ANALYZING

THE REPUBLICAN “TAX CUT”

WHAT SHOULD WE EXPECT FROM OUR TAX SYSTEM?

- We want it to pay for the expenditures authorized by Congress without leading to continually rising deficits. (We hope budgets actually reflect what the citizenry wants and needs.)

- We want our tax system to be fair. (Of course, we have to define what “fair” means.)

THE TRUTH ABOUT THE BILL

- It's a tax cut, not tax reform.
- It is not tax simplification. Indeed, for many taxpayers the bill will make filing more complicated.
- It's not the biggest tax cut in history---not even close.
- For households, it will create winners and losers. Further, individual tax cuts expire in 2025.
- The bill provides corporations with an explicit, permanent preference for earning income in low-tax countries rather than the United States.
- The bill gives a windfall to companies that kept profits "offshore" in the past
- At the end of 10 years, it will increase the deficit by more than the advertised $1.5 trillion. Even so, the estimated deficit increase in the bill would cause automatic cuts in Medicare ($25B), Medicaid and other programs.
- It will not lead to a 3% permanent real economic growth.

WHAT ABOUT INDIVIDUAL TAXES?

- **Lowers (many) individual rates**: The bill retains 7 tax brackets, but changes the rates:
  - New rates: 10%, 12%, 22%, 24%, 32%, 35% and 37%.
  - Old rates: 10%, 15%, 25%, 28%, 33%, 35% and 39.6%.
- **Nearly doubles the standard deduction**: For single filers, an increase to $12,000 from $6,350; for married couples filing jointly an increase to $24,000 from $12,700. The number of filers itemizing could drop sharply, since the only reason to do so is if your deductions exceed your standard deduction.
- **Eliminates personal exemptions**: Today you're allowed to claim a $4,050 personal exemption for yourself, your spouse and each of your dependents. Doing so lowers your taxable income and thus your tax burden. The GOP tax plan eliminates that option. For families with three or more kids, that could mute if not negate any tax relief they might get as a result of other provisions in the bill.
- **Maintains the additional standard deduction for the elderly.** Filers age 65 and older can claim an additional $1,550 if they file as single or head-of-household. Married couples filing jointly can claim $1,250 if one is 65 or older, and $2,500 if both meet the age requirement.
- **Expands child tax credit**: The credit is doubled to $2,000 for children under 17. It also is available to high earners because the bill raises the income threshold for filers to claim the full credit to $200,000 for single parents, up from $75,000 today; and to $400,000 for married couples, up from $110,000 today.
- **Caps state and local tax deduction**: The final bill will preserve the state and local tax deduction for anyone who itemizes, but it will cap the amount that may be deducted at $10,000.

WHAT ABOUT INDIVIDUAL TAXES? (CONT.)

- **Lowers cap on mortgage interest deduction**: On new mortgages you are allowed to deduct the interest on debt up to $750,000, down from $1 million today. Current mortgages are unaffected.
- **Curbs who's hit by AMT**: Reduces filers subject to the AMT by raising the income exemption levels to $70,300 for singles, up from $54,300; and to $109,400, up from $84,500, for married couples.
- **Preserves smaller but popular tax breaks**: Deductions for medical expenses (threshold down to 7.5% from 10%) , student loan interest and classroom supplies bought with a teacher's own money and retains the tax-free status of tuition waivers for graduate students..
- **Exempts almost everybody from the estate tax**. The bill eliminates it for most people by doubling the amount of money exempt from the estate tax--now $5.49 million for individuals, and $10.98 million for married couples. Even at today's levels, only 0.2% of all estates are subject to the estate tax.
- **Slows inflation adjustments in tax code**: The bill would use "chained CPI" to measure inflation —a slower measure than is used today. The net effect is deductions, credits and exemptions will be worth less—because inflation adjusted dollars defining eligibility and maximum value would grow more slowly. More income would be subject to higher rates in future years.
- **Eliminates health insurance mandate**: There’s no longer a penalty for not buying insurance. Expect health insurance premiums to rise.

WHAT ABOUT CORPORATE TAXES?

Slashes corporate rate: The bill cuts the corporate rate from 35% to 21%, starting next year. The bill would also repeal the alternative minimum tax on corporations.

Unlike the Individual tax cuts, the corporate tax cuts are permanent

Through 2022, companies can deduct 100% of the cost of qualified property. (Property with longer production periods and certain aircraft get an extra year of special treatment.) Over the following five years, the amount of bonus depreciation decreases by 20 percent, until the provision sunsets in 2027.

Lowers tax burden on pass-through businesses: The tax burden on owners, partners and shareholders of S-corporations, LLCs and partnerships—who pay their share of the business' taxes through their individual tax returns —would be lowered by a 20% deduction. The 20% deduction would be prohibited for anyone in a service business—unless their taxable income is less than $315,000 if married ($157,500 if single).

Includes rule to prevent abuse of pass-through tax break: If the owner or partner in a pass-through also draws a salary from the business, that money would be subject to ordinary income tax rates.

WHAT ABOUT CORPORATE TAXES? (CONT.)

Change how U.S. multinationals are taxed: Today U.S. companies owe Uncle Sam tax on all their profits, regardless of where the income is earned. They're allowed to defer paying U.S. tax on their foreign profits until they bring the money home. Many argue that this "worldwide" tax system puts American businesses at a disadvantage. That's because most foreign competitors come from countries with territorial tax systems, meaning they don't owe tax to their own governments on income they make offshore.

The final GOP bill will switch the U.S. to a territorial system. It also includes some anti-abuse provisions to prevent corporations with foreign profits from gaming the system. In the meantime it would require companies to pay a one-time tax on their existing overseas profits—15.5% on cash assets and 8% on non-cash assets (e.g., equipment abroad in which profits were invested).

LOOKING AT THE CORPORATE TAX CUT

There are good reasons to cut the corporate tax rate—our statutory rate is higher than almost all other countries. But the corporate tax cut will have a much smaller impact on growth than promised. Plus, the way it is implemented promises to increase inequality.

- Our multinationals consistently face an effective tax rate way below that statutory rate. Boeing, for example, paid an average of only 3% of income between 2002 and 2016. The effective rate is similar for other large multinationals.
- Lower corporate tax rates mostly benefit old investment and encourage tax sheltering. The 21% corporate tax rate is so much lower than the top individual tax rate that there is a strong incentive for the rich to use corporations and other methods as tax shelters.
- The bill may encourage, not discourage, overseas investment. By generally exempting the foreign profits of multinationals from US corporate income tax under a so-called territorial tax system, the bill will encourage US companies to locate investment, jobs, and reported profits overseas.
- The rate cuts will encourage other countries to follow suit. Combined with the new territorial tax system, falling corporate rates overseas will drive more investments and jobs offshore.
- The plan is expensive. If revenue losses are not offset by spending cuts, the increase in government borrowing will reduce future income growth by raising interest rates and discouraging private investment.

THE BILL'S PUNITIVE MEASURES

- <u>Instead of **expanding** the earned income tax credit to encourage work, the legislation will, for the first time in American history, impose a higher tax rate on employment income than on income earned by proprietors and partnerships.</u>

- **There is no evidence to support the administration's claim that the legislation will pay for itself**. Republicans are playing a cynical game. By reducing revenues now, they will be in a position to justify cuts to services benefiting lower- and middle-class Americans down the road – all in the name of "fiscal responsibility" and "entitlement reform."

- **The tax legislation is riddled with provisions that will dramatically increase inequality and limit economic and social mobility**. The legislation amounts to a handout for the wealthy, paid for by the middle class and future generations.

- **The legislation also prioritizes investment in physical and financial capital over more investment in human capital and lifelong learning** to help workers and communities cope with the disruptive effects of automation and artificial intelligence.

- **The legislation is an unabashedly partisan attack on Democratic-leaning states and cities**. The bill will have a disproportionately adverse effect on people living in high-cost Democratic strongholds such as New York and California.

- **The bill intentionally penalizes higher-tax states like California and New York**, by capping the federal deduction for state and local income and property taxes.

POTENTIAL FIXES FOR A BROKEN SYSTEM

Stop coddling the super-rich

Tax capital gains as ordinary income; keep or extend the estate tax; end “step-up” basis, a provision that means heirs don’t have to pay capital gains on inherited wealth. Also, no more disguising wage income as corporate profits to get a lower tax rate.

Two new ideas—A Financial Transactions Tax and a Carbon Tax

Even a tiny **financial transaction tax (FTT)** would likely raise $100 billion to $200 billion over ten years. A dime on a $1,000 trade is unlikely to have much impact. Today’s financial markets are afflicted by too many high-frequency trades that have nothing to do with efficient capital allocation and everything to do with nanosecond price arbitrage.

A tax on carbon, which could take the form of a higher federal gas tax is more of a bipartisan one than what’s in the rest of this agenda These two ideas share a thread: They’re so-called Pigouvian taxes, designed to put a higher price on some activity that’s underpriced from the perspective of the broader society. Financial transactions and climate pollution certainly fit that bill.

One new/old idea

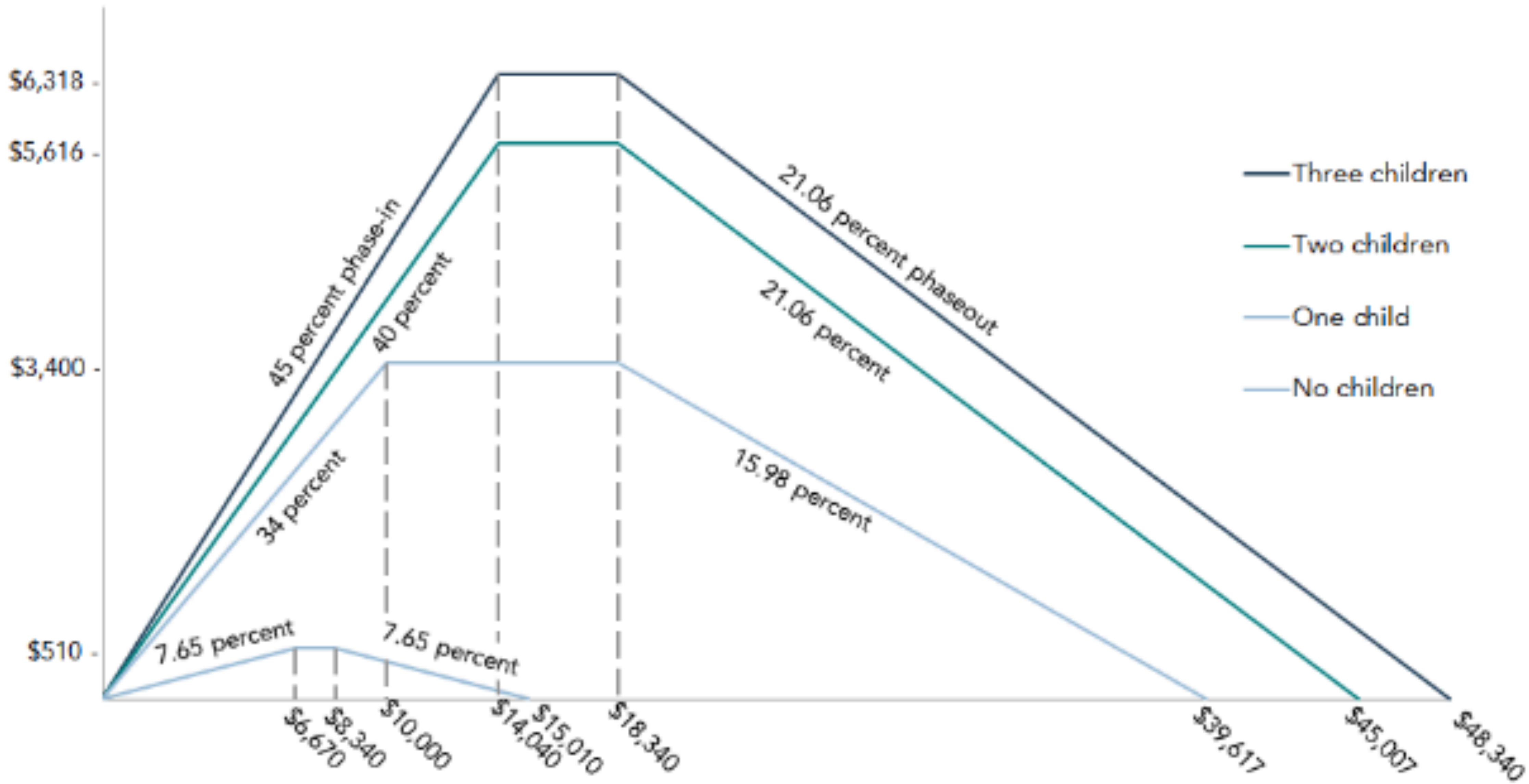
One tax credit that should not only remain in the code, but should be increased, is the **earned income tax credit**, a wage subsidy for low-wage workers in low-income families. It’s a strong anti-poverty program—in 2015, the EITC lifted about 6.5 million people out of poverty, including about 3.3 million children—that both encourages and rewards work. This could do wonders to decrease income and wealth inequality.

IN THE END…

- This tax bill will weaken the U.S. economy and make it harder to respond to the next recession. It will mean taking funds away from urgent priorities such as our infrastructure, health care and education. And it will exacerbate our very serious problems of income inequality and economic insecurity.
- **A real concern should be that the emphasis on small tax cuts provided to individuals in the bottom 90% will shift the focus from the real harm this tax bill can do to the long run prospects of the US economy.**

Earned Income Tax Credit
2017

Credit amount



Source: Urban-Brookings Tax Policy Center; IRS Rev. Proc. 2016-55.
Note: Assumes all income comes from earnings. Amounts are for taxpayers filing a single or head-of-household tax return. For married couples filing a joint tax return, the credit begins to phase out at income $5,590 higher than shown.