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Analysis of the 2017 Tax Cuts and Jobs Act

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The Tax Cuts and Jobs Act is the most sweeping update to the U.S. tax code in more than 30 years. The reforms will simplify taxpaying for many individual Americans, lower taxes on individuals and businesses, and update the business tax code so that American corporations and the people they employ can be globally competitive again.[1]

The Tax Cuts and Jobs Act has the potential to unleash higher wages, more jobs, and untold opportunity through a larger and more dynamic economy. The bill's pro-growth components include a deep reduction in the corporate tax rate, a scaled-back state and local tax deduction, full (albeit temporary) expensing, and lower individual tax rates. The bill also repeals Obamacare's individual mandate, expands college savings accounts, and increases some non–growth-enhancing tax credits and deductions.

The conference report demonstrates a serious effort to reform a complex and badly broken system that provides significant relief to the vast majority of taxpaying Americans. While Congress surrendered to the pressures of special interests in several areas, eroding many of the boldest components of their original proposals, the conference agreement nevertheless reflects a critical step in the right direction.

This paper, in its entirety, can be found at
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Following is an explanation of the major provisions of the Tax Cuts and Jobs Act. A summary is provided in Appendix Table 1.

Business Tax Reform

The Tax Cuts and Jobs Act's most significant changes are to modernize the tax treatment of businesses in the United States. Taken together, the business reforms will result in a significant boost to the U.S. economy by attracting international business investment and jobs to America.

Previous analysis of the two similar bills, independently passed by the House and the Senate, estimates that the economy could grow between 2.6 percent and 2.8 percent larger in the long run.[2] The expected boost to gross domestic product translates into an increase of about $4,000 to $4,400 per household.

21 Percent Corporate Rate. The bill permanently lowers the corporate tax rate to 21 percent starting in 2018.

Historically, U.S. businesses have faced some of the highest statutory corporate tax rates in the developed world.[3] A 21 percent corporate tax rate, down from the current federal rate of 35 percent, is the most pro-growth component of the Tax Cuts and Jobs Act. The reform will encourage significant new investment in the U.S., which will benefit workers primarily through higher wages and more jobs.[4]

A 21 percent federal corporate tax rate still leaves the United States with a higher rate than many of its largest trading partners around the world. When average state taxes are added, the U.S. will have a cumulative rate around 26 percent—higher than the worldwide average of 23 percent.[5] Further reductions in the corporate tax rate will be necessary in the future.

Temporary Expensing. The bill expands the current-law 50 percent bonus depreciation for new short-lived capital investments to 100 percent or "full expensing" for five years and then phases out over the subsequent five years. Expensing allows companies to deduct the cost of investments immediately and removes a current tax bias against investment.[6]

The bill also expands expensing for small businesses under Section 179 by raising the cap on eligible investment from $500,000 to $1 million. The phase-out increases from a $2 million cap to a $2.5 million cap on total equipment purchases. In 2022, businesses will no longer be able expense their research and development costs; this is a step in the wrong direction toward longer write-off schedules rather than toward expensing.

Immediate and full expensing should be permanent and afforded to all business purchases, not just used to favor new equipment. The Senate bill originally included shorter depreciation periods for longer-lived structures, but this provision was not included in the conference report. Limiting expensing to new equipment exacerbates the relative tax disadvantage faced by longer-lived capital investments and undermines the potential economic growth promised by tax reform. Congress must follow up in future legislation to make full expensing permanent and available to all investments.

20 Percent Pass-Through Deduction. Small and pass-through businesses that pay their taxes as individuals (and face the new lower individual tax rates) will receive a newly created deduction. Pass-through businesses will be able to deduct 20 percent of certain types of non-salary business income, bringing the top marginal tax rate (on most pass-through income) down from 39.6 percent under current law to 29.6 percent. Certain service providers in the fields of health, law, consulting, athletics, financial, or brokerage services are denied the deduction if their income is over a $315,000 threshold, where the deduction begins to phase out.

Although lower marginal tax rates for small and pass-through businesses are an important component of economic growth, the discrepancy in top rates between individual income and small and pass-through business income will increase the incentives to treat income from wages artificially as business income. This new tax privilege has no consistent policy rationale, arbitrarily favors certain types of businesses over others, introduces new complexity, and will provide new opportunities for unproductive tax planning.

Territoriality and Repatriation. The bill abandons the current worldwide international tax system for a new territorial regime. In principle, the new system only taxes corporate income earned in the U.S. It does this by allowing an exemption for dividends from foreign subsidiaries. The bill includes new anti-base erosion taxes and rules at varying rates on a broader definition of global income.

The act imposes a new onetime transition tax on international firm's accumulated overseas profits. The onetime tax rate is 15.5 percent for liquid assets and 8 percent for physical assets.

Limited Interest Deduction. The current unlimited deduction for net interest expense for C-corporations is capped at 30 percent of earnings before interest and taxes. For the first four years, the cap applies to a slightly different definition of earnings before interest, taxes, depreciation, and amortization.

The current treatment of interest in the tax code is neither uniform nor ideal. Many forms of interest expenses are not deductible for the individual

1. Tax Cuts and Jobs Act, H.R. 1, 115th Congress, 1st Session.
2. Parker Sheppard and David Burton, "How the GOP Tax Bill Will Affect the Economy," Heritage Foundation *Issue Brief* No. 4789, November 28, 2017, http://www.heritage.org/taxes/report/how-the-gop-tax-bill-will-affect-the-economy.
3. Adam N. Michel, "The U.S. Tax System Unfairly Burdens U.S. Business," Heritage Foundation *Backgrounder* No. 3217, May 16, 2017, Chart 1, http://www.heritage.org/taxes/report/the-us-tax-system-unfairly-burdens-us-business.
4. Adam N. Michel, "The High Price That American Workers Pay for Corporate Taxes," Heritage Foundation *Backgrounder* No. 3243, September 11, 2017, http://www.heritage.org/taxes/report/the-high-price-american-workers-pay-corporate-taxes.
5. Kari Jahnsen and Kyle Pomerleau, "Corporate Income Tax Rates around the World, 2017," Tax Foundation *Fiscal Fact* No. 559, September 7, 2017, https://taxfoundation.org/corporate-income-tax-rates-around-the-world-2017/ (accessed September 29, 2017).
6. Adam N. Michel and Salim Furth, "For Pro-Growth Tax Reform, Expensing Should Be the Focus," Heritage Foundation *Issue Brief* No. 4747, August 2, 2017, http://www.heritage.org/taxes/report/pro-growth-tax-reform-expensing-should-be-the-focus.

and can often escape taxation when distributed to international or other tax-preferred entities. Short of moving to a fully consistent treatment of interest, a partial limit on the net interest deduction is an acceptable compromise to bring partial parity between debt and equity financing.[7]

Many Special-Interest Subsidies Remain. A large subsidy for domestic manufacturing is eliminated, but most other credits and deductions marked for repeal in the original House bill remain in the conference report. Among the surviving subsidies are tax credits for electric vehicles, wind-energy production, energy-efficient buildings, historic rehabilitation, orphan drugs, new market investments, and employer-provided child care. The conference report also adds a new tax credit for employers who provide paid family and medical leave.

Congress should resist the temptation to extend many of the existing privileges that are set to expire in the future and should also avoid new ones. Lawmakers should continue to work toward a tax code free of subsidies for special interests.

Individual Reform

For a vast majority of Americans, the Tax Cuts and Jobs Act will lower their federal tax bill in 2018. This is accomplished through lower tax rates, a larger standard deduction, and an expanded child tax credit. Most of the individual tax changes revert to current law before 2025 to meet political constraints and Senate budget rules. Although temporary tax policy is never ideal, the expirations give Congress an incentive to revisit the tax code in the coming years to provide more far-reaching and permanent reform.

Lower Individual Tax Rates. The framework lowers rates for almost every tax bracket. The current seven brackets remain, but with new, generally higher income thresholds and lower rates. Table 1 describes the changes for single and married filers; the bill also retains the head of household status with similar adjustments to income brackets.

Larger Standard Deduction. The standard deduction is almost doubled, consolidating the additional standard deduction and personal exemptions into one larger deduction. For married joint filers, the deduction will be $24,000; for single filers, it will be $12,000. The expanded deduction simplifies tax filing by cutting the percentage of tax filers who will need to itemize their deductions in half. Approximately nine of 10 taxpayers will simply claim the new standard deduction.

The change will also exempt more people from paying any income tax at all. When fewer people pay income taxes, the harmful side effect is that government appears to cost less for those taxpayers. Decreasing the number of households that pay any federal income tax at all lowers their personal cost of future government expansions, which could lead to higher overall tax rates in the future.

$2,000 Child Tax Credit. The child tax credit (CTC) is doubled from a current-law level of $1,000 to $2,000 per child. The new larger credit begins to phase out for married filers with incomes of more than $400,000—an increase from $110,000 under current law. The new larger credit offsets the repeal of the personal exemption for dependents. For any family in the 25 percent tax bracket or lower, this is an expansion of the tax subsidy for children.

The new larger child tax credit is refundable for taxpayers with no federal income tax liability. This effectively allows a taxpayer to accrue a negative tax liability that results in a federal spending outlay of up to $1,400 per child in 2018. The refundable threshold is indexed to inflation, capping out at the full $2,000 value. A new non-refundable credit of $500 is added for non-child dependent care like care for adult family members with disabilities or elderly parents.

Like all subsidies in the tax code, it is best to minimize disparate treatment of similar taxpayers. A tax code that prioritizes equity and economic growth should limit subsidies provided through tax credits like the child tax credit in favor of lower marginal rates for everyone.

$10,000 State and Local Tax Deduction. Taxpayers who itemize their taxes will be able to deduct up to $10,000 of state and local property taxes and income taxes (or sales taxes) paid. Only about one in 10 taxpayers is expected to itemize deductions under the new tax code.

In future reforms, Congress should eliminate all state and local tax deductions, as well as the exemption for municipal bond interest. Allowing taxpay-

7. Alan Cole, "Interest Deductibility–Issues and Reforms," Tax Foundation *Fiscal Fact* No. 548, May 4, 2017, https://taxfoundation.org/interest-deductibility/ (accessed September 29, 2017).

TABLE 1

How Will Your Tax Bracket Change in 2018?

SINGLE

Old Rates	Old Bracket	New Rates	New Brackets
10%	$0–$9,525	10%	$0–$9,525
15%	$9,526–$38,700	12%	$9,526–$38,700
25%	$38,701–$93,700	22%	$38,701–$82,500
28%	$93,701–$195,450	24%	$82,501–$157,500
33%	$195,451–$424,950	32%	$157,501–$200,000
35%	$424,951–$426,700	35%	$200,001–$500,000
39.6%	$426,701+	37%	$500,001+

MARRIED, JOINT FILER

Old Rates	Old Bracket	New Rates	New Brackets
10%	$0–$19,050	10%	$0–$19,050
15%	$19,051–$77,400	12%	$19,051–$77,400
25%	$77,401–$156,150	22%	$77,401–$165,000
28%	$156,151–$237,950	24%	$165,001–$315,000
33%	$237,951–$424,950	32%	$315,001–$400,000
35%	$424,951–$480,050	35%	$400,001–$600,000
39.6%	$480,051+	37%	$600,001+

SOURCES: Heritage Foundation research and Tax Cuts and Jobs Act, H.R. 1, 115th Congress, 1st Session.

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ers to write off the cost of state and local taxes benefits only a minority of taxpayers and maintains a federal subsidy for the expansion of government at the state level. This forces people in low-tax states to subsidize big government in states like California, Illinois, and New York. The full elimination of these deductions could allow federal tax rates to decline further than they would under the current Tax Cuts and Jobs Act.[8]

$750,000 Limit on Mortgage Interest Deduction. The bill does not change the treatment of existing mortgages. Interest paid on up to $750,000 of new home mortgage debt will remain deductible for principal residences for taxpayers who itemize. The new rules lower the threshold from the current-law level of $1 million and exclude the ability to deduct interest on second homes.

The current treatment of interest payments for individuals in the tax code is uneven, treating different interest payments differently. Ideally, all interest should be treated uniformly while minimizing double taxation.

Charitable Deduction Expanded. The charitable deduction expands for those who itemize, from 50 percent of income to 60 percent. The charitable deduction is denied for payments made in exchange for seats at college sports games.

Other Itemized Deductions Retained. The most politically sensitive itemized deductions and exclusions for medical expenses, tuition compen-

8. Rachel Greszler, Kevin D. Dayaratna, and Michael Sargent, "Why Tax Reform Should Eliminate State and Local Tax Deductions," Heritage Foundation *Backgrounder* No. 3256, October 17, 2017, http://www.heritage.org/taxes/report/why-tax-reform-should-eliminate-state-and-local-tax-deductions.

sation, private activity bonds, student loan interest, and teacher spending are all retained. The bill expands the deduction for medical expenses for two years for expenses exceeding 7.5 percent of adjusted gross income, down from the current-law level of 10 percent. The original House-passed version of the bill rightly eliminated all of these deductions and more in an effort to simplify the tax code and remove tax subsidies for each of these expenditures.

529 College Savings Accounts Expanded. 529 college savings accounts—named after their section of the Internal Revenue Code—are expanded to allow parents to save for K–12 and homeschooling expenses. The reform increases the ability of parents to pay for education options outside the public school system, giving families more education choices.

Individual Mandate Repealed. Obamacare's individual mandate tax is repealed. Zeroing out the tax, which is intended to force individuals to buy health insurance, provides tax relief to millions of Americans who cannot afford the rising costs of Obamacare insurance.

Death Tax Remains. The basic exclusion from the estate tax doubles from its current $5.6 million per person to about $12 million. The 40 percent asset tax remains in the tax code.

Not repealing the death tax is economic malpractice. It undermines potential economic growth and will likely make full repeal of the tax more difficult in future years when those affected by it will constitute an even smaller minority of Americans.[9]

Individual Alternative Minimum Tax Remains. The exemption for the alternative minimum tax (AMT) increases from $86,200 to $109,400 for married filers. The exemption phases out starting at $1 million, up from $164,100. The new exemption is $70,300 for non-married filers and phases out beginning at $500,000.

The AMT applies a two-rate alternative tax schedule to a more broadly defined measure of income and allows a narrower set of deductions. The tax increases the tax liability of those who can uniquely lower their effective tax rate through the normal tax system. The AMT does its intended job poorly and inefficiently by burdening taxpayers with additional paperwork and not addressing the underlying problem: The tax code has too many credits and deductions that are easily gamed. Full repeal of the AMT, as included in the House bill, would have been a far better policy.

PEP and Pease Repealed. The bill rightly repeals two obscure provisions that complicate the tax code and increase effective marginal tax rates. The personal exemption phaseout (PEP) adds more than one percentage point per person to affected taxpayers' marginal tax rates. For example, it can add 4.5 percentage points to a family of four's marginal tax rate. The phaseout of itemized deductions (Pease) adds an additional percentage point to affected taxpayers' marginal tax rates. Repealing these provisions simplifies the code and reduces marginal tax rates.

Conclusion

The U.S. tax code is sorely in need of reform, and the Tax Cuts and Jobs Act is a pro-growth plan that simplifies taxpaying for many individuals, lowers tax rates, and updates the business tax code so that American corporations and the people they employ can be globally competitive again.

Political and procedural hurdles prevented some of the boldest reforms from making their way into the final conference report and encouraged lawmakers to design many important features of the reform as expiring provisions. Congress will have to revisit the tax code in the coming years to finish the work it is just now beginning. Future reforms should include full expensing for all business costs, further tax cuts for individuals and businesses, parity in rates between individual and business income, the elimination of tax preferences, and further simplification.

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9. John L. Ligon, Rachel Greszler, and Patrick Tyrrell, "The Economic and Fiscal Effects of Eliminating the Federal Death Tax," Heritage Foundation *Backgrounder* No. 2956, September 23, 2014, http://www.heritage.org/taxes/report/the-economic-and-fiscal-effects-eliminating-the-federal-death-tax.

APPENDIX TABLE 1

Major Provisions in the Tax Cuts and Jobs Act (Page 1 of 2)

Provision	Current Law	Conference Report	Heritage Recommendation
Individual Tax Rates	Seven brackets: 10%, 15%, 25%, 28%, 33%, 35%, 39.6%	Seven brackets: 10%, 12%, 22%, 24%, 32%, 35%, 37%	Lower marginal tax rates for all Americans, including the top marginal tax bracket
Standard Deduction	Single: $6,350, married: $12,700	Single: $12,000, married: $24,000	
State and Local Tax Deduction (SALT)	Income or sales and property SALTs are fully deductible for itemizers	Caps SALT deduction at $10K	Repeal full SALT deduction
Child Tax Credit	$1,000 credit for each child; credits phased out at $110K (married)	$2,000 credit, $500 credit for non-minor child dependents; credits phased out at $400K (married)	Only increase child tax credit to make up for other changes in the tax code, such as the repeal of the dependent exclusion
Mortgage Interest Deduction	Interest paid on up to $1 million of mortgage debt is deductible	Threshold lowered to $750K for new mortgages	Treat all interest consistently and avoid double taxation
"Pass-through" Tax Treatment	"Pass-through" income taxed at personal income-tax rates	Deduction allowed for 20% of qualifying "pass-through" income; denied to service industry over $315K (married)	Lower top marginal income tax rate as needed; avoid special deductions
Corporate Tax Rate	Federal corporate tax rate of 35%	Permanent and immediate tax-rate reduction to 21%	Permanent and immediate tax-rate reduction to 20% or lower
Expensing	Complicated rules for deducting business expenses over many years	Five years of expensing for new equipment; phased out after year five; expanded expensing for small businesses.	Permanent, full expensing of all business expenses
International Tax Rules	Taxes worldwide corporate profits which can be deferred minus taxes paid elsewhere	Moves towards a territorial system; adds new anti-base erosion taxes	Territorial system with limited base erosion rules
Repatriation Tax	N/A	15.5% on liquid assets, 8% on physical assets	Profits earned abroad should not be subject to tax
Obamacare Taxes	3.8% net investment income tax; individual mandate tax penalty; 0.9% Medicare payroll tax	Repeals individual mandate	Repeal all Obamacare taxes

APPENDIX TABLE 1

Major Provisions in the Tax Cuts and Jobs Act (Page 2 of 2)

Provision	Current Law	Conference Report	Heritage Recommendation
Estate Tax	40% tax on assets over $5.6 million per person	Immediately doubles the basic exclusion; does not repeal the tax	Immediately repeal the estate tax
Education	Two different education savings plans and seven other education incentives	Expanded 529 savings plans to include K–12 expenses	Expand 529 savings plans to include K-12 expenses; eliminate federal tax subsidies for higher education
Alternative Minimum Tax (AMT)	Second, parallel, tax system for certain businesses and individuals.	Repeals corporate AMT; maintains individual AMT and increases exemption thresholds	Repeal both individual and corporate AMT

SOURCES: Heritage Foundation research and Tax Cuts and Jobs Act, H.R. 1, 115th Congress, 1st Session.

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