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Thoughtful Investing.

The American Rescue Plan Act:

Potential Consequences for Clients

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The American Rescue Plan Act (ARPA) of 2021, the third in a massive series of COVID-19 relief packages, provides individuals and businesses with support in the form of direct payments, unemployment benefits, forgivable loans and other policy measures to promote the resumption of normal social and economic activities. ARPA also provides support for states and local government as its largest provision. This article explores some ways ARPA impacts our clients' lives and interests.

ARPA is landmark legislation that, along with COVID-19 relief, includes groundbreaking anti-poverty provisions geared towards children. Tax credits, including an expansion of child tax credits, are the second-largest provision in ARPA and account for $338B over the next ten years.

The legislation's provisions for financial support predominately benefit individuals and businesses hit hardest by the pandemic. This focus may disproportionately include those in lower-income brackets, and many of our clients may not be affected directly.

However, the legislation's support for vaccinations, testing and social distancing should be of interest to everyone. Moreover, given the sheer size and breadth of the legislation, the spending measures in ARPA may impact our clients meaningfully.

The Biden administration encountered numerous political hurdles in passing ARPA, and had to give up some high-profile Democratic proposals and use the budget reconciliation process to pass the bill. These challenges may signal future challenges in passing other parts of President Biden's agenda, especially tax increases.

A. ARPA may impact our clients as investors.

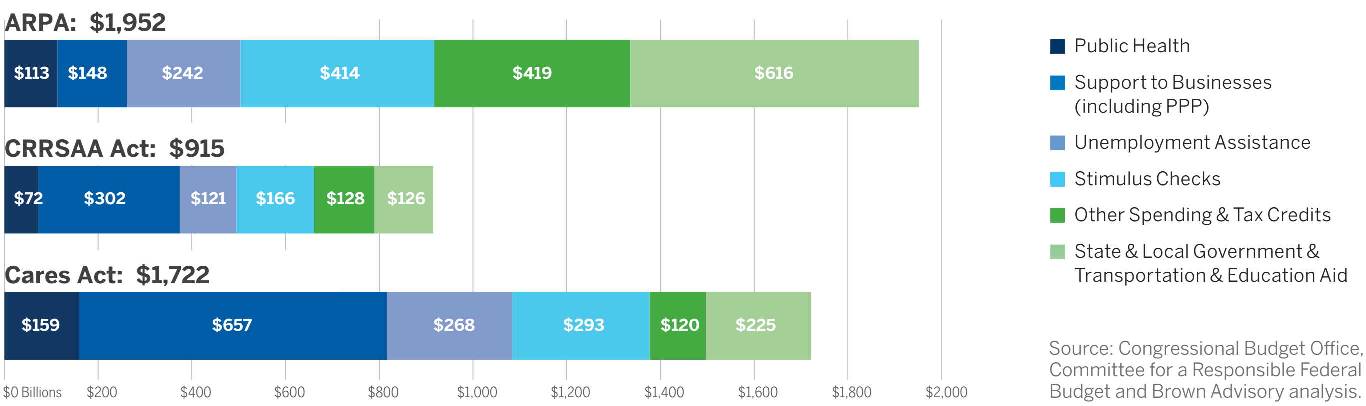
Economic Stimulus that is provided by ARPA may be positive for the overall economy and perhaps the companies in which our clients invest. ARPA provides $1.9 trillion to states and local governments, households and businesses, on top of the stimulus provided by the Coronavirus Aid, Relief and Economic Security ("CARES") Act enacted in March 2020. According to the Bureau of Economic Analysis, the $1.9 trillion provided by ARPA amounts to 14% of 2020 GDP and is expected to increase economic demand and GDP growth. GDP growth projections for 2021 are currently at 5.6%, according to Bloomberg, the highest since 1984.

Inflation Risk. Increased government spending and the expected increase in demand resulting from the payments to ARPA's beneficiaries and the economy reopening may create inflationary pressures. The stimulus comes as household savings already total $3.93 trillion as of January 31, 2021, according to Bloomberg.

That figure is nearly three times the yearly average of $1.03 trillion for the decade between 2010 and 2019. The stimulus, high household savings and pent-up demand may increase the risk of overheating the economy. Inflation could also lead to higher interest rates, which would impact the performance of many asset classes.

ARPA supports a broad set of initiatives and puts greater emphasis on individual, state and local government relief.

Estimated 10-year cumulative outlays of major federal Coronavirus relief bills.



Source: Congressional Budget Office, Committee for a Responsible Federal Budget and Brown Advisory analysis.

B. ARPA may affect some of our clients as business owners and taxpayers.

Extension of Paycheck Protection Program (PPP) Loans and Employee Retention Credits. The additional funding for the PPP program and payroll credits can serve as an important source of cash flow to help businesses retain employees and cover other fixed costs necessary to stay in business. Additionally, ARPA sets aside funds for restaurant and events venues, which have been especially hit hard by the pandemic.

Business Tax Provisions. ARPA includes tax changes to generate some revenue, giving us a preview of changes to come and underscoring that Biden and the Democratic leadership in Congress need to raise revenue to carry out their agenda. In ARPA, Congress made some discreet and largely unnoticed tax changes targeting deductions affecting a narrow class of taxpayers, including large international corporations, highly paid executives, and owners of pass-through businesses. These tax provisions are small compared to the large-scale tax increases Biden has proposed and which are expected in a subsequent round of legislation.

Extended Limits on Deductions for Excess Losses. The $500,000 limit on the deduction of excess losses from unincorporated businesses is extended to the end of 2026 from the end of 2025, in part to pay for the suspension of these deduction limits in 2020 as a result of COVID-19. The extended limitation may impact many of our high-earning clients who own businesses through pass-through entities such as LLCs and have significant tax losses in excess of $500,000.

Enhanced Limits on Deductions for Executive Compensation. ARPA expands the number of employees covered by the limitations on deductions for executive compensation above $1 million. The limits will apply to compensation paid to 10 highly compensated employees rather than five as under previous law.

Interest expense/base erosion measures for international corporations. International corporations now have less flexibility to allocate interest expense in a way that minimizes their US tax liability.

Expanded Reporting for the Gig Economy. ARPA increases the reporting of payments to gig workers by platform businesses, such as Uber, eBay and AirBnB.

C. ARPA may impact our clients who are parents to students or young adults.

Educational support. ARPA devotes considerable resources to accelerating a return to in-person learning. The reopening of schools, including colleges and universities, should mean students can spend more time learning at school instead of at home. Closed schools have put tremendous stress on children and parents, often disproportionately on working women. In many cases, this should allow older students to move out of their parent's homes. Also, the discharge of certain student loans is excluded from income until January 1, 2026, which seeks to provide financial relief to certain students.

Stimulus, Unemployment Assistance and Child Tax Credits. Many clients will be relieved that this legislation seeks to provide support to family members who have been unemployed or earn only low or modest incomes. These individuals may be eligible to receive an income tax credit of up to $1,400 per person. Additionally, enhanced unemployment benefits of $300 a week should be continued through September under ARPA. There will also be child tax credits up to $3,600 per child, which is intended for low and moderate-income earners.

D. ARPA may affect our clients' philanthropic goals and activities.

Support for Charitable Organizations. Many of the charitable organizations that our clients support may benefit from ARPA's support for employers. These provisions should help charities maintain staff and cover other fixed costs, making it easier for them to serve their communities and charitable missions. The support for charities includes:

- Additional funding for PPP Forgivable Loans
- Extended Employee Retention Credits
- ARPA's $350B for state and local governments (which are not permitted to cut taxes), some of which might flow through to nonprofits.

Tax Increases May Encourage Charitable Giving. The spending measures in ARPA on top of the growing budget deficit is expected to put additional pressure on Congress to raise taxes. Any subsequent tax increase should increase the tax benefit of charitable giving because the contributions offset higher-taxed income. This enhanced benefit, however, could be undercut on limits on itemized deductions.

E. Our clients will hopefully be able to resume normal personal, social, civic, educational and economic activity sooner as a result of ARPA.

Funding for vaccines should allow more vaccines to be administered more quickly.

Funding for testing and tracing should give more confidence and safeguards for opening up normal activity and minimize the size of any further outbreaks.

F. The passage of ARPA underscores the challenge Biden and the Democrats face in meeting their agenda, particularly with respect to tax increases.

The passage of ARPA underscores the potential roadblocks to enacting tax legislation; it also ramped up deficit spending, increasing pressure on Congress to generate more revenue.

Not a single Republican supported the bill, and there were challenges in bringing Red-State Democrats like West Virginia Senator Joe Manchin on board. These challenges suggest that tax hikes may be more muted than desired by the Biden administration.

Estate tax legislation may be less likely. Tax legislation will likely focus on raising revenue and less on social objectives, such as reducing wealth inequality. Thus, certain tax proposals, such as an estate tax hike, may not be practical or worth the political capital if they do not move the needle on revenue. Estate tax hikes may not be a priority as they generally raise only one to two percent of federal tax revenue.

Conclusion

ARPA is a historic piece of legislation given its size, scope and timing. However, it may take time to assess its long-term impact. It may be viewed favorably in hindsight, much as the Troubled Asset Relief Program (TARP) and auto industry bailouts that followed the financial crisis were. On the other hand, it may also become an example of undisciplined federal spending that provided only temporary solutions while ballooning deficits and spurring inflation. Many of ARPA's policies will likely take time to come into effect, and it may also take substantial effort to deploy the large resources it authorizes. As always, we will continue to monitor this legislation and its programs and help clients take full advantage of ARPA.