

The Distributional and Tax Planning Consequences of the Tax Cuts and Jobs Act

Testimony before the U.S. House of Representatives Ways and Means Committee

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Chairman Neal, Ranking Member Brady, and Members of the Committee. Thank you for inviting me to testify on the “Tax Cuts and Jobs Act” (TCJA) and in particular on its distributional effects and tax planning opportunities. My name is Jason Oh. I am a tax law professor at the UCLA School of Law. My primary areas of research are tax law and policy and the political economy of taxation.

The TCJA was the most significant overhaul of the tax system in over three decades. It is commendable that this committee is evaluating how this law affects the American public. We are fortunate to have the projections of the Joint Committee on Taxation and various think tanks, but the sheer amount of data can be overwhelming. The goal of my testimony is to crystallize that data into five major takeaways. I pair each takeaway with a figure that captures the point visually.

Who received tax cuts and how much? Will that change over time? How are we as Americans going to pay for the deficits created by the TCJA? How does the new law make taxes easier to avoid? What can history tell us about how tax laws change after major legislation?

The tax cuts in the TCJA are weighted towards the rich.

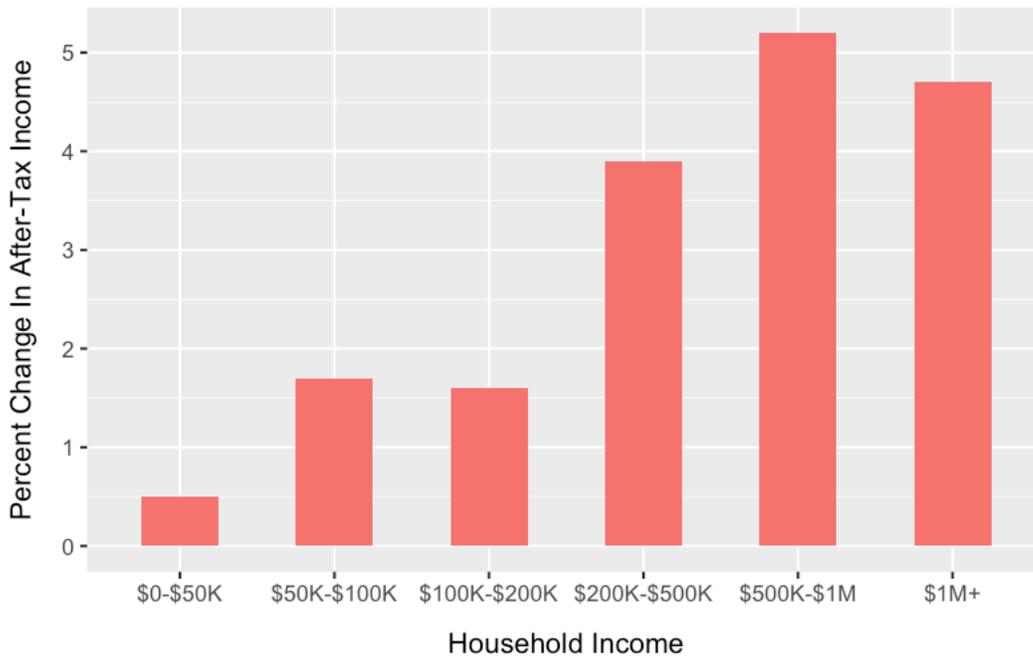
The TCJA disproportionately benefits the rich. For comparison purposes, let us focus on households that earn less than \$50K and those that earn more than a million. In 2019, low-income households are projected to save roughly \$200 dollars in taxes – one car payment or five trips to the gas station.¹ Millionaire households are projected to save over 300 times more, or roughly \$64,000 dollars. That’s either a lot of gas or a brand-new BMW X-5. Of course, richer households paid more taxes before the law change, and so it is somewhat unsurprising that they are saving more in taxes.

However, the same pattern emerges if we consider the percent increase in after-tax income. Using those same comparison groups, low-income households see their after-tax income go up by roughly 0.5%. Wealthier groups enjoy a much more significant increase of three to five percent. The TCJA makes the tax system less progressive. This basic

¹ Changes to wage withholding made the tax cuts seem more dramatic than they actually were. As they file their 2018 tax returns, many taxpayers are finding that their refunds are much smaller than in past years or that they owe additional taxes.

takeaway is confirmed by various think tanks and is robust to different assumptions regarding economic growth.² The tax cuts are heavily tilted towards the wealthy.³

FIGURE 1: Percent Change in After-Tax Income⁴



- Poorer households receive an increase in after-tax income of less than 1%.
- Wealthier households experience an increase in after-tax income of 3% to 5%.

The distribution of tax cuts from the TCJA will become even more unequal over time.

The second takeaway is that over time the distribution of tax cuts will become even more unequal. In 2025, the majority of the individual income tax changes sunset. The remaining tax cuts will be concentrated among the wealthy. By 2027, the Tax Policy Center predicts that the top 1% of US households will receive 83% of the benefits.⁵

For the poorest households, the tax-cuts disappear after 2025. In 2027, low-income households will actually owe an average of \$264 *more*. For many low-income households that's a month's rent. This point is worth reiterating. By 2027, many of the poorest households will actually owe more in taxes than they would have under the old law.

² Tax Policy Center, Distributional Analysis of the Conference Agreement for the Tax Cuts and Jobs Act. Tax Foundation, The Distributional Impact of the Tax Cuts and Jobs Act over the Next Decade.

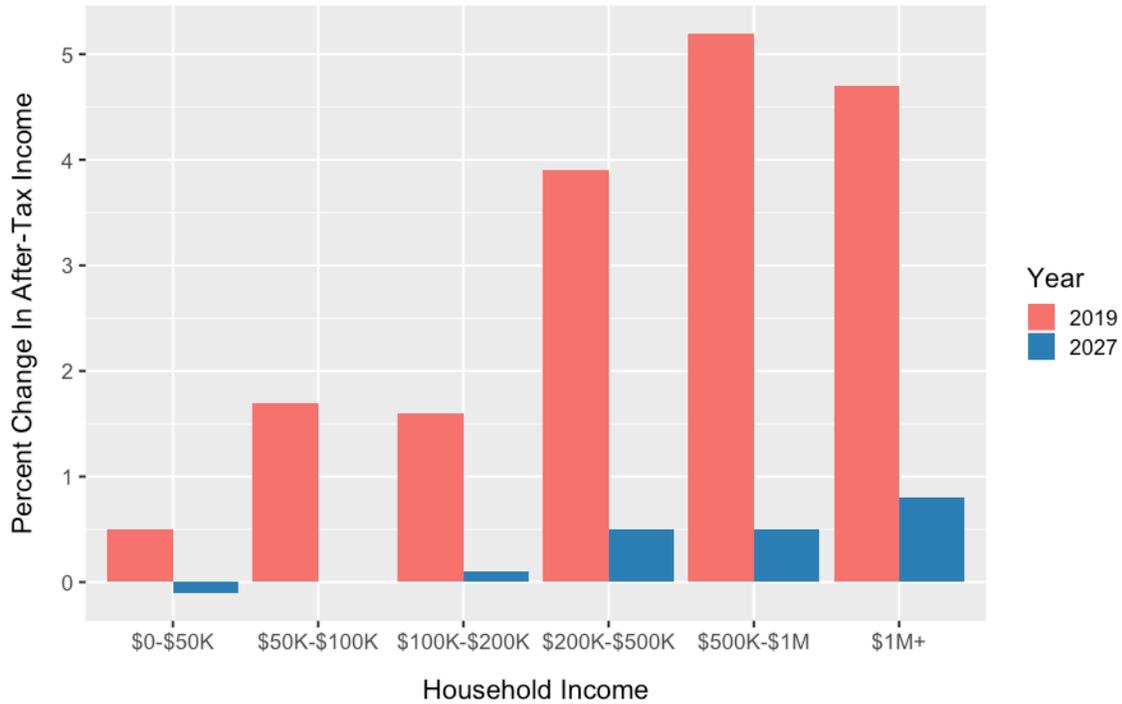
³ There are a few provisions that are primarily responsible for the uneven distribution. The reduction in the top marginal rate only benefits taxpayers that earn more than half-million dollars. The benefits of the pass-through deduction are heavily tilted towards the wealthy (discussed in greater depth below).

⁴ Source: Author's Calculations Based on JCT Projections.

⁵ Tax Policy Center, Distributional Analysis of the Conference Agreement for the Tax Cuts and Jobs Act.

Figure 2 adds dark blue bars to indicate the percent change in after-tax income in 2027. For the poorest households, the average change goes from an increase of 0.5% in 2019 to a 0.1% decrease in 2027. In 2027, only those households earning more than 200K see a meaningful increase in after-tax income.

FIGURE 2: Percent Change in After-Tax Income in 2019 and 2027⁶



- Poorer households will face a tax increase in 2027 relative to old law.
- Wealthier households continue to enjoy higher after-tax income in 2027 relative to old law.

JCT predicts that the TCJA will increase the deficit by over a trillion dollars. How will the American people pay that bill?

The third takeaway is that these tax cuts have to be paid for eventually. Once the financing of deficits is included in the analysis, the overall effect of the TCJA will likely be even more unequal. Most projections estimate that this legislation will add over a trillion dollars to the federal deficit even accounting for increased economic growth.⁷ JCT and CBO originally estimated that the law would increase the deficit by roughly \$1.5 trillion dollars between 2018 and 2027. JCT also used a variety of models to estimate the economic growth created by the TCJA. Including the effect on economic growth, JCT

⁶ Source: Author’s Calculations Based on JCT Projections.

⁷ Even the rosier forecasts provided by the Tax Foundation predict that the deficit will increase by almost a half-trillion dollars. Tax Foundation, Preliminary Details and Analysis of the Tax Cuts and Jobs Act. These deficits will be even larger if the sunset tax provisions are renewed.

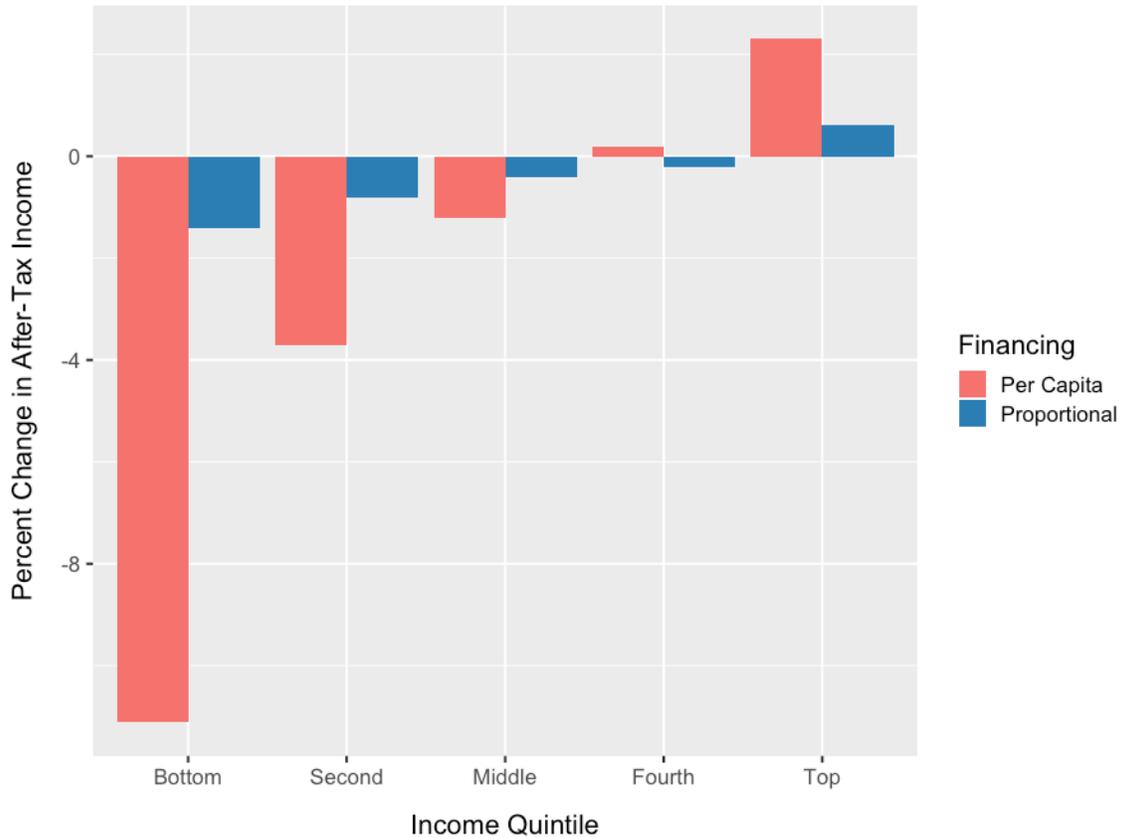
estimated that the increase in the deficit would still be over \$1 trillion. CBO has revised these estimates upwards in its most recent estimates. The tax cuts are most assuredly not paying for themselves.

Eventually, those deficits will have to be funded either through tax increases or spending reductions. To the extent we cut mandatory spending programs, the overall effect will be to make the TCJA even more regressive since mandatory spending programs predominantly help lower-income Americans. If we instead increase future taxes, we are shifting a fiscal burden onto our children and grandchildren. Neither choice is particularly appetizing.

The Tax Policy Center has published distributional tables that incorporate various assumptions regarding the financing of the tax cuts. Figure 3 displays the consequences to after-tax income under two different assumptions. The red bars show the change in after-tax income assuming that the tax cut is paid for by decreasing spending (or increasing taxes) on each American household equally. It roughly approximates the net effect of funding the deficits through a spending cut. The poorest Americans, those in the bottom quintile, are projected to have an average 11.1% reduction in their after-tax income relative to old law. Only the top 40% of American households would be better off assuming the deficit is financed through a per capita spending cut.

An alternative which may more closely approximate financing the tax cut with a tax increase is to assume that the deficits will be financed by a tax increase proportional to income. The dark blue bars show the difference in after-tax income relative to old law. Only the richest 20% of taxpayers would be better off. All other groups would have less after-tax income than before the TCJA.

Figure 3: Change in After-Tax Income If Tax Cut Is Financed By A Per Capita Spending Cut or Proportional Tax Increase⁸



- If the tax cuts are financed by per capita spending cuts or proportional tax increases, the distributional effect of the TCJA becomes even more unequal.

How does the TCJA make business taxes easier to avoid?

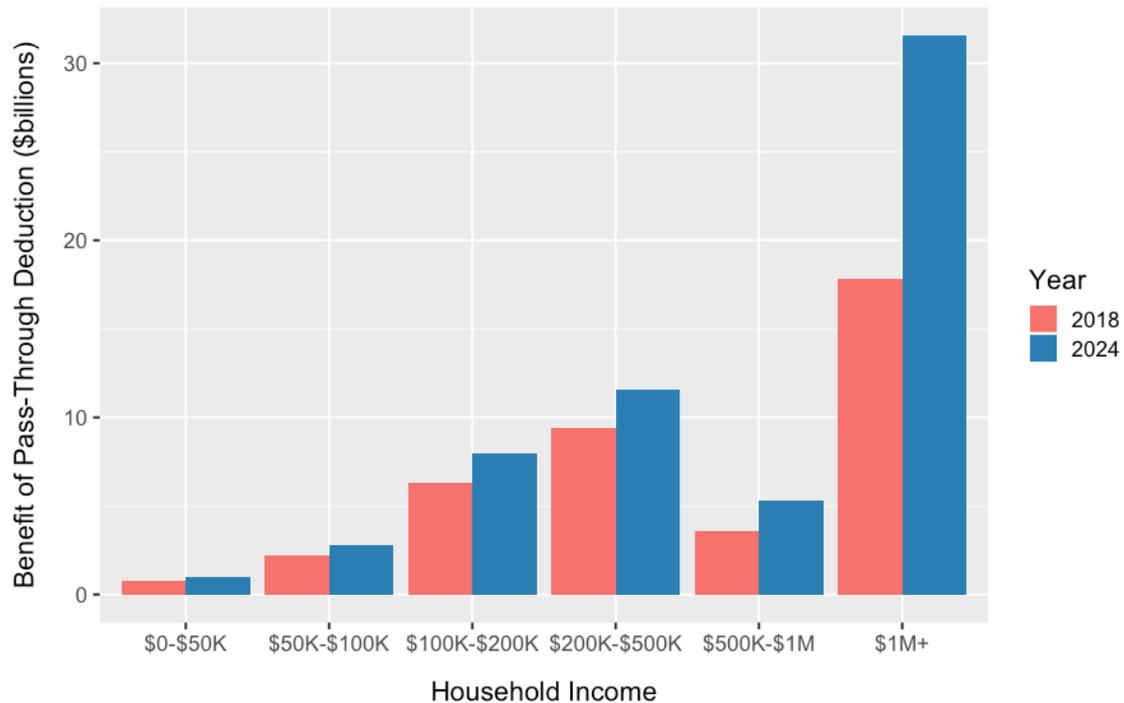
The TCJA also creates several new opportunities for businesses to engage in tax planning. The pass-through deduction provides a 20% deduction for income earned by sole proprietors, partnerships, and LLCs. The deduction draws arbitrary distinctions between different types of business activities. For example, the deduction is much more generous to architecture and engineering than to medicine, law, and accounting. Horizontal equity is a basic concept in tax policy that similar activities should be taxed the same. The pass-through deduction violates that concept: pushing market actors into certain sectors over others, violating basic notions of fairness, and creating substantial planning opportunities for sophisticated taxpayers.

This provision is projected to cost over \$400 billion dollars over the next decade. This number could increase dramatically as wealthy taxpayers restructure their business

⁸ Source: Tax Policy Center, Effects of the Tax Cuts and Jobs Act: A Preliminary Analysis, tbl. 8.

activities to take advantage.⁹ Even though this deduction will provide some tax cuts to small businesses, the primary beneficiaries are rich Americans who can structure their business activities to take advantage of this provision. JCT predicts that roughly half of the benefits of the pass-through deduction will go to millionaire households. The benefits of the deduction are distributed very unequally in 2018 and even more unequally in 2024.

FIGURE 4: Distributional Benefits of the Pass-Through Deduction¹⁰



- The benefits of the pass-through deduction are heavily weighted towards wealthy households.
- The distribution becomes more unequal over time.

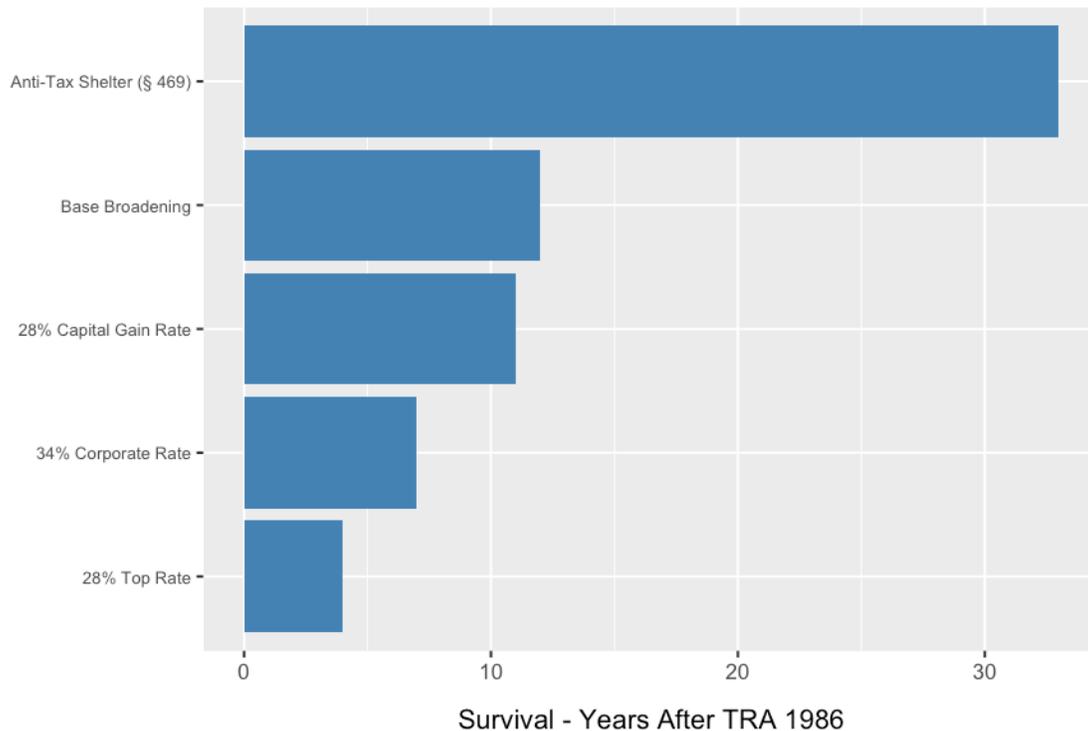
Tax legislation is unstable. Partisan tax legislation is particularly unstable.

My research finds that tax legislation is fundamentally unstable. This is true even when a law has strong bipartisan support as was the case with the Tax Reform Act of 1986. Many of the key features of that law unraveled slowly over the past thirty years.

⁹ The Treasury Regulations interpret the “skill and reputation” exclusion in Section 199A very narrowly. This may open the door for many high-income earners to take advantage of the pass-through deduction. David Kamin, *“Reputation or Skill” in the New Pass-Through Regulation*.

¹⁰ Source: Author’s Calculations Based on JCT Projections.

Stability of Tax Reform Act of 1986¹¹



- The important pieces of the Tax Reform Act had differential political stability. Some provisions lasted for a very short time, while others have lasted for decades.

However, the political instability of legislation is exacerbated when legislation is passed without bipartisan support and legislation tends to unravel much more quickly. When political coalitions shift, tax legislation is often amended or reversed within years. This instability creates real costs for the American people. It makes compliance more difficult. It makes long-term planning for businesses and families uncertain.

This is not to say that the most egregious parts of the TCJA should be left untouched. Rather this is a plea from one American citizen for a return to more stable bipartisan tax policymaking.

Thank you again for the invitation. These are pressing issues for the American public, and I look forward to addressing them with you.

¹¹ The corporate tax rate was increased by only one-percentage-point in 1993 and then remained unchanged until the TCJA. Total tax expenditures adjusted for inflation did not reach their 1985 levels until 1998 (after the enactment of the Taxpayer Relief of 1997). When tax rates go up, the cost of tax expenditures also rises.

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