

The Effects of the Trump Tax Cuts on Firms and Households

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Tax Cuts and Jobs Act of 2017

- Similarity to the Bush Tax Cuts:
 - Statutory Tax Rates reduced
 - Child Tax Credit increased
 - State of the Economy similar, better today
- Other changes to the Individual Income Tax:
 - Standard Deduction increase (nearly doubled)
 - State and Local Tax Deduction cap
 - Mortgage Interest Deduction cap
 - Insurance Mandate Penalty Tax removed
 - Alternative Minimum Tax exemption level increased
- Changes to the Corporate Income Tax

Reduction in Statutory Tax Rates

Married Couples	<u>taxable income</u>	<u>change in rate</u>
	\$19,000 - \$77,000	15% → 12%
	\$77,000 - \$165,000	25% → 22%
	\$165,000 - \$315,000	28% → 24%
	\$400,000 - \$425,000	33% → 35%
	over \$480,000	39.6% → 35% or 37%

- Similar rate reductions to the Bush Tax Cuts
- Scheduled to expire in 2025 (Bush Tax Cuts expired in 2012)

Child Tax Credit

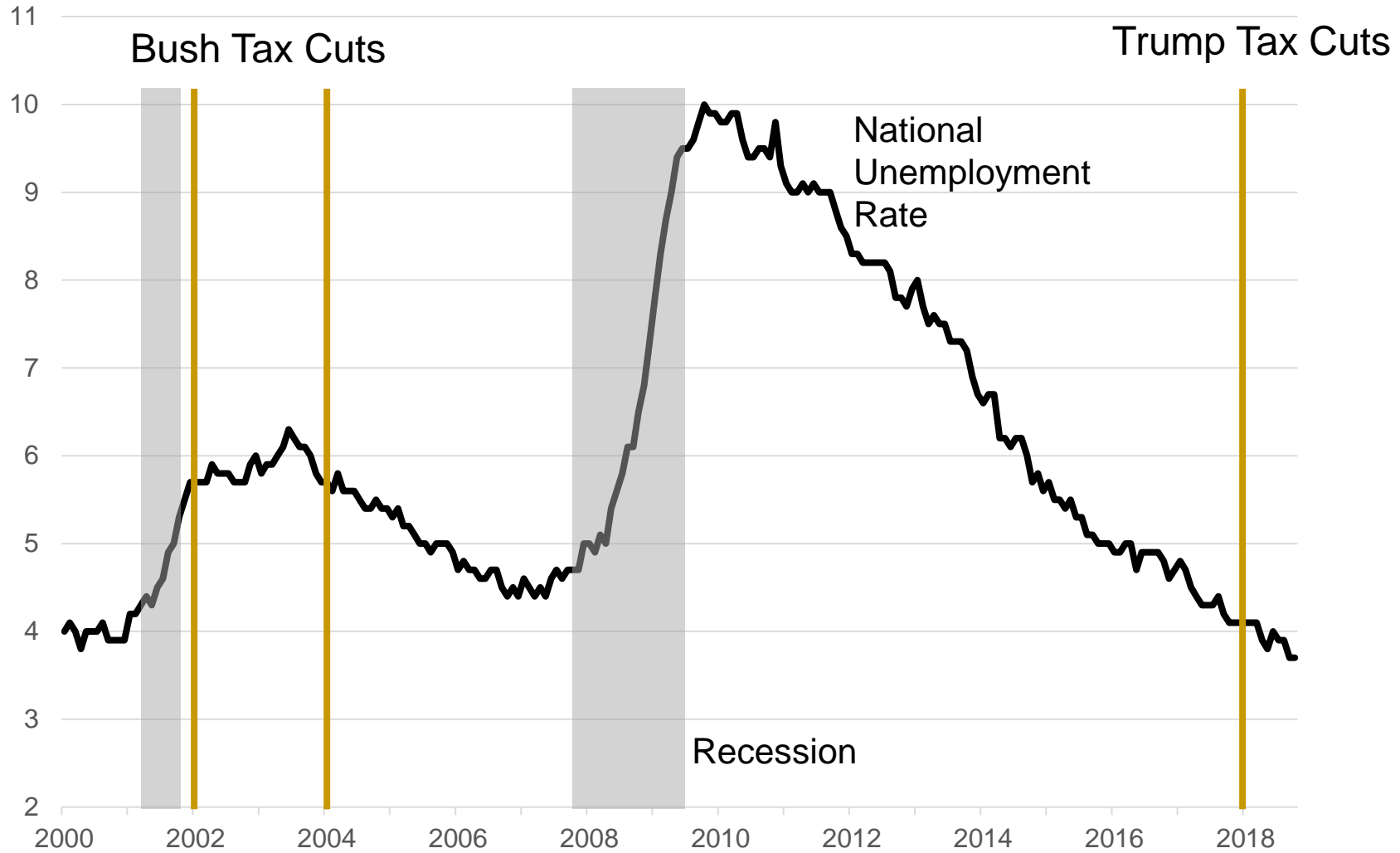
- Bush Tax Cuts increased the Child Tax Credit from \$500 to \$1,000 per child
- Trump Tax Cuts increase the Child Tax Credit from \$500 to \$2,000 per child
 - Credit phase out now begins at \$400,000 rather than \$110,000
 - Simultaneously remove the personal and dependent exemption
 - New nonrefundable \$500 credit for other dependents
- The rate changes + child tax credit increase are the most important changes for my personal tax bill, just as they were in the early 2000s.

Short-Run Tax Effects

- Tax cuts stimulate the economy because they increase aggregate demand by putting more money in the hands of people who will spend it.
- Empirical evidence from the Bush Tax Cuts shows that 70 to 90 percent of the tax cut money was saved and had little stimulus effect:
 1. Most of the tax cut dollars went to those at the top of the income distribution and they tend to save.
 - Trump Tax Cuts: average value of tax cut to top 5% is \$21,000; to bottom half is \$400.
 2. Tax code is complicated. Many people didn't realize that they would benefit from the tax cut.
 3. Low level of unemployment, high levels of unfilled job openings, and economy at potential. The middle class used the tax cut dollars to pay down debt.

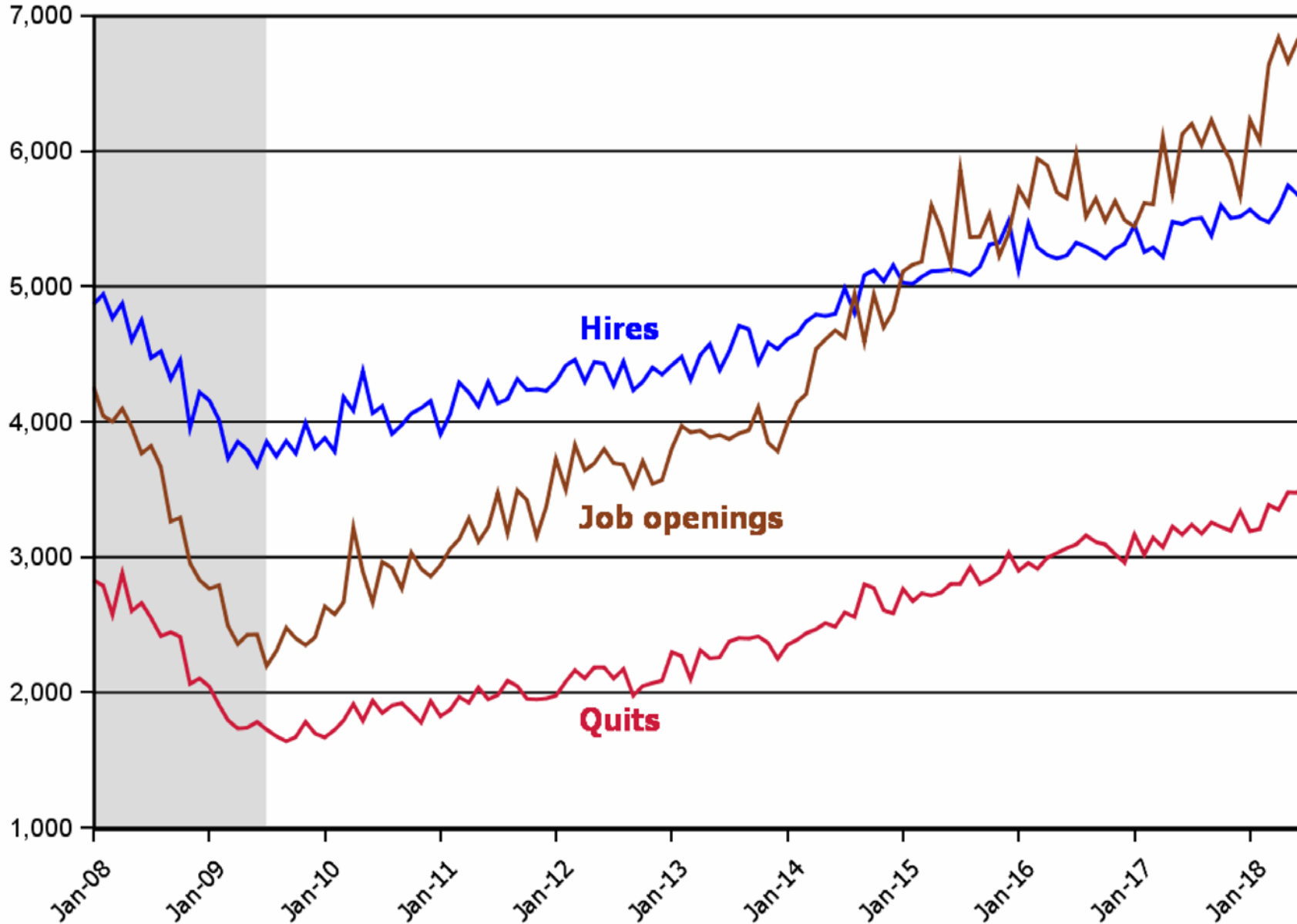
Unemployment is now below pre-recession level

Percent of Labor Force Unemployed

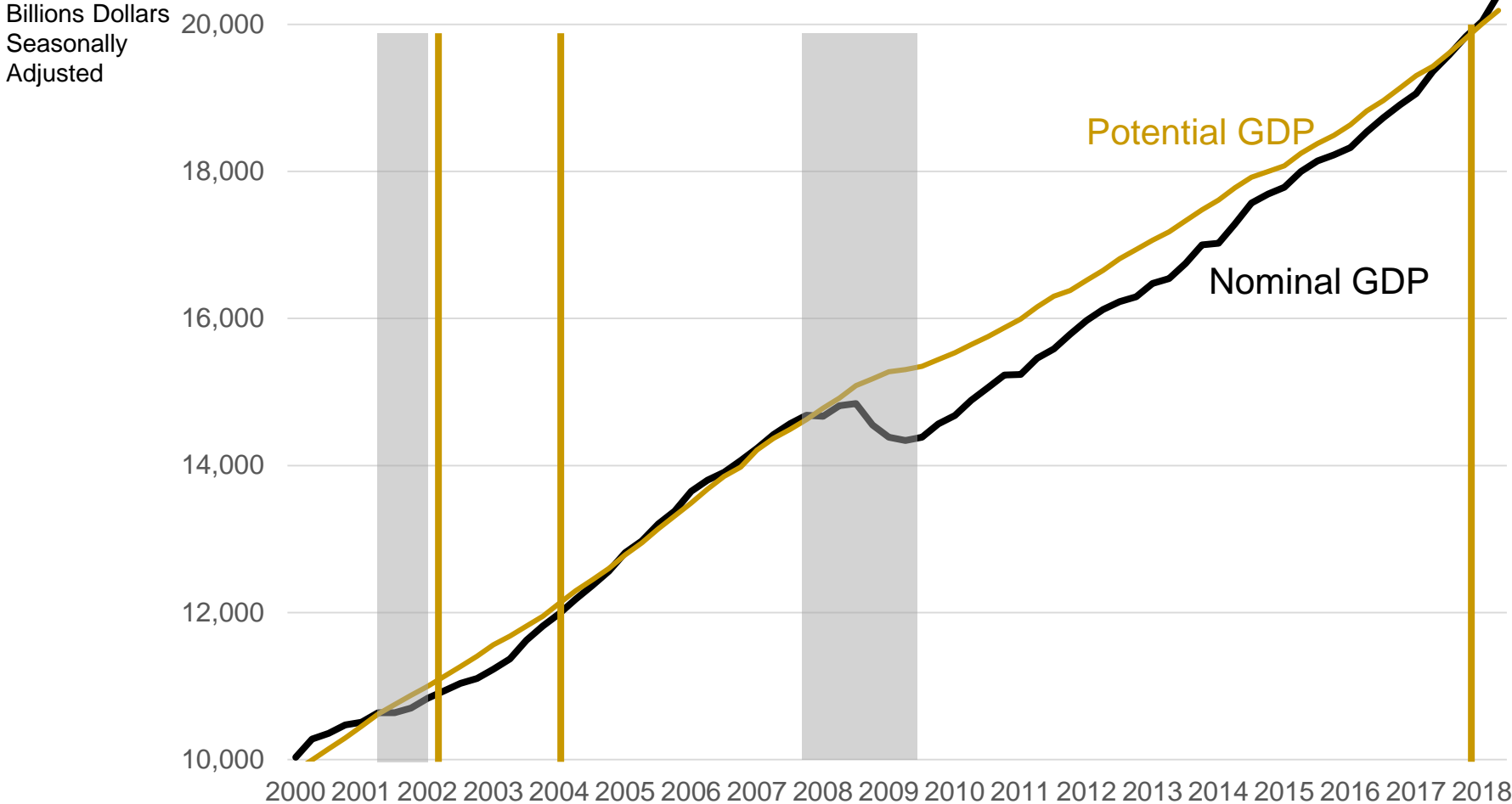


Job Openings are at a Record High

Seasonally adjusted, in thousands



GDP has caught up to potential



GDP is the market value of all final goods and services produced in the U.S. in a year

Source: Bureau of Economic Analysis (U.S. Department of Commerce)

Other Individual Tax Changes

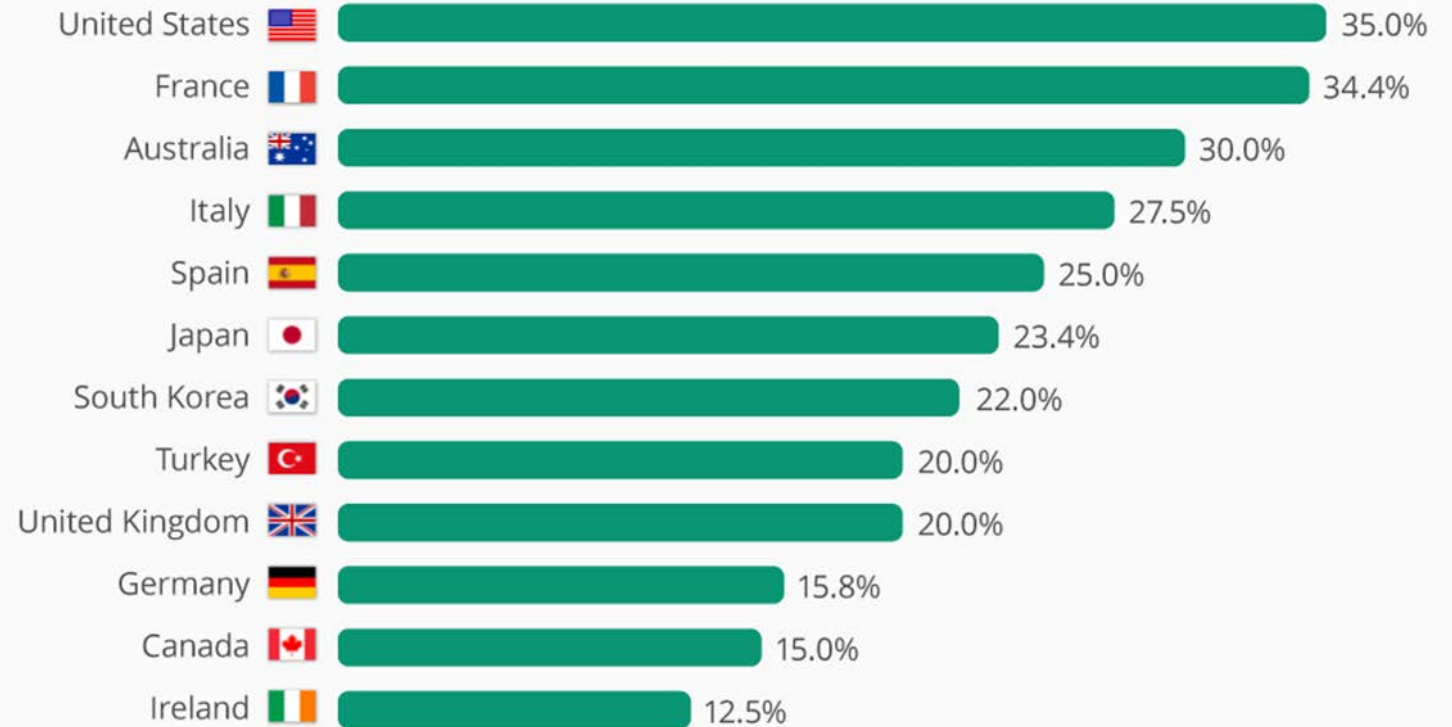
- Imposes a \$10,000 cap on the deductibility of state and local taxes
- Limits the deductibility of mortgage interest to the first \$750,000 of loan principal on primary residences and eliminates the deductibility of interest for home equity loans
- Removes the individual mandate for health insurance penalty tax of \$695 per adult and \$347 per child
- Changes the range of income where the 15% rather than the 20% long-term capital gains rate applies
- Raises the exemption level for the Alternative Minimum Tax
- Raises the standard deduction to \$24,000
 - 30% of taxpayers itemized in 2015, static estimate is that 5% will itemize in 2018
 - Charitable donation bunching strategy

Corporate Income Tax Changes

- US Corporate Income Tax Rate was among the highest in the world
- Top corporate tax rate 35% to 21%
 - below the average tax rate for OECD countries

Global Corporation Tax Levels In Perspective

Corporate income tax rate in selected OECD countries in 2016



* The basic central government statutory (flat or top marginal) corporate income tax rate.

Source: OECD

Other Corporate Income Tax Changes

- Full Expensing (100% bonus depreciation) for 5 years
 - Phased out beginning in 2023 at 20 percentage points each year
- Expensing limit for small business doubled to \$1 million
- Net business interest deduction limited to 30% of business income
- Net operating losses deduction limited to 80% of taxable income

- Corporate tax change has no immediate affect on business operation or wages, but does affect investment decisions

International Firms

- Bush Tax Cuts had little effect on the private savings rate in the long-run.
- Most of the additional firm investment will be financed by capital inflows from abroad.
- Some will come because the Trump Tax Cuts made sweeping changes to the treatment of foreign source income
 - US corporations hold \$2.6 trillion in untaxed income in foreign affiliates
 - Reduced rate of 15.5% for cash and 8% for illiquid assets when returned to the US

Fiscal Effects

- During the debate the CBO estimate was \$1.5 trillion over 10 years
 - Static estimate without allowing for economic growth
- Accounting for Economic Growth
 - 8 different agencies/think tanks have now completed their estimates of how much of this 1.5 trillion cost will be covered by increased tax revenue from economic growth.
 - The estimates range from the Tax Policy Center's estimate of 12% to the Tax Foundations estimate of 69%. The median is the CBO with an estimate of 31%.
 - National debt will increase by a total of about \$1 trillion over 10 years

Pass-Through Business Income

- New pass-through rules are inequitable and complex
- New 20 percent deduction for income from a pass-through business will create complexities for both taxpayers and the IRS
- Some taxpayers will decide to become independent contractors instead of employees to qualify for the deduction
- Owners of S corporations will have increased incentives to declare a lower salary in order to substitute profits eligible for the deduction
- Doctors, dentists, and lawyers now have a strong incentive to split their business into two companies