FISCAL FACT
No. 597
July 2018

Making the Tax Cuts and Jobs Act Individual Income Tax Provisions Permanent

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Key Findings

- The Tax Cuts and Jobs Act (TCJA) significantly lowered individual income tax rates and made aspects of the individual income tax code simpler primarily by reducing the attractiveness of itemizing deductions.
- These individual tax code provisions are all scheduled to expire at the end of 2025.
- If extended, these provisions would increase long-run GDP by 2.2 percent, long-run wages by 0.9 percent, and add 1.5 million full-time equivalent jobs.
- If extended, these provisions would decrease federal revenue on a static basis by $638 billion over the 2019-2028 budget window, while on a dynamic basis, extending these provisions would lead to a loss of $576 billion in revenue over the same window.
- In the long run these provisions would reduce federal revenue by $165 billion annually on a conventional basis and $112 billion dynamically.
- The distributional impact of making the individual side of the TCJA permanent would mean a roughly 1.5 percent increase in after-tax income for every income quintile.

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Introduction

The TCJA featured, on the individual income tax side, broad marginal rate cuts and the curbing or elimination of several deductions, along with the expansion of some tax credits. Some of the most prominent changes in the TCJA: the top income tax bracket rate went from 39.6 percent to 37 percent; the standard deduction was doubled; both the state and local tax deduction and the mortgage interest deduction were capped; the personal exemption was eliminated; the child tax credit was doubled. The outcome of these changes has been to lower the tax rate on labor and to push filers towards choosing the standard deduction instead of itemizing, which means the process of tax filing will be much simpler.

However, all these provisions are scheduled to expire in 2025. If the current iteration of TCJA goes unchanged and these parts of the bill are allowed to expire, then households will see higher tax rates and a more complicated filing system when they file their taxes in 2026. This paper will consider the economic, revenue, and distributional impacts of making these provisions permanent.

Growth Impact

Making the TCJA's expiring individual tax code changes permanent would result in a larger economy in the long run. The increase in long-run size of the economy would predominantly be thanks to making the lower marginal income tax rates permanent and increasing incentives to work and invest.[1]

According to the Tax Foundation Taxes and Growth (TAG) model, making these provisions permanent would have a small, positive impact on the economy during the 2019 to 2028 budget window. The growth impact of expansion is limited, due to the extension's timing. The provisions are currently in effect through 2025, meaning that only three years of extension are being captured in the budget window. The economic benefits from making these provisions permanent are found in the long run, as the impacts of tax reform take several years to being fully realized. In the long run, making all individual tax provisions permanent will lead to 2.2 percent higher long-run GDP, 0.9 percent higher wages, and 1.5 million more full-time equivalent jobs.

TABLE 1.

The Long-Run Impact of Making the TCJA Individual Provisions Permanent

Long-Run GDP	+2.2%
Wages	+0.9%
Jobs	+1.5 million

Source: Tax Foundation Taxes and Growth Model, April 2018

1 The extension of the Section 199A pass-through deduction would be pro-growth, but arguably reforms to the deduction's structure would be more beneficial. For more information, see Scott Greenberg and Nicole Kaeding, "Reforming the Pass-Through Deduction," Tax Foundation, June 21, 2018, https://taxfoundation.org/reforming-pass-through-deduction-199a.

Revenue Impact

Making these provisions of the TCJA permanent would decrease revenue both in the short run and long run.

During the 2019 to 2028 budget window, making the provisions permanent would lead to a loss in revenue of $638 billion. However, it is important to note that those losses in revenue, while measured in a 10-year budget window, are only in the last three years of that 2019 to 2028 window.

On a dynamic basis in the 10-year budget window, the revenue losses would be smaller than the revenue losses measured in a static model. Thanks to added economic growth in that budget window, there would be $62.1 billion in dynamic revenue reflow; however, that would be insufficient to fully offset the revenue loss from extension. From 2019 to 2028, extending the provisions would reduce federal revenues by $575.9 billion on a dynamic basis.

In the long run, revenue would also decrease. Federal revenues would be $165.8 billion lower annually on a static basis. However, thanks to the larger economy from the tax cuts, revenues would only decrease by $112.8 billion on a dynamic basis, reducing the cost of extension by about 30 percent.[2]

2 This is the primary deficit impact and does not include the additional interest on the debt that would be accumulated.

TABLE 2.

10-Year Revenue Impacts of Extension by Provision (2019 to 2028)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2019-2028
10%, 12%, 22%, 24%, 32%, 35%, and 37% income tax rate brackets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-167.7	-185.1	-200.0	-552.9
Modify standard deduction ($12,000 for singles, $24,000 for married filing jointly, $18,000 for HoH)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-114.5	-125.7	-134.5	-374.7
Repeal of deduction for personal exemptions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	180.6	197.9	210.5	589.0
Allow 20 percent deduction of qualified business income and certain dividends for individuals and for gross income of agricultural or horticultural cooperatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-31.2	-34.2	-36.7	-102.1
Modification of child tax credit: $2,000 not indexed; refundable up to $1,400 indexed down to nearest $100, base year 2018; $2,500 refundability threshold not indexed; $500 other dependents not indexed; phaseouts $200K/$400K not indexed	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-87.1	-92.7	-93.5	-273.3
Repeal of itemized deductions for taxes not paid or accrued in a trade or business (except for up to $10,000 in state and local taxes), interest on equity debt, non-disaster casualty losses, and certain miscellaneous expenses	0.0	0.0	0.0	0.0	0.0	0.0	0.0	110.1	**122.0**	132.3	364.3
Increase the Individual AMT Exemption Amounts and Phaseout Thresholds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-87.5	-96.5	-104.3	-288.4
Total	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-197.3	-214.5	-226.3	-638.1
Dynamic Revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	7.0	20.8	34.5	62.1
Total Dynamic	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-190.3	-193.7	-191.8	-575.9

Source: Taxes and Growth Model, April 2018

Distributional Impact

Making the individual income tax provisions of the TCJA permanent would increase after-tax incomes by 1.6 percent on average.[3] Taxpayers in the bottom four income quintiles (0 to 20%, 20% to 40%, 40% to 60%, and 60% to 80%) would see an increase in after-tax income between 1.2 percent and 1.6 percent. The top 1 percent of earners would only see an increase of 1.2 percent. Others at the very high end of the income distribution, those between the 95th and 99th percentiles, would see their incomes increase by 2.4 percent. This outlier is predominantly due to the pass-through business income deduction and the reduction in the Alternative Minimum Tax.

Income Group	Conventional Distributional Impact
0% to 20%	+1.2%
20% to40%	+1.6%
40% to 60%	+1.4%
60% to 80%	+1.6%
80% to100%	+1.5%
80%to 90%	+1.4%
90% to 95%	+1.4%
95% to 99%	+2.4%
99% to 100%	+1.2%
Total	+1.6%

Source: Taxes and Growth Model, April 2018

Conclusion

Making the individual income tax provisions in the Tax Cuts and Jobs Act permanent would increase the long-run size of the economy. In the long run, increased incentives to work and invest translates into a 2.2 percent larger economy, 0.9 percent higher wages, and 1.5 million full-time equivalent jobs. Making these provisions permanent will also increase the deficit, reducing federal revenues by $638 billion ($575 billion on a dynamic basis) over the 10-year budget window and in the long run, reduce federal revenue on an annual basis by $165 billion ($112 billion on a dynamic basis).[4] The distributional impact of making these provisions permanent would be approximately proportional across income quintiles. Ultimately, making individual income tax provisions from the TCJA permanent would make the TCJA a much more beneficial long-term policy in terms of the size of the economy, although it would also further reduce federal revenue.

3 The income (adjusted gross income) breakpoints in 2018: 0% to 20%: <$15,344, 20% to 40%: $15,344 - $27,750, 40% to 60%: $27,750 - $43,800, 60% to 80%: $43,800 - $70,168, 80% to 100%: >$70,168, 80% to 90%: $70,168 - $99,773, 90% to 95%: $99,773 - $139,936, 95% to 99%: $139,936 - $345,877, 99% to 100%: >$345,877.

4 Long-run revenue estimates in 2019 dollars

Methodology and Modeling Notes

The Tax Foundation uses its General Equilibrium Model to simulate the effects of government tax and spending policies on the economy and on government revenues and budgets. The model can produce both conventional and dynamic estimates of tax policy.[5]

There are two primary sources of uncertainty in modeling the provisions of the Tax Cuts and Jobs Act: the significance of deficit effects and the timing of economic effects.

Some economic models assume that there is a limited amount of saving available to the United States to fund new investment opportunities when taxes on investment are reduced, and that when the federal budget deficit increases, the amount of available saving for private investment is "crowded out" by government borrowing, which reduces the long-run size of the U.S. economy. While past empirical work has found evidence of crowd-out, the estimated impact is usually small. Furthermore, global saving remains high, which may explain why interest rates remain low despite rising budget deficits. We assume that global saving is available to assist in the expansion of U.S. investment, and that a modest deficit increase will not meaningfully crowd out private investment in the United States.

We are also forced to make certain assumptions about how quickly the economy would respond to lower tax burdens on investment. There is an inherent level of uncertainty here that could impact the timing of revenue generation within the budget window.

5 Stephen J. Entin, Huaqun Li, and Kyle Pomerleau, "Overview of the Tax Foundation's General Equilibrium Model, April 2018 Update," Tax Foundation, https://files.taxfoundation.org/20180419195810/TaxFoundaton_General-Equilibrium-Model-Overview1.pdf.