The Tax Cuts and Jobs Act of 2017

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Abstract

The Tax Cuts and Job Act of 2017 pledges to reform the current tax code and result in a boon for the American economy, while simultaneously simplifying the tax filing process. This paper will examine who the GOP bill benefits and who is at a disadvantage. After considering the changes that will go into effect on January 1st, 2018, it is obvious that the tax code favors individuals and businesses in the highest income bracket, and fails to address the needs of all its stakeholders,

On December 22nd, 2017, President Trump signed the Tax Cuts and Jobs Act (TCJA), arguably one of the largest tax overhauls in history. This GOP bill was passed with the stated intent of simplifying taxes, while simultaneously lowering them. It may be too early to determine if these affects will transpire, but the huge number of changes, especially as they relate to corporations, suggests that the goal is not fully achieved. Some of the most major changes are a temporary lower income taxation to corporations, a temporary simplification of and reduction in individual income taxes, and dissolution of the Affordable Care Act. A close examination of the Act proves that it has significant effects on businesses, individuals, governments, and, ultimately, the general economy. Analyzing these effects reveals that the tax overhaul favors certain groups, particularly large corporations and wealthy individuals, while many taxpayers are left doubting the validity of the Act's title. Considering this imbalance, the long-term overall impact of the GOP bill is detrimental to the majority of American taxpayers.

After summarizing the contents of the bill, it will be possible to answer the question as to who really benefits from the new legislation and, conversely, who is at a disadvantage. The most prominent changes that the TCJA introduced relate to tax rates. Of these changes, the amendment to the corporate tax rates has received a lot of attention. Before 2018, corporations in the highest bracket were taxed at 35%, but as of January 1st, 2018 it dropped to 21%. In addition to this, there is an elimination of the taxation of most foreign corporate income of US corporate shareholders, with a one-time transition tax on untaxed profits of 15.5% on liquid and 8% on non-liquid assets. The GOP Bill decreases tax rates for almost every income bracket, as well as doubling the standard deduction, but also gets rid of the personal exemption. Most Americans will owe less in taxes in 2018 than they did in 2017. This means that the current 44% of Americans who don't owe any taxes will become 47.5%. The cuts for individuals, though, are

not permanent and will go back in 2025, while the business taxes will be permanent. This discrepancy reveals the first instance where the Act favors the wealthy (Long, 2017).

Republicans hope that the future Congress will extend the lower rates for individuals, but there is no guarantee that their rates will not rise after 2025. It is important to note that the new method of measuring inflation pushes taxpayers into higher tax brackets more quickly, thereby decreasing the proposed benefit. Amongst individuals, there are some Americans who are rewarded more handsomely than others. Some of the factors that will determine the extent of a taxpayer's benefit are income, age, and occupation (Drucker, J., & Rappeport, A., 2017). Most low-income families are actually harmed by the TCJA. The nonpartisan Congressional Budget Office predicts that by 2019, Americans earning less than $30,000 will be in a worse situation. By 2020, that number will have risen, and Americans earning less than $40,000 will be at a disadvantage. The cause for this discrepancy is due to another provision in the bill that relates, not to taxes, but to healthcare.

The TCJA removes the Affordable Care Act, which made it mandatory for all US citizens to have health insurance. In response, economists believe health insurance premiums will rise. The people who are most likely to get rid of their health insurance are low-income and middle-class taxpayers. Once they stop paying their premiums, they will not be eligible for certain tax credits and deductions, thereby raising their taxes due. The cuts that will be made to the government funding of Medicaid, Medicare, and the Basic Healthcare Program also contribute to the net loss of low-income families (Long, 2017).

This imbalance is present amongst older adults as well. Seniors in the high-income tax bracket will receive a substantial break, while those in lower bracket will pay approximately the same amount, once the new inflation rates are taken into account. The reason is because low

income seniors, who make less than $33,000, get most of their income from Social Security payments, which require very little federal income tax to be paid. Economists estimate that middle-class seniors will receive a $300 tax cut by 2019, compared to the $1,000 cut that will belong to high-income seniors (Gleckman, 2017). Since the bill will increase the federal deficit by over $1.5 trillion, it will result in huge cuts in vital government programs. This number is even more shocking when one considers that this amount allows for the predicted economic growth from the tax bill. For seniors, it is especially concerning because of the impact the deficit will have on Medicare, which will suffer a 4% reduction ("How the New US Tax Bill," 2017).

Changes to the AMT is another important section of the TCJA. The corporate alternative minimum tax (AMT) is removed by the GOP Bill. The individual AMT was also affected, although not removed. The threshold to require complete payment was raised from the previous $120,700 (160,900 if married) to $500,000 for singles and $1 million if married. Though some families will still have to pay some AMT if their income is above $200,000, the amount is significantly lower than it would have been before (Long, 2017). Though the estate tax, also known as the "death tax," is still part of the tax code, fewer people will need to pay it. Taxpayers used to be able to pass on 5.5 million dollars tax free (11 if married); this number has been doubled by the GOP Bill to 11 million (22 if married). Like the income tax cuts, these changes benefit wealthy individuals who are survived by estates worth several million dollars (Long, 2017).

Many deductions will be modified or eliminated under the Act. The government's motivation behind these changes is to simplify taxes. With the standard deduction doubled, and many of the itemized deductions reduced or eliminated, taxpayers will be discouraged from taking itemized deductions, which are more difficult to process. The standard deduction under

current law is $12,700 for married taxpayers filing jointly and $6,350 for single taxpayers. The Act will increase the standard deduction to $24,000 for married taxpayers filing jointly and $12,000 for single taxpayers. The personal exemption, however, will be eliminated. There is another big change to state, local, and property tax deductions; the GOP Bill limits the deductions to $10,000 inclusive of any state and local taxes. This limit applies to marrieds and singles alike (Matak, 2017).

The Act does not eliminate deduction for charitable contributions, but with the standard deduction doubled, fewer people will be taking advantage of this deduction. Since many taxpayers will forgo the itemized deductions in the future, they are being encouraged to contribute to a donor-advised funds, or DAFs. A DAF works like a charitable savings account, into which donors can contribute money, receive an immediate tax benefit, and recommend donations to a specific charity when they want. Cash contributions, normally subject to a 50 percent AGI limitation, will now have a higher threshold of 60 percent AGI (Matak, 2017).

There are many industries that will gain from the new tax bill, but the commercial real estate industry gains an especially obvious tax benefit. Like all other pass-through entities, real estate owners will have their tax rates lowered from a rate as high as 39.6% to one as low as 29.6%. Aside from this, real estate also bypassed new limits on interest deductions and some of the pass-through provisions (Drucker, J., & Rappeport, A., 2017). There is one change in the laws pertaining to real estate, however, that is not beneficial. Under current law, the interest on mortgages for first and second homes is deductible for the first $1 million of the loan. The GOP bill would cut that to the first $750,000 and eliminate the owner's ability in the current law to deduct the interest on a home-equity loan up to $100,000. This could drive down home prices in

some high-end markets; good for prospective buyers but bad for prospective sellers (Drucker, J., & Rappeport, A., 2017).

Similar to the commercial real estate industry, big corporations will benefit from the significant tax break. As previously mentioned, under the current tax laws, these corporations pay close to 35%, but that rate will be lowered to 21%. In addition to this, companies will not owe full corporate taxes on future profits they claim to earn internationally. This change in the code gives an incentive for corporations to move their income into tax havens abroad (Drucker, J., & Rappeport, A., 2017).

Those who own personal service entities cannot get the special business income tax rate. They will be taxed at their individual income tax rates. Those endeavors included are in the fields of law, accounting, consulting, engineering, financial services, or performing arts. Under the Act, there is a zero percent capital percentage for some personal service businesses. This means that although they would not normally be eligible for the 25 percent rate on business income, they can elect an "alternative capital percentage based on the business's capital investments" (Matak, 2017). This provision, although it does benefit personal service entities, encourages taxpayers to fund the corporations that are allowed the 25 percent rate.

Excise taxes for liquor businesses, mostly owned by entrepreneurs in rural areas, were reduced. Their win can be attributed to their heavy lobbying efforts, as well as their relationship with senators in many powerful states. In the first drafts of the bill, architects and engineers were originally unable to take full advantage of the tax cuts for pass-through entities. In the final version, however, these businesses were given specific provisions that would allow them to have the full tax break, provided that they structured their business in a specific way. This change resulted from excluding architects and engineers from the definition of "personal service

provider," who must phase out of the deduction when their taxable income reached $175,000 (single) or $315,000 (joint) (Boo, 2017). The sports industry, unlike liquor and architecture businesses, is adversely affected by the bill. The Act eliminates the deduction available for up to 80 percent of the amount paid for the right to purchase athletic tickets. It also disallows deductions for entertainment expenses, as well as tax exemption on bonds used to finance sports stadiums. The term "professional stadium bond" means any bond issued to finance capital expenditures that fund a facility which, during at least five days during any calendar year, is used as a stadium or arena for professional sports exhibitions, games, or training (Matak, 2017).

Banks and financial institutions can also be included amongst some of the biggest "winners" yet. They get the benefits of pass-through entities and preferable tax treatment, as well as lower corporate rates. Some of the biggest banks saw some losses in earnings in their fourth quarter from the tax law, but they do anticipate benefits in the long run. Banks are even anticipating this bill lowering their tax rate below the current 21%, maybe even as low as 19 or 17% next year. PNC, for example, has expressed its excitement to be able to use the savings in taxes to give larger dividends to the shareholders, claiming that this bill will be good for them as well. American Express voiced that this bill "is expected to be a significant ongoing benefit to us. Beginning in 2018, we anticipate an effective tax rate in the low twenties before discrete tax items" (Tankersley, 2018).

Over 70 financial institutions expect to raise their workers' pay or give bonuses because of this tax bill. A third of community banks are pass-through companies so not only is their tax rate reduced to 21%, but they also benefit from 20% deductions. In the past, banks paid higher effective tax rates than other industries, such as manufacturing. Democrats are pushing banks to put all this new-found wealth through to their workers, as opposed to dividends and stock

buybacks. JPMorgan Chase said it would be “increasing and accelerating” investments in “employees customers and communities” (Tankersley, 2018).

The federal government, although not taxed of course, is also impacted by the TCJA. The huge increase in its deficit is the most obvious effect, but the IRS in particular will have new challenges. The Treasury Department and IRS need to turn this bill into “rules and regulations.” The IRS will need to be there to help tax preparers and taxpayers figure it all out. Firstly, the IRS needs to help businesses figure out how to know how much to withhold for taxes from employee paychecks. Taxpayers should have seen some sort of changes in their paycheck in February. The IRS has announced that it will work with the current W-4’s, despite the absence of personal exemptions. The IRS also had to incorporate the retroactive changes in medical expense deductions for the 2017 taxes. For the 2018 changes the IRS has a year to figure out how to react and create new forms. Kathy Pickering, the executive director of the Tax Institute at H&R Block said, “The good news is they’ve got a year to get it done, because they’re going to need every bit of it” (Jagoda, 2017). The IRS and Treasury will need to increase their regulation on taxpayers, especially pass-through entities, who will be trying to lower their taxes as much as they can. The changes to international tax will require additional regulations, since it basically allows US companies to avoid paying taxes on income made in foreign countries (Jagoda, 2017).

Apart from analyzing the effects of the Tax Cuts and Jobs Act on individuals, corporations, and the government, it is critical to study its macroeconomic effects. The intention of the bill was to bolster the economy mainly through lowering the tax rates for both corporations and individuals. “We are creating a model that creates economic growth in this country,” says Gary Cohn, the director of Mr Trump’s National Economic Council (“What is the Purpose,” 2017). With a lower corporate tax rate, businesses would have incentive to operate in

the United States and would also have more capital to invest in the economy. Additionally, salaries are predicted to rise due to the excess money that employers have. According to the Tax Foundation's Taxes and Growth Model, the Senate's version of the TCJA would increase the long-run size of the U.S. economy by 3.7 percent. It estimates the static net fiscal stimulus for individuals and corporations at around $1.46 trillion over ten years, or 0.7% of GDP per year on average. Lower individual income tax rates will raise household disposable income and boost consumption. Part of the increase in after-tax income will also contribute to a rise in savings, particularly amongst wealthier individuals. In addition, lower corporate taxes should boost household wealth because the amount of dividend distributions will rise as a result ("Preliminary Details and Analysis," 2017).

Many economists, however, argue that these benefits only apply in the short term. In the long-run, rising interest rates resulting from the deficits and expiration of the temporary tax cuts will hurt the economy. The legislation also encourages borrowing from abroad, giving foreigners a claim to domestic income and leaving national income virtually unchanged by 2028. At this point, it is difficult to determine the exact long-term effects of the Act, since it depends on how the tax reform will be financed and the impact of a higher deficit on federal debt costs. If the reform will be financed by the deficit, which is most probable, then there will be higher long-term interest rates. The cost of capital will rise with the interest rates, and the positive effects of the TCJA will be negated.

The Tax Cuts and Jobs Act of 2017 has an obvious impact on every American taxpayer. Certain industries, like banking, real estate, and healthcare businesses, experience a notable amount of changes to their tax laws. To some degree, it achieves its goal of simplifying taxes by altering the laws that pertain to deductions. Still, there are many changes, particularly to

corporate taxation, that complicate tax preparation. Altogether, the Act favors corporations and wealthy individuals over individuals in mid to lower income tax brackets. The comprehensive impact on the market seems to be positive in the short-term, but only time will tell if the Tax Cuts and Jobs Act will really be a boon the economy. Future Congresses will have to consider new strategies when the time comes to revisit tax reform.

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