Feeling Blue: What to Expect in 2021

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Here's what CPAs and financial planners should keep in mind as we head into 2021 with Democratic majorities in the House and Senate and a new president in the White House.

So far, 2021 continues the 2020 theme of "expect the unexpected." The election cycle of 2020 finally ended on January 5 with the Georgia runoff elections where Democrats won both Senate seats. As a result, President Joe Biden enters his first term with small Democratic majorities in both the House and the Senate. While not exactly the blue tsunami Democrats were hoping for, Democratic control opens the door for significant tax and regulatory policy changes in 2021 and beyond. Here are the major changes to watch and plan for this year.

The American Rescue Plan

On January 14, President Biden outlined his American Rescue Plan, offering the first glimpse of what 2021 legislation would look like. The $1.9 trillion economic relief plan is the first step in a two-part plan that is needed immediately and will be followed by an economic recovery plan in February. The American Rescue Plan would bring the total amount of COVID-19 relief to upwards of $5 trillion. Here are the most important proposals included in the bill.

The American Rescue Plan would send $1,400 in direct payments to most Americans. It would also allow residents who are married to undocumented residents—who were barred in prior rounds—to receive stimulus payments.

Biden's plan includes $20 billion to create a national vaccine distribution program that would offer free shots to all U.S. residents regardless of immigration status. The plan calls for creating community vaccination centers and deploying mobile units in hard-to-reach areas. Biden is also calling for $50 billion to ramp up testing efforts, including purchasing rapid-result tests, expanding lab capacity, and helping local jurisdictions implement testing regimens.

The plan would expand tax credits for low- and middle-income families and make them refundable for 2021, expanding the child tax credit to $3,000 from $2,000 for each child 17 and younger. Children under age six would be eligible for $3,600. Biden is also requesting $25 billion for a stabilization fund to open childcare centers and $15 billion in grants to help essential workers meet childcare costs.

The plan also calls for $170 billion to help schools open. About $130 billion would go to K-12 schools to help them hire additional staff to reduce class sizes, modify spaces, and obtain resources to help meet students' academic and mental health needs. The plan would also direct $35 billion to colleges and universities and create a $5 billion fund for governors to direct help to schools hit hardest by the pandemic.

The proposal would extend the eviction and foreclosure moratorium through September and provide $30 billion to help low-income households who have lost jobs to pay rent and utility bills. The plan would also provide $5 billion to states and localities to offer emergency housing for families facing homelessness.

The Biden plan would require all employers, regardless of size, to offer paid sick leave to workers during the pandemic, impacting a projected 106 million workers. Parents and family members caring for sick relatives or out-of-school children could receive more than 14 weeks of paid sick and family leave. The plan would provide benefits of up to $1,400 per week and tax credits for employers with fewer than 500 employees to reimburse them for the cost of the leave. Biden's plan would also extend and expand unemployment benefits that are scheduled to run out mid-March. The proposal increases a weekly federal benefit from $300 to $400 and extends it through the end of September.

The proposal would increase the federal minimum wage from $7.25 to $15 an hour and would end the tipped minimum wage widely used by restaurants and the hospitality industry.

Biden is proposing to leverage $35 billion in government funds into $175 billion in low-interest loans to finance small businesses. He is also calling for $15 billion in grants for small business employers.

Finally, the proposal includes $350 billion in funding assistance for state, local, and territorial governments plus $20 billion for public transit systems.

The Build Back Better Recovery Plan

President Biden has said his American Rescue Plan will be followed by a second economic recovery plan, the Build Back Better Recovery Plan, targeted toward recovery, infrastructure, green energy, health care, and education initiatives. It will focus on the longer-term recovery and will be outlined in more detail in February.

Biden's Campaign Tax Platform

From a tax policy perspective, 2021 could be a year of significant legislative tax change as well. Biden's American Rescue Plan did not include any tax increases, and with stimulus plans taking priority, it may be mid-year or later before a Biden tax package is put forth. Biden's campaign plan included increased income tax rates on taxpayers with income greater than $400,000, increased social security taxes on income above $400,000, and increased capital gains rates on income above $1 million. Many other tax cuts in the Tax Cuts and Jobs Act (TCJA) could be rolled back as well, including the 21 percent corporate tax rate.

Some fear that these tax increases will be retroactive to Jan. 1, 2021, which is certainly possible. The last time a significant tax increase was enacted retroactively was in August of 1993, when the Omnibus Budget Reconciliation Act included an increase in the top estate tax rate from 50 percent to 55 percent, retroactive to January 1, 1993. However, most feel that retroactive tax increases are unlikely since unemployment is still high and the economic recovery from COVID-19 has been slow. It seems more likely that the expected tax increases would be effective later in 2021 or on Jan. 1, 2022, giving investors more time to plan.

While Democrats seem united in rolling back the tax cuts in the TCJA for high-income households, there are party differences on the finer points of how to raise taxes. The 50-50 split in the Senate means that to pass a tax bill, every Democratic senator will need to support it if no Republicans do, setting the stage for extensive negotiations on any potential legislation. Some moderate Democrats have already expressed concern over the size of President Biden's proposals, and he will need their full support to pass any bill. In addition, because Democrats have slim hope of securing the 10 Republican votes necessary to avoid a filibuster, they will likely need to use the budget reconciliation process to advance any legislation, forcing more targeted and revenue neutral proposals.

Securing a Strong Retirement Act

In October 2020, the Securing a Strong Retirement Act was introduced in the House. If passed, this bill would significantly impact 401(k)s, 403(b)s, and IRAs, helping employers improve the strength of their retirement offerings by expanding coverage and increasing retirement savings. Here are the key proposals in the bill.

The bill would raise the age to begin mandatory distributions. While 2019's Setting Every Community Up for Retirement Enhancement (SECURE) Act generally increased the required minimum distribution (RMD) age to 72, the proposed legislation would bump it up again to 75.

The bill would exempt individuals with low account balances from RMD rules, no longer requiring participants to take a RMD if the balance in their retirement plans and IRAs (excluding defined benefit plans) is not more than $100,000 indexed on December 31 of the year before they turn 75.

The proposal would also reduce the excise tax on certain accumulations in qualified retirement plans, such as reducing the penalty for failure to take a RMD from 50 percent to 25 percent. If a failure to take a RMD is corrected in a timely manner (as defined by the bill), the excise tax on the failure is reduced again from 25 percent to 10 percent.

The legislation would allow a higher catch-up contribution after age 60. Currently, employees who are ages 50 and older can make catch-up contributions to retirement plans that exceed overall applicable limits. For 2021, the catch-up contribution limit is $6,500, and the proposed legislation would increase this limit to $10,000 for individuals over age 60. It would also allow employers to offer small immediate financial incentives, like gift cards, to employees for contributing to a retirement plan.

It would also build on the SECURE Act by expanding automatic enrollment in retirement plans. Employers offering 401(k), 403(b), and SIMPLE plans would be required to automatically enroll eligible participants unless employees opt out. The initial automatic enrollment deferral would be at a minimum of 3 percent but no more than 10 percent. Each year, the amount would increase by 1 percent until it reaches the maximum 10 percent.

The proposal would amend the Saver's Credit to create a single 50 percent rate, increase the maximum credit amount from $1,000 to $1,500 per person, and raise the maximum income eligibility amount. The legislation would index the credit to inflation. It would also index IRA catch-up limit contributions beginning in 2022. Under current law, the limit on IRA contributions is increased by $1,000 (not indexed) for individuals who have reached age 50.

Finally, the bill would modify the credit for small employer pension plan startup costs. The proposed credit would be increased from 50 percent of administrative costs to 100 percent for employers with up to 50 employees. The applicable percentage would be 100 percent in the first and second years, 75 percent in the third year, 50 percent in the fourth year, and 25 percent in the fifth year.

2021 is shaping up to be another year of significant new legislation in the wake of the blue wave, leading to many tax and financial planning opportunities for CPAs, financial planners, and investors to navigate. With the potential of retroactive tax legislation unlikely, we can start planning now for these upcoming changes.

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