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What the AFP, ARP, and AJP mean for states

Presentation for the Governor's Council on Tax Reform

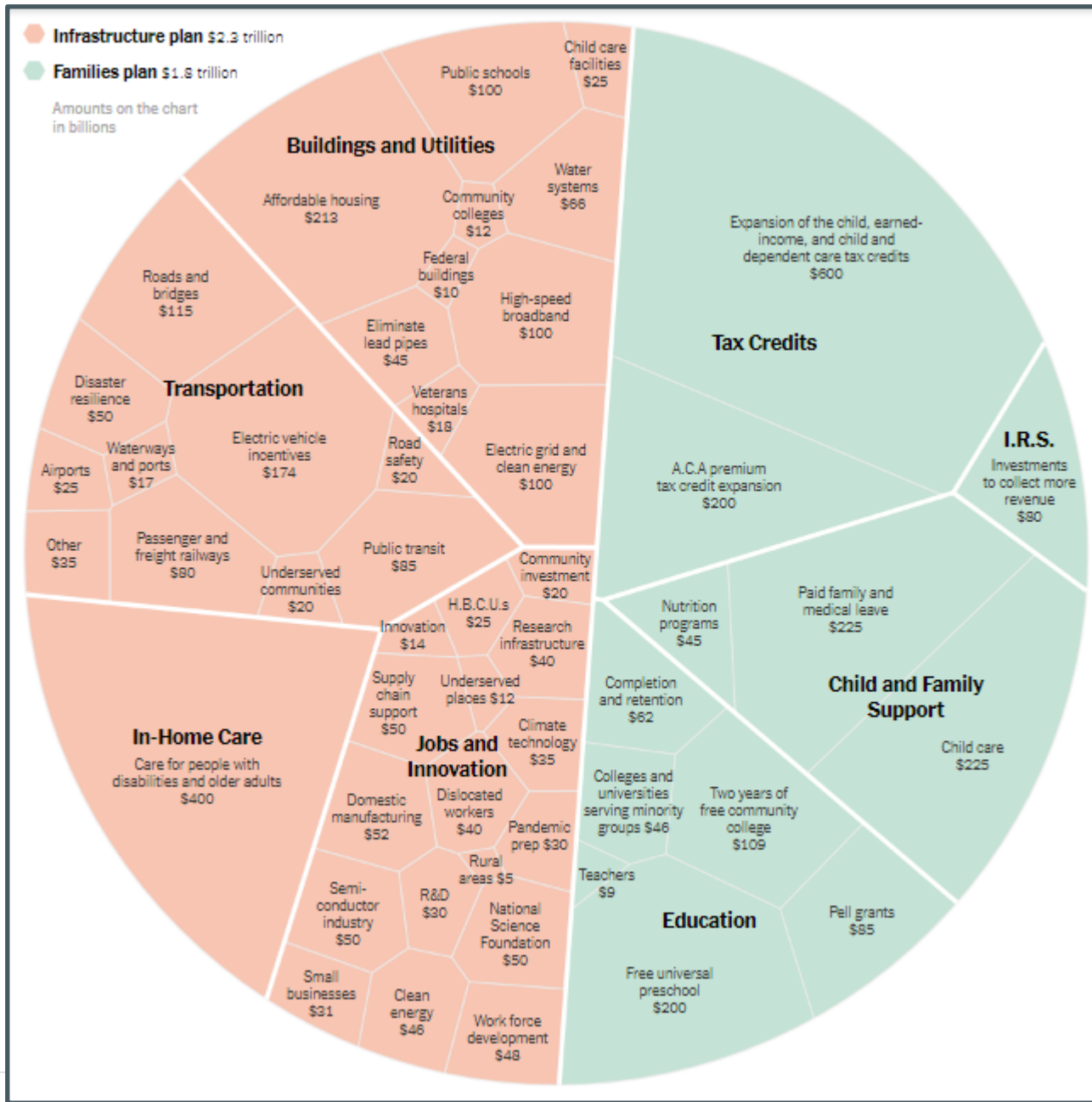
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What major federal legislation means for states



- American Rescue Plan (ARP) – *enacted: \$1.9 trillion over decade*
 - \$350 billion in state and local aid
 - Federal rules on how the federal dollars can be spent
 - What we know about ARP's state tax cut restriction
- American Jobs Plan (AJP) – *proposed March 31: \$2.3 trillion over decade*
 - Major focus on transportation (EVs, bridges and highways, public transit), energy-efficient housing units, broadband, domestic manufacturing, and home care services
 - Includes significant federal corporate tax changes
- American Family Plan (AFP) – *proposed April 28: \$1.8 trillion over decade*
 - Major focus on education (free pre-K, community college) childcare, healthcare expansion, and extension and expansion of credits introduced in ARP
 - Includes expansion of income taxes, largely rate changes and increased enforcement



Source: The White House; Alicia Parlapiano. "Biden's \$4 Trillion Economic Plan, in One Chart." *The New York Times*. April 28, 2021.

Notes: The plan released by the White House did not include estimated costs for the expansion of the child tax credit, earned-income tax credit, or child and dependent care tax credit. The \$600 billion estimate is the difference between the total tax cuts mentioned in the plan (\$800 billion) and the \$200 billion included for Affordable Care Act premium tax credits.

American Families Plan

\$1.8 trillion to help workers, families, children (over a decade)

- \$500 billion for education (free universal pre-kindergarten, tuition-free two-year community college, expansion of Pell grants and HBCU grants)
- \$600 billion for expansion and extension of the child credit, EITC, child and dependent care credits (*New York Times* estimate)
- \$500 billion for child and family support (childcare subsidies, family and medical leave)
- \$200 billion for expansion of healthcare (ACA premium tax credits)
- \$80 billion for IRS investments to increase enforcement and collections

\$1 trillion in spending, \$800 billion in tax credits

This is all an outline, we're waiting on more details

Plan to raise \$1.5 trillion over a decade, by:

- Improving enforcement and decrease tax evasion (\$700 billion over 10 years)
- Raising the top marginal tax rate to 39.6% from 37% for top 1% of taxpayers
- Raising capital gains and dividend tax rates for those earning more than \$1 million
- Eliminating step-up of basis at death for high-income taxpayers for those earning more than \$1 million
- Ending special real-estate break for exchanging property
- Ending carried-interest loophole (hedge fund)
- Ensuring 3.8 percent Medicare tax is applied consistently across all taxpayers earning over \$400,000

We hope to have estimates shortly

Impact on state income taxes

- Limited direct effect for states from tax rate changes
 - But could affect timing of capital gain realizations, decreases in state revenues
- Increased tax enforcement could increase state revenues through increased reporting of income (and if piggyback on audit cases)
- Step-up of basis and tax on unrealized capital gains, closing loopholes could flow through to states
- EITC expansion could increase value of state credit depending on conformity
- Changes to SALT deduction limit may be added in future versions of proposed plans

American Rescue Plan

\$350 billion in direct aid to state and local governments

- \$195.3 billion for states
 - Small share divided equally; larger share divided by 3-month Dec 2020 unemployment rates
 - **Kansas: \$1.586 billion**
- \$130.2 billion for local governments
 - County aid is based on population, municipal aid is distributed based on the federal Community Block Grant formula (based on population, poverty levels, and housing overcrowding)
 - **Kansas: \$989 million**
- \$10 billion for capital projects
 - **Kansas: \$143 million**
- **Kansas total federal ARP funds: \$2.718 billion**

What ARP funds can (and cannot) be spent on

- Responding to the public health emergency
- Offsetting the pandemic's negative economic effects
- Providing premium pay for front-line public sector workers
- Replacing lost tax revenue
- Investing in infrastructure improvements
- **ARP funds cannot be spent on (state) tax cuts or pension contributions**
 - “A state or territory shall not use the funds ... to either directly or indirectly offset a reduction in the net tax revenue ... (by providing for a reduction in a rate, a rebate, a deduction, a credit, or otherwise) or delays the imposition of any tax or tax increase.”
 - Treasury can clawback every dollar in violation of this rule
 - Treasury working on rules in how this is defined
 - Conformity to federal changes okay – still waiting on more information

Does ARP really end states' abilities to cut taxes? (Hint: Of course not)



- The AG of Ohio immediately sued the Biden administration over the state tax cut restriction; 21 other Republican AGs wrote a letter to Treasury threatening legal action
- In a response, Secretary Janet Yellen wrote the ARP provision is conventional congressional guidance and only applies to these specific federal funds
 - “Nothing in the Act prevents States from enacting a broad variety of tax cuts. That is, the Act does not ‘deny States the ability to cut taxes in any manner whatsoever.’ It simply provides that funding received under the Act may not be used to offset a reduction in net tax revenue resulting from certain changes in state law. If States lower certain taxes but do not use funds under the Act to offset those cuts—for example, by replacing the lost revenue through other means—the limitation in the Act is not implicated.”
- Additional lawsuit brought by 13 additional states
- Still, all states need official Treasury guidance as they move forward this year

Prominent examples of possible state tax cuts and ARP implications



- Fully exempting unemployment benefits (AR, DE, MD did before the ARP; others considering) or conforming with the ARP's \$10,200 exemption
 - Conforming to Federal changes are okay
- Using ARP funds to restore unemployment insurance trust funds (and prevent tax hikes)
 - Many states used CARES funds for this; Maryland just announced it will use ARP funds for this. Also hard to imagine this use of federal funds triggering the restriction
- Enacting or expanding an earned income tax credit or child tax credit
 - Very much in line with the stated goals for the ARP funds
 - Likely able to do more of this with expansions in AFP
- Small changes such as increasing the standard deduction or retirement income credits
 - Will probably depend on the specific proposal and the specific state's fiscal standing
- Eliminating the state income tax without offsets (Mississippi and West Virginia)
 - This could certainly trigger the restriction – reason for inclusion

Other notable recent state tax trends

- New York approved legal and taxable marijuana sales
 - New Mexico is also close to approving legislation
 - North Dakota rejected legislation
- Florida approve *Wayfair* legislation that will allow these states to collect tax from online transactions including marketplace-facilitator. Louisiana moving bill for standard local rate.
- Other state changes still being considered, WV still talking about large decreases in income tax rates
- More states conforming (NY agreed to federal PPP treatment)

American Jobs Plan

\$2 trillion infrastructure (over 8 years)

- \$115 billion for highways and roads
- \$85 billion to modernize existing transit systems
- \$174 billion in grant and incentive programs for state and local governments and the private sector to build a national network of 500,000 electric-vehicle chargers by 2030
- \$25 billion for airports
- \$100 billion to deliver universal broadband (particularly for rural Americans)
- \$213 billion for affordable and sustainable housing

- This is all an outline. We're still waiting on more details.

\$1.8 trillion tax plan (over 15 years)

Made in America Tax Plan

- Raises the corporate tax rate from 21% to 28%
 - Note: Federal rate changes do not affect state taxes
- Increases the global minimum tax (GILTI) paid from about 13% to 21%
- Impose a 15% minimum tax on the income large US corporations report to their shareholders
- Repeal the base erosion and anti-abuse tax (BEAT) and replace it with an unspecified provision to bar foreign corporations based in countries that do not adopt their own “strong” minimum tax from deducting intra-company payments
 - These changes could affect state taxes (because they are changes to the tax base) but the change will most likely be small
 - Question if will include changes in SALT limit