

If the AFP increases the tax on long-term capital gains, it may make long-term capital gain property an even more desirable option for charitable giving. Typically, these gifts are simple to make, with the donor transferring possession of the asset to the charity using any document of title. The gift is deductible at fair market value (FMV) up to 30% of adjusted gross income (depending on the donee), with a five-year carryover of any excess deduction. Because the donor does not owe any capital gains tax on appreciation, significantly appreciated property is a tax-wise giving choice that may allow for a more substantial gift.

***Example:*** Michael owns appreciated property with a fair market value of $5,000—property he purchased years ago for $1,000.

If Michael sold the property and donated the cash, he would have to pay a capital gains tax of approximately $800 (a gain of $4,000 taxed at 20%) plus the net investment income tax of $152 (3.8% on capital gains for taxpayers with MAGI above $200,000 or $250,000 for joint filers). The cash donation would be $4,048—well short of the property's $5,000 FMV.

However, if Michael makes a gift of the appreciated property, the qualified charity receives property worth the full $5,000, and Michael's net cost of making that charitable donation is far less:

| | |
|---|---|
| Gift amount (FMV of property) | $5,000 |
| Tax savings from the charitable income tax deduction (assuming a 37% income tax bracket) | ($1,850) |
| Tax savings (capital gains tax + NIIT) | ($952) |
| Net Cost of Gift | $2,198 |

An increase in the highest income tax bracket would increase Michael's charitable deduction, and an increase in the capital gains tax (if it applied to Michael) would result in greater tax savings for his gift.

### Child Tax Credit

If signed into law as it stands, the AFP will expand the Child Tax Credit that was passed in the TCJA and make it permanently refundable. The White House notes that the proposed legislation "expands the Child Tax Credit from $2,000 per child to $3,000 per child for six-years old and above, and $3,600 per child for children under six. It also makes 17-year-olds eligible for the first time and makes the credit fully refundable on a permanent basis, so that low-income families—the families that need the credit the most—can benefit from the full tax credit."[4] The AFP would also make this a credit that is "delivered regularly," meaning that a family claiming this credit would receive regular payments during the year rather than waiting to claim the credit at tax time each year.

**DONOR IMPACT:**

Those in the upper tax brackets are typically the focus for larger charitable donations, but those in the lower and middle-income tax brackets may still be consistent and faithful charitable givers. While these donors may not be able to make a large one-time gift, a lifetime of smaller weekly or monthly donations can still result in a significant overall gift. For some of the families who will receive this expanded tax credit, the decrease in their financial burden could result in an increase in regular donations.

## Home Run or Big Miss?

Perhaps the opposite of Babe Ruth's "called shot" is Mighty Casey's misplaced certainty in Ernest Lawrence Thayer's poem "Casey at the Bat." Up to bat in the final inning and fully intending to bring his team to victory, Casey was not as fortunate as the Babe:

> Oh, somewhere in this favored land the sun is shining bright,
>
> The band is playing somewhere, and somewhere hearts are light;
>
> And somewhere men are laughing, and somewhere children shout,
>
> But there is no joy in Mudville—mighty Casey has struck out.

President Biden has stepped up to the plate and is taking a proverbial swing at changing our nation's tax policy. Though the contents and specifics of the bill will certainly change over the course of the debate on its ratification, the Democrat-controlled House and the presence of Vice President Harris as a tiebreaker in the Senate makes it possible that, with enough party-line maneuvering, it could pass almost as proposed. With rising inflation, a burgeoning stock market, and exploding home values, the increased tax on capital gains alone could have a farther-reaching effect than the stated desire to impact only the wealthy.

At this point, there is no clear answer as to whether the American Families Plan will be a home run or a big miss. What is certain is that knowledge, planning, and preparation are the keys to navigating any tax policy that comes out of Washington.

### ENDNOTES


1 John Horne, "The Babe's Called Shot," Baseball History Series, National Baseball Hall of Fame. baseballhall.org/discover-more/stories/baseball-history/called-shot

2 "Fact Sheet: The American Families Plan," The White House Briefing Room, April 28, 2021. whitehouse.gov/briefing-room/statements-releases/2021/04/28/fact-sheet-the-american-families-plan/

3 IRC §1411.

4 "Fact Sheet: The American Families Plan," The White House Briefing Room, April 28, 2021. whitehouse.gov/briefing-room/statements-releases/2021/04/28/fact-sheet-the-american-families-plan/

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