Insight

Major Tax Policy Changes in the Consolidated Appropriations Act

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Executive Summary

- On December 21, Congress passed the Consolidated Appropriations Act, 2021 (CAA) – a single legislative vehicle for a long-awaited COVID-related fiscal relief package, an omnibus appropriations act, and a tax extenders package.
- Among the many provisions in the legislation are tax policies designed to provide relief from the economic fallout from the COVID-19 pandemic.
- The most conspicuous and costly among the tax provisions in the legislation is a second round of recovery rebates of $600 per taxpayer.
- In total, the CAA contains 72 separate tax-related provisions, though most are somewhat routine extensions or clarifications.
- Combined with other elements in the legislation, the direct payments provide a substantial fiscal boost as the United States enters a challenging holiday season.

Introduction

On December 21, Congress passed the Consolidated Appropriations Act, 2021 (CAA) – a single legislative vehicle for a long-awaited fiscal relief package, an omnibus appropriations act, and a tax extenders package. Among the major federal policies in the legislation are tax policy changes. Perhaps the most conspicuous and certainly the costliest single tax policy in the legislation is a second round of direct payments to eligible individuals of $600 per taxpayer, at a cost of $164 billion. The legislation also clarifies the tax treatment of PPP loans, and it enhances and expands several tax provisions in the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Combined, the CAA contains 72 new tax policies, myriad extensions, refinements, and other tax-law clarifications for a combined cost of $328 billion. While the majority of this cost is devoted to COVID-related fiscal relief, this total reflects the inclusion of a tax extenders package that includes substantially unrelated, or only proximally related, tax policies. This analysis examines the most significant new tax policies in the CAA.

Direct Payments

The CAA provides a direct payment to individuals and families. For individuals with incomes up to $75,000, the Act provides a $600 payment, phasing out at a rate of $5 for every $100 in income above $75,000. The payment is thus phased out entirely for an individual making $87,000. Married couples with combined incomes up to $150,000 would receive $1,200, subject to the same phaseout as that applying to individuals. Thus, for married couples making $174,000, the payment would be phased out. The provision also provides an additional $600 per child, though also subject to phaseout. Eligibility and benefit levels would be based on 2019 income tax filings. Individuals will not be required to repay any overpayment when filing their 2020 taxes next year.

According to analysis by the Kyle Pomerleau of the American Enterprise Institute, 84 percent of U.S. households should receive the full rebate, while another 5 percent should receive a reduced rebate. The Joint Committee on Taxation (JCT) estimated that this provision would cost $164 billion, down considerably from the $293 billion cost of the $1,200 rebates in the CARES Act.

Clarification of Tax Treatment of PPP Loans

The CAA clarified the tax treatment of otherwise-deductible expenses for recipients of forgivable loans under the Paycheck Protection Program (PPP). Typically, when businesses compute their tax liabilities, they deduct business expenses such as the costs of their payrolls. The difference between a firm's deductible expense and its receipts is of course its income, on which the firm pays the applicable tax. When Congress established the PPP, largely to fund eligible businesses payrolls, Congress made clear that the loans should not be taxable. Congress was less explicit, however, in clarifying that expenses funded by PPP loans would also remain deductible. When congressional budget agencies assessed the cost of the CARES Act, they assumed the intent of Congress was to allow those expenses to remain deductible. The IRS, however, issued guidance that precluded the deduction of those expenses, with the expressed approval of Secretary Mnuchin. Because the budget agencies assumed the cost of these deductions in cost estimate for the CARES Act, this clarification will not add costs beyond those originally estimated, but the legislative clarification will allow for deductions of, by one estimate, $120 billion to be granted.

Enhanced Retention Credit

The CARES Act created a new tax credit to incentivize firms to retain their workforce, available through the end of the year. The provision provided eligible employers with a refundable tax credit equal to 50 percent of employee compensation (inclusive of health insurance) up to $10,000 per employee. The CAA substantially enhances the eligibility and generosity of the CARES Act credit by increasing the credit percentage to 70 percent of qualified wages, expanding the wage base to $10,000 per employee per quarter (as opposed to per year), and reducing the thresholds for losses that business must meet to be eligible for the credit. The Act also expands the credit to include publicly charted entities, such as credit unions, and public universities and hospitals. Uptake of the credit has been somewhat modest, in part because firms could not simultaneously claim the retention credit and participation in the more popular PPP program. The CAA also provides that firms receiving PPP loans may claim the new, enhanced retention credit to pay any payroll expense not otherwise covered by PPP. The credit is set to expire four quarters after June 30, 2021. JCT estimated these provisions would cost $20.5 billion.

Business Meal Deduction

Under current law, firms may deduct the 50 percent of the cost of business-related meals. Typically – and under an income tax, correctly – firms may deduct the full cost of ordinary expenses. By that logic, business meals should be fully deductible. Since people must eat irrespective of the tax code, however, some portion of fully deductible business meals would simply subsidize individual consumption. In 1993, Congress limited this deduction to 50 percent. The CAA temporarily increases this deduction to 100 percent through the end of 2022 at a cost of $6.3 billion.

Temporary Lookback for Earned Income Tax Credit and Child Tax Credit

The Earned Income Tax Credit (EITC) and Child Tax Credit (CTC) are two of the most robust income support programs the federal government delivers. Run through the tax code, these programs offer refundable tax credits to working Americans. These programs, however, require taxpayers show "earned" income for the year in which they claim the credits. The EITC provides a credit as a percentage of their earnings up to a certain maximum, while the CTC provides a fixed dollar amount credit (again subject to phaseout) for taxpayers with earned income above $2,500. Accordingly, taxpayers who have lost employment in 2020 could receive reduced income support through these programs. The CAA allows taxpayers to use 2019 tax information for the purposes of claiming these credits. JCT estimated this policy would cost $4.1 billion.

Enhanced Charitable Deduction

The CARES Act created a new tax incentive for charitable giving by providing individuals with a new $300 above-the-line deduction on charitable donation and increasing previously enacted limitations on charitable deductions. As an above-the-line deduction, this provision allows taxpayers who do not normally claim itemized deductions to deduct contributions up to $300. The CAA extends this policy for a year and increases the limit to $600 for married couples. JCT estimated this policy would cost $2.9 billion.

Extension of Paid Sick and Family Leave Credits

The Families First Coronavirus Response Act established refundable payroll tax credits to compensate employers for costs associated with paid sick leave as well as the family and medical leave separately mandated in the Act. CBO estimated the cost of these credits to be $95 billion over 2020-2021. These credits were subject to sunset at the end of the year. The CAA extends these credits for three additional months at a cost of $1.6 billion.

Payroll Tax Deferral

In August, the president issued a memorandum that allowed employers to elect to defer employees pay roll taxes until January of next year, providing employees essentially with an interest-free loan. Under the previous provisions, employers would be required to increase withholding and pay the deferred amounts between January 1, 2021 and April 31, 2021, after which, penalties and interest on deferred unpaid tax liability would begin to accrue. The CAA extends the repayment period through December 31, 2021. While the policy assumes taxpayers do repay the deferral, the JCT estimated this policy would lose $16 million.

Conclusion

The CAA provides the next phase of Congress's fiscal response to the COVID-19 pandemic. In addition to other major interventions, the bill contains 72 tax provisions to provide relief to individuals and businesses, including $164 billion in payments to individuals and families.